

PREFACE

This is an index to the subjects dealt with in the Report and the Minutes of Evidence of the Company Law Committee, and to the names of individual witnesses and organisations whose evidence is printed in the Minutes of Evidence or referred to in the Report. It was compiled by the Board of Trade Library.

References in the index take the following forms:

REPORT References following the word "*Report*" are to **PARAGRAPH NUMBERS** in the Report. In a few cases, however, these references are preceded by the abbreviation "p." or "pp." and followed by "*(para. . .)*"; these refer consecutively to the page numbers and paragraph numbers of the two Notes of Dissent (pp. 207-216 of the Report) which are not included in the main paragraph numbering.

MINUTES OF EVIDENCE Unprefixed references preceded by the words "*Evidence*" and (in the entries for individual witnesses) "*Memorandum*" and "*Oral evidence*" are to **PAGE NUMBERS** in the Minutes of Evidence. In the case of witnesses who gave oral evidence, each page number is followed immediately by the relevant **QUESTION NUMBERS** to be found on and following the page referred to; these question numbers are in brackets with the prefix "Q". For example, among the references in the column *Evidence* under the heading "Nominee shareholders" is the following:

Law Society, 1194, 1150 (Q. 5574-6)

This means that the written evidence of the Law Society on this subject is printed on p. 1194 of the Minutes of Evidence, and that its answers to Questions 5574-6 on the same subject begin on p. 1150 of the Minutes.

A list of the separately published parts of the Minutes of Evidence, showing the page numbers and question numbers included in each part, is given on p. 2.

TABLE OF CASES A Table of Cases quoted in the Report and in the Minutes of Evidence appears on pp. 3-4. The names of cases are not included elsewhere in the index.



PUBLICATIONS REFERRED TO IN THE INDEX

REPORT OF THE COMPANY LAW COMMITTEE. ix, 223 p. H.M.S.O., 1962. (Cmnd. 1749).

MINUTES OF EVIDENCE TAKEN BEFORE THE COMPANY LAW COMMITTEE. H.M.S.O., 1960-61. Published in 19 parts, as follows:

<i>Day</i>	<i>Pages</i>	<i>Question Nos.</i>	<i>Witnesses</i>
1	1-70	1-417	H. Wincott (Investors' Chronicle); Courtaulds Ltd.; G. Newton (Financial Times).
2	71-144	418-721	J. Lyons & Co. Ltd.; The Lord Piercy; Guest, Keen & Nettlefolds Ltd.
3	145-214	722-978	Professor W. T. Baxter; H. C. Edey; John Lewis Partnership Ltd.
4	215-278	979-1337	The Economist; Professor E. V. Morgan; Trade Indemnity Co. Ltd.
5	279-348	1338-1663	Registrar of the Companies Court; National Chamber of Trade; General Council of British Shipping.
6	349-428	1664-2035	Accepting Houses Committee and Issuing Houses Association; Society of Investment Analysts Ltd.; Association of International Accountants Ltd.
7	429-502	2036-2401	Association of British Chambers of Commerce; Committee of Scottish Bank General Managers; National Association of Trade Protection Societies.
8	503-556	2402-2793	Council of Associated Stock Exchanges; Charles Clore and L. Sainer; Association of Stock and Share Dealers.
9	557-656	2794-3184	British Insurance Association; Committee of London Clearing Bankers; Institute of Actuaries.
10	657-742	3185-3633	Association of Unit Trust Managers; Association of Investment Trusts; S. I. Fairbairn.
11	743-834	3634-4052	Institute of Directors; Chartered Institute of Secretaries.
12	835-906	4053-4420	Association of Certified and Corporate Accountants; Council of Scottish Chambers of Commerce.
13	907-998	4421-4821	General Council of the Bar; Trades Union Congress; British Overseas Banks Association.
14	999-1098	4822-5184	H. S. Morgan, J. M. Young, F. A. Petito; G. A. Brownell, F. A. O. Schwarz; C. D. McDaniel.
15	1099-1220	5185-5627	The Stock Exchange, London; The Law Society.
16/17	1221-1348	5628-6211	Faculty of Advocates; The Law Society of Scotland; Institute of Chartered Accountants of Scotland.
18	1349-1454	6212-6510	Institute of Chartered Accountants in England and Wales; Federation of British Industries.
19	1455-1520	6581-6792	M. F. Cohen; Professor L. Loss.
20	1521-1607	6793-7161	Board of Trade.

TABLE OF CASES

- Agricultural Wholesale Society
Evidence: 335
- Allen v. Gold Reefs of West Africa Ltd.
Report: 192
Evidence: 1321
- American Sumatra Tobacco Corporation v. S.E.C.
Evidence: 1074, 1511
- Ammonia Soda Co. v. Chamberlain
Report: 341
- Andrews v. Gas Meter Co.
Evidence: 1308
- Antigen Laboratories Ltd.
Evidence: 1310
- Apex Film Distributors Ltd.
Evidence: 1213
- Ashbury Railway Carriage & Iron Co. v. Riche
Evidence: 1187
- Atherton
Evidence: 1300
- Auriferous Properties Ltd.
Evidence: 1213
- Baird v. Baird & Co.
Evidence: 1321
- Baird v. Lees
Evidence: 1323
- Bolton (H.L.) Engineering Co.
Evidence: 1212
- Brown v. British Abrasive Wheel Co.
Evidence: 1331
- Bugle Press Ltd.
Report: 291
- Carse v. Coppen
Evidence: 1303
- Castiglione's Will Trusts
Evidence: 1302
- City Equitable Fire Insurance Co.
Evidence: 335
- Clydesdale Bank (Moore Place) Nominees Ltd. v. Snodgrass
Evidence: 1303
- Cooper (Cuthbert) & Sons
Evidence: 987, 1310
- Cotman v. Brougham
Report: 43
- Davis & Collett
Evidence: 1310
- Dimbula Valley (Ceylon) Tea Co. v. Laurie
Report: 336
- Duple Motor Bodies Ltd.
Evidence: 1361 (Q. 6292)
- Edwards v. Halliwell
Evidence: 1309
- Elder v. Elder & Watson Ltd.
Report: 204
Evidence: 1310, 1322, 1323, 1257 (Q. 5897)
- Evans v. Brunner, Mond & Co.
Report: 52
- Foss v. Harbottle
Report: 206
Evidence: 1308, 1309, 1320, 1256 (Q. 5889-94)
- Garners Motors Ltd.
Evidence: 979
- Gibson v. Barton
Evidence: 1342
- Governments Stock and other Securities Investment Co. v. Christopher
Evidence: 1057, 1449
- Greenhalgh v. Ardenne Cinemas Ltd.
Evidence: 1321
- Harmer (H.R.) Ltd.
Report: 200
Evidence: 330, 283 (Q. 1386-7), 437 (Q. 2106), 975, 1147 (Q. 9549), 1310, 1321-3, 1534 (Q. 6916)
- Hartley Baird Ltd.
Evidence: 825
- Hawken (S.A.) Ltd.
Evidence: 1310
- Head (Henry) & Co. v. Ropner Holdings Ltd.
Evidence: 804, 932 (Q. 4630), 1337, 1437
- Hemans v. Hotchkiss Ordnance Co.
Evidence: 976
- Ince Hall Rolling Mills Co. Ltd. v. Douglas Forge Co.
Evidence: 335
- Indo-China Steam Navigation Co.
Evidence: 1196
- Inland Revenue Commissioners v. Duple Motor Bodies Ltd.
Evidence: 1361 (Q. 6292)
- Jon Beauforte (London) Ltd.
Report: 40
Evidence: 559 (Q. 2814), 678 (Q. 3375), 963
- Jones v. Bellgrove Properties
Evidence: 826
- Karlo-Stocan Mining Corporation
Evidence: 981
- Kelner v. Baxter
Report: 44
Evidence: 1052
- Kingston Cotton Mill Co. (No. 2)
Evidence: 1302
- Loch v. Blackwood Ltd.
Evidence: 1323
- London and General Bank (No. 2)
Evidence: 1302
- MacDougall v. Gardiner
Evidence: 1308
- Marshall Fleming & Co.
Report: 190
Evidence: 1313

" EVIDENCE " references are to PAGE NUMBERS and Q = QUESTION

- Meyer v. Scottish Textile and Manufacturing Co.
Report: 200, 203
Evidence: 975, 1300, 1310, 1321, 1322
- Miles Aircraft Ltd.
Evidence: 1212
- Newborne v. Sensolid (G.B.) Ltd.
Report: 44
Evidence: 1052
- Parent Trust & Finance Co.
Evidence: 335
- Pavlidis v. Jensen
Evidence: 1054, 1321
- Percival v. Wright
Report: 89
Evidence: 533
- Perlman v. Feldmann
Evidence: 1013 (Q. 4916), 1054
- Prenn's settlement: Truvox Engineering Co. v. Board of Trade
Report: 57
Evidence: 1216, 1219, 1220, 1453
- Prudential Assurance Co. v. Chatterly-Whitefield Collieries
Evidence: 1168
Report: 195
- Qualter Hall & Co. v. Board of Trade
Report: 57
Evidence: 1251
- R. v. Kysant
Report: 398
- Regal (Hastings) Ltd. v. Gulliver
Evidence: 985, 1054
- Rica Gold Washing Co.
Evidence: 981
- Rosenfeld v. Fairchild Engine and Airplane Corporation
Evidence: 1059
- Royal British Bank v. Turquand
Report: 41
- Salomon v. Salomon & Co.
Report: 21
Evidence: 933 (Q. 4633)
- Scottish Co-operative Wholesale Society v. Meyer
Report: 200
Evidence: 330, 285 (Q. 1386), 457 (Q. 2108), 799, 1147 (Q. 5549), 1310, 1534 (Q. 6916)
- Scottish Insurance Co. v. Wilsons and Clyde Coal Co.
Report: 195
Evidence: 1168
- Short v. Treasury Commissioners
Evidence: 49
- Smith v. Anderson
Evidence: 1188
- Trevor v. Whitworth
Report: 167
Evidence: 333, 292 (Q. 1423)
- V.G.M. Holdings Ltd.
Evidence: 391 (Q. 3064)
- Victor Battery Co. v. Curry's Ltd.
Report: 181
- Victors v. Lingard
Evidence: 497, 453 (Q. 2264)
- Welsh Anthracite Collieries Ltd.
Evidence: 819
- Westburn Sugar Refineries Ltd. v. Inland Revenue Commissioners
Report: 336
Evidence: 1266 (Q. 5980)
- Yenidje Tobacco Co.
Evidence: 288 (Q. 1406)

"REPORT" references are to PARAGRAPH NUMBERS

INDEX

A.B.C.C. see Association of British Chambers of Commerce

Accepting Houses Committee

Memorandum: 395-417

Oral evidence: 349-372 (Q. 1664-1849)

Accountancy Advisory Committee

Report: 229

Accountants

Evidence: *Assoc. Internat. Accountants*, 386 (Q. 1972-2035)

Accounts

(see also ACTIVITIES REPORT; ASSETS; AUDITORS; BALANCE SHEETS; CAPITAL EXPENDITURE; CAPITAL FUNDS ANALYSIS; DEFERRED LIABILITIES; DEPRECIATION; DIRECTORS—REMUNERATION; INVESTMENTS, COMPANY; OVERHEADS; PROFIT AND LOSS ACCOUNT; PROPERTIES; SHARE PREMIUM ACCOUNT; STOCK VALUATION; TAXATION CHARGES; TRADE CREDIT; TRADE INVESTMENTS; TRADING ACCOUNT; UNIT TRUSTS)

Report: 330-4, 419-23, 519

Evidence:

A.B.C.C., 482-3

Assoc. Certified & Corp. Accountants, 891

Assoc. Investment Trusts, 732, 734

Baxter and Edey, 188-204, 145 (Q. 724-5), 155 (Q. 765-85), 159 (Q. 792-8), 163 (Q. 816), 164 (Q. 819-21), 165 (Q. 825-6), 166 (Q. 828-30), 167 (Q. 832-45)

Board of Trade, 1587-90

Brit. Insurance Assoc., 625-30

Chartered Inst. Secretaries, 820-1

Cohen and Liss, 1456 (Q. 6587-8), 1467 (Q. 6624)

Committee Scottish Bank General Managers, 499

Courtauld, 61, 26 (Q. 250-73), 31 (Q. 276-87)

Economist, 264-5, 226 (Q. 1095-1103)

F.B.I., 1450

Guest Keen Nettlefolds, 135, 137-8

R. F. Henderson and Tew, 209-14, 179 (Q. 921-2)

Inst. Chartered Accountants, 1418, 1349 (Q. 6214-8), 1355 (Q. 6249-52)

Inst. Chartered Accountants Scotland, 1335

Law Society, 1202

J. Lewis Partnership, 207

E. V. Morgan, 273-4, 236 (Q. 1179)

H. S. Morgan etc., 1041 (Q. 5104-7), 1047 (Q. 5156-9), 1048 (Q. 5170-1)

National Chamber Trade, 340

Newton, 68

Piercy, 119

Securities & Exchange Commission, 1510-1

Accounts—continued

Soc. Investment Analysts, 418-21, 373 (Q. 1857-74), 378 (Q. 1905-13), 385 (Q. 1967-9)

Stock Exchange London, 1178

Trade Indemnity Co., 277, 253 (Q. 1299-1304)

T.U.C., 989, 953 (Q. 4763-4)

Wincott, 48, 55, 16 (Q. 168-86)

Board of Trade discretionary powers

Report: 419, 423

Evidence: *Inst. Chartered Accountants Scotland*, 1289 (Q. 6157); *Law Society*, 1203-4

Exemptions from legal provisions

(see also BANKS AND BANKING; INSURANCE COMPANIES; SHIPPING COMPANIES; UNQUOTE COMPANIES)

Report: 61, 393, 397, 398-418, 433-4, 435, pp. 211-16 (para. 1-18)

Evidence:

Accepting Houses & Issuing Houses, 405, 362 (Q. 1774-90)

Assoc. Certified & Corp. Accountants, 892

Assoc. Investment Trusts, 733

Baxter and Edey, 191, 204

Board of Trade, 1589

Brit. Insurance Assoc., 628-30, 633-6, 568 (Q. 2906-82), 579 (Q. 2986-3015)

Brit. Overseas Banks Assoc., 997, 954 (Q. 4768-4821)

Committee London Clearing Bankers, 643-8, 650, 592 (Q. 3071-91), 598 (Q. 3096-3109)

Committee Scottish Bank General Managers, 499, 458 (Q. 2298-2313), 462 (Q. 2322-35)

Economist, 265-6, 224 (Q. 1074-86), 226 (Q. 1093-4), 231 (Q. 1142-4)

Gen. Council Brit. Shipping, 342-8, 315 (Q. 1585-1615), 320 (Q. 1617-21), 321 (Q. 1625-59)

R. F. Henderson and Tew, 214, 179 (Q. 921)

Inst. Actuaries, 652-6, 603 (Q. 3116-84)

Inst. Chartered Accountants, 1426-7, 1370 (Q. 6360-5)

Inst. Chartered Accountants Scotland, 1339, 1286 (Q. 6138-51)

Law Society, 1203

H. S. Morgan etc., 1044 (Q. 5135-50)

Newton, 68, 44 (Q. 387-401)

Soc. Investment Analysts, 420-1, 379 (Q. 1914-28)

Stock Exchange London, 1178

T.U.C., 990, 939 (Q. 4677-4710)

Wincott, 56, 17 (Q. 175-86)

Expenditure on research etc.

Evidence: *Baxter and Edey*, 195-6

Holding companies

(see also SUBSIDIARY COMPANIES; TRADE INVESTMENTS; UNITED STATES LAW)

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Accounts—continued**Holding companies—continued**

Report: 150, 165, 347, 365, 369, 375, 377, 382, 397

Evidence:

Assoc. Certified & Corp. Accountants, 840 (Q. 4093-7)

Board of Trade, 1588

Brit. Insurance Assoc., 626

Chartered Inst. Secretaries, 822

Courtaulds, 63

R. F. Henderson and Tew, 212

Inst. Chartered Accountants, 1419, 1421, 1371 (Q. 6368-70)

H. S. Morgan etc., 1038 (Q. 5078-88), 1044 (Q. 5131-4)

Soc. Investment Analysts, 418, 385 (Q. 1967-8)

T.U.C., 992

Wincott, 54, 57

Period of coverage

Report: 395-6.

Evidence:

Baxter and Edey, 189, 163 (Q. 812-4)

Board of Trade, 1587-8, 1589

Courtaulds, 62, 30 (Q. 269-73)

Economist, 265

R. F. Henderson and Tew, 213-4, 179 (Q. 922)

Inst. Chartered Accountants, 1369 (Q. 6358)

E. V. Morgan, 273, 243 (Q. 1228-9)

T.U.C., 992-3

Rental agreements *see* OVERHEADS

Subsidiary companies *see* SUBSIDIARY COMPANIES

Take-over bids

Evidence: *Board of Trade*, 1576-7

Activities changes

(*see also* OBJECTS OF COMPANY; ULTRA VIRES)

Report: 118

Evidence:

Accepting Houses & Issuing Houses, 397, 351 (Q. 1685-9), 384 (Q. 1957)

Assoc. Certified & Corp. Accountants, 883, 842 (Q. 4114-23)

Assoc. Investment Trusts, 728, 679 (Q. 3379-90), 681, (Q. 3394-3402)

Board of Trade, 1565

Brit. Insurance Assoc., 616, 561 (Q. 2831-9), 578 (Q. 2983-4)

Council Assoc. Stock Exchanges, 545

Council Scottish Chambers Commerce, 904, 864 (Q. 4298-4303)

Courtaulds, 58, 22 (Q. 216-20), 35 (Q. 297)

Economist, 262, 220 (Q. 1031-7)

Faculty Advocates, 1296-7, 1223 (Q. 5651-63)

F.B.J., 1444, 1382 (Q. 6460-2)

General Council Bar, 912 (Q. 4466-72)

Guest Keen Nettelfolds, 130, 102 (Q. 677-81)

Inst. Chartered Accountants, 1403

Inst. Chartered Accountants Scotland, 1328

Activities changes—continued

Inst. Directors, 794, 746 (Q. 3659-67)

Law Society Scotland, 1308, 1253, (Q. 5877-88)

J. Lewis Partnership, 205, 171 (Q. 857-63), 178 (Q. 916-9)

Newton, 66

Piercy, 117, 90 (Q. 575)

Registrar Companies Court, 282 (Q. 1366-70), 296 (Q. 1452-4), 303 (Q. 1496-8)

Stock Exchange London, 1165, 1099 (Q. 5186-5208)

Wincott, 50, 7 (Q. 70-82), 10 (Q. 99-108), 19 (Q. 190-1)

Activities report

Report: 113-6, 122, 138, 140, 360

Evidence:

Board of Trade, 1588-9

Brit. Insurance Assoc., 562 (Q. 2840-50)

Chartered Inst. Secretaries, 825

Cohen and Loss, 1471 (Q. 6643)

Courtaulds, 31 (Q. 279-87)

Economist, 265, 227 (Q. 1099-1100), 231 (Q. 1135-41)

Gower, 1058

Inst. Chartered Accountants Scotland, 1344

Inst. Directors, 794, 746 (Q. 3644-7)

E. V. Morgan, 249 (Q. 1253)

H. S. Morgan etc., 1075, 1084, 1038 (Q. 5076-88), 1039 (Q. 5090-2)

Soc. Investment Analysts, 419-20, 376 (Q. 1892-1905), 382 (Q. 1939-42)

T.U.C., 993

Administration *see* Management

Advertising *see* Circulars (investments);

Deposits solicitation; Prospectuses

Allotment of shares *see* Shares

American investments

Evidence: *R. F. Henderson and Tew*, 214

American law *see* United States law

Annual general meeting *see* Meetings

Annual returns *see* Returns

Assets

Report: 356-7, 362, 369

Evidence: *Assoc. Certified & Corp. Accountants*, 893; *Baxter and Edey*, 189-90; *Inst. Chartered Accountants*, 1423, 1367 (Q. 6336-7); *Law Society*, 1156 (Q. 5617-8)

Assets disposal

Report: 113, 117, 122

Evidence:

Accepting Houses & Issuing Houses, 397

A.B.C.C., 476, 430 (Q. 2044-5)

Assoc. Certified & Corp. Accountants, 883, 843 (Q. 4124-34)

Assoc. Investment Trusts, 728

Council Assoc. Stock Exchanges, 546

“REPORT” references are to PARAGRAPH NUMBERS

Assets disposal—continued

- Courtaulds*, 23 (Q. 221-2)
Economist, 262, 220 (Q. 1032), 221 (Q. 1038-40)
Faculty Advocates, 1296-7, 1223 (Q. 5691-8)
F.B.I., 1444, 1382 (Q. 6459-60)
Guest Keen Nettlefolds, 130, 102 (Q. 677-81)
Inst. Chartered Accountants, 1403
Inst. Chartered Accountants Scotland, 1328-9
Inst. Directors, 794, 747 (Q. 3668-72)
Law Society, 1140 (Q. 5531-6)
H. S. Morgan etc., 1019 (Q. 4966-7)
Newton, 66
Piercy, 117, 90 (Q. 576-8)
Registrar Companies Court, 283 (Q. 1371-4), 294 (Q. 1434-7)
Stock Exchange London, 1165, 1100 (Q. 5058-5208)
Wincott, 51, 8 (Q. 83-6)

Assets revaluation

(see also CAPITAL REDUCTION; DIVIDENDS)
Report: 122, 353-61, 369
Evidence:

- Accepting Houses & Issuing Houses*, 404, 365 (Q. 1791-3)
A.B.C.C., 483
Assoc. Certified & Corp. Accountants, 891-2, 855 (Q. 4231-7)
Assoc. Investment Trusts, 733
Baxter and Edey, 189, 200-2, 150 (Q. 742-62), 156 (Q. 771), 157 (Q. 776), 162 (Q. 806-11), 163 (Q. 817-8), 164 (Q. 822-4), 166 (Q. 827), 167 (Q. 831)
Board of Trade, 1577, 1588
Clore, 552
Cohen and Liss, 1469 (Q. 6635-7)
Courtaulds, 62, 26 (Q. 250-2)
Faculty Advocates, 1239 (Q. 5767-76)
Guest Keen Nettlefolds, 108 (Q. 715-21)
R. F. Henderson and Tew, 209-10, 211, 179 (Q. 923-4), 182 (Q. 938-63)
Inst. Chartered Accountants, 1350 (Q. 6219-44)
Inst. Chartered Accountants, Scotland, 1335-6, 1346-7, 1268 (Q. 6003-46)
Inst. Directors, 803-4, 759 (Q. 3764-66), 760 (Q. 3769-71)
J. Lewis Partnership, 207, 173 (Q. 879-84)
E. V. Morgan, 271-3, 238 (Q. 1199-1220), 243 (Q. 1224-7), 244 (Q. 1233-8), 248 (Q. 1247-8)
H. S. Morgan etc., 1044 (Q. 5126-30)
Newton, 68
Soc. Investment Analysts, 421
T.U.C., 990-1, 944 (Q. 4711-4)
Wincott, 55, 16 (Q. 171-4), 19 (Q. 188)

Associated companies see **Shareholdings of company; Investments, Company; Subsidiary companies**

Association, Memorandum of see **Memorandum of association**

Association of British Chambers of Commerce

Memorandum: 475-494
Oral evidence: 429-450 (Q. 2036-2232)

Association of Certified and Corporate Accountants

Memorandum: 880-902
Oral evidence: 835-858 (Q. 4053-4252)

Association of International Accountants

Memorandum: 423-427
Oral evidence: 386-394

Association of Investment Trusts

Memorandum: 727-734
Oral evidence: 678-695 (Q. 3370-3500)

Association of Stock and Share Dealers

Memorandum: 554-555
Oral evidence: 534-544 (Q. 2708-93)

Association of Unit Trust Managers

Memorandum: 709-726
Oral evidence: 657-678 (Q. 3185-3369)
Report: 309, 310, 311

Assurance see **Insurance companies**

Astin, E. C. see **National Association of Trade Protection Societies**

Aston, C. W. see **General Council of British Shipping**

Audit

Report: 150, 424-35, 503
Evidence:

- Assoc. Certified & Corp. Accountants*, 893-4
Assoc. International Accountants, 424-5
Assoc. Investment Trusts, 733
Baxter and Edey, 193
Board of Trade, 1590-1
Chartered Inst. Secretaries, 821
Council Scottish Chambers Commerce, 905, 862 (Q. 4285)
Faculty Advocates, 1302, 1238 (Q. 5761), 1239 (Q. 5767-76)
General Council Bar, 967-8, 985, 917 (Q. 4500-14)
Guest Keen Nettlefolds, 136, 138
Inst. Chartered Accountants, 1424-8, 1370 (Q. 6360-5), 1371 (Q. 6368-70), 1377 (Q. 6416)
Inst. Chartered Accountants Scotland, 1340-2, 1286 (Q. 6138-51), 1288 (Q. 6155-6), 1294 (Q. 6203-7)
Law Society, 1204
H. S. Morgan etc., 1046 (Q. 5151-3)
Nat. Chamber Trade, 340
Newton, 69

Private companies exemption
Report: 58, 424-5, 435

Evidence:

- A.B.C.C.*, 483, 444 (Q. 2182-3)
Assoc. Certified & Corp. Accountants, 894-5
Assoc. International Accountants, 425-6, 386 (Q. 1972-2035)
Board of Trade, 1567-8, 1591
Chartered Inst. Secretaries, 772 (Q. 3875-6)

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Audit—continued**Private companies exemption—continued***Council Scottish Chambers Commerce*, 905*Faculty Advocates*, 1302-3*F.B.I.*, 1450, 1382 (Q. 6450-4)*Inst. Chartered Accountants*, 1427-8, 1369 (Q. 6359), 1370 (Q. 6366-7)*Inst. Chartered Accountants Scotland*, 1341, 1288 (Q. 6152-5)*Law Society*, 1204-5*Law Society Scotland*, 1253 (Q. 5871)*Nat. Assoc. Trade Protection Societies*, 469 (Q. 2369-70)*Nat. Chamber Trade*, 340, 305 (Q. 1517-9), 310 (Q. 1549)*Piercy*, 119, 88 (Q. 556, 564)*Trade Indemnity Co.*, 276, 252 (Q. 1282-3)*T.U.C.*, 939 (Q. 4672-4)**Unit trusts***Report*: 318, 329*Evidence: Inst. Chartered Accountants*, 1416-7**Auditors' remuneration***Report*: 391, 397*Evidence: Inst. Chartered Accountants*, 1422, 1367 (Q. 6334-5)**Australian Associated Stock Exchanges***Report*: p. 209 (para. 10)**Australian draft Uniform Companies Bill***Report*: 474**B****Balance sheets***Report*, 333, 353-80, 519**Evidence:***Baxter and Edey*, 200-03, 145 (Q. 726-31)*Brit. Insurance Assoc.*, 626*Chartered Inst. Secretaries*, 821*Cohen and Loss*, 1472 (Q. 6645-8)*General Council Bar*, 985*R. F. Henderson and Tew*, 210-11, 185 (Q. 964-5)*Inst. Chartered Accountants*, 1354 (Q. 6245-53)*Inst. Chartered Accountants Scotland*, 1268 (Q. 6003-4)*E. V. Morgan*, 243 (Q. 1224-7)*T.U.C.*, 990-1**Ballantyne, W. R. see Committee of Scottish Bank General Managers****Banks and banking***(see also ACCOUNTS—EXEMPTIONS FROM LEGAL PROVISIONS)**Report*: 243, 252, 393, 397, 399-407, pp. 211-16 (para. 1-18)**Evidence:***Accepting Houses & Issuing Houses*, 362 (Q. 1774-90)*Assoc. Certified & Corp. Accountants*, 857 (Q. 4249-55)*Brit. Overseas Banks Assoc.*, 997, 954, (Q. 4768-4821)**Banks and banking—continued***Cohen & Loss*, 1459 (Q. 6950-1)*Committee London Clearing Bankers*, 643-8, 650, 592 (Q. 3071-91), 598 (Q. 3096-3109)*Committee Scottish Bank General Managers*, 499-500, 458 (Q. 2298-2313), 462 (Q. 2322-35)*Economist*, 224 (Q. 1079-83), 226 (Q. 1093-4)*F.B.I.*, 1397 (Q. 6570)*Newton*, 45 (Q. 388-401)*Wincott*, 17 (Q. 178, 182-6)**Bar, General Council of the see General Council of the Bar****Bardell, R. C. W. see British Insurance Association****Barrington, K. C. see Accepting Houses Committee****Barter, J. W. see Association of International Accountants****Baxter, W. T.***Memorandum*: 188-91*Oral Evidence*: 145-69 (Q. 722-845)**Beard, R. E. see Institute of Actuaries****Beneficial interest see Directors—Nominee directors; Nominee shareholders****Benson, Henry see Institute of Chartered Accountants of England and Wales****Berkeley, Maurice see Registrar of the Companies Court****Bird, R. E. see Economist, The****Board of Trade***Memorandum*: 1565-1607*Oral evidence*: 1521-1564 (Q. 6793-7161)*(For particular references to aspects of the Board's work see ACCOUNTS—BOARD OF TRADE POWERS; BUSINESS NAMES—ENFORCEMENT OFFICERS; DEALERS IN SECURITIES; INSPECTORS APPOINTED BY THE BOARD OF TRADE; "LIMITED", LICENSED DISPENSATION WITH; PROSPECTUSES—BOARD OF TRADE SCRUTINY; STOCK EXCHANGES—CONSULTATION WITH BOARD OF TRADE; TAKE-OVER BIDS—BOARD OF TRADE RULES)***Borrowing powers***(see also FLOATING CHARGES)***Evidence:***Accepting Houses & Issuing Houses*, 397-8, 412*A.B.C.C.*, 477*Assoc. Certified & Corp. Accountants*, 883, 888*Assoc. Investment Trusts*, 729, 682 (Q. 3403-4)*Brit. Insurance Assoc.*, 616*Committee London Clearing Bankers*, 637, 582 (Q. 3023-7)*Committee Scottish Bank General Managers*, 496, 451 (Q. 2243-54)*Council Assoc. Stock Exchanges*, 546, 507 (Q. 2452)**"REPORT" references are to PARAGRAPH NUMBERS**

Borrowing powers—continued

- Courtauld's*, 23 (Q. 232-6)
F.B.I., 1444
Inst. Chartered Accountants, 1404
Inst. Chartered Accountants Scotland, 1329
Inst. Directors, 795
Register Companies Court, 284 (Q. 1380-1)
Stock Exchange London, 1165-6

British Insurance Association

- Memorandum*: 615-636
Oral evidence: 557-581 (Q. 2794-3015)
Report: 409

British Overseas Banks Association

- Memorandum*: 997
Oral evidence: 954-961 (Q. 4768-4821)

Brocklebank, Sir John see General Council of British Shipping**Brooke, S. K. see British Overseas Banks Association****Brownell, G. A.**

- Oral evidence*: 999-1051 (Q. 4822-5184)
Report: 142, 207

Building societies

- Evidence: Wincott*, 20 (Q. 193-195)

Bunford, J. F. see British Insurance Association**Business commencement restrictions see Commencement of business****Business names**

(see also REGISTRATION FEES)

- Report*: 436-56 514-5
Evidence:
Accepting Houses & Issuing Houses, 406
A.B.C.C., 483-4
Assoc. Certified & Corp. Accountants, 895
Assoc. International Accountants, 427
Assoc. Investment Trusts, 734
Board of Trade, 1592-5, 1524 (Q. 6825), 1526 (Q. 6844-5), 1560 (Q. 7128-60)
Brit. Insurance Assoc., 631
Clore, 552
Committee London Clearing Bankers, 649
Committee Scottish Bank General Managers, 498, 501, 457 (Q. 2292-7), 460 (Q. 2314-8)
Council Assoc. Stock Exchanges, 547
Council Scottish Chambers Commerce, 906, 871 (Q. 4361-8)
F.B.I., 1450-1
General Council Bar, 988
Guest Keen Nettlefolds, 139, 140
Inst. Chartered Accountants Scotland, 1342
Law Society, 1206-8, 1218-9
Law Society Scotland, 1316-7, 1266 (Q. 5986), 1267 (Q. 5997-6000)

Business names—continued

- Nat. Assoc. Trade Protection Societies*, 464 (Q. 2342-65)
Nat. Chamber Trade, 340, 309 (Q. 1542-8)
Trade Indemnity Co., 253 (Q. 1292-8), 257 (Q. 1336-7)
Enforcement officers
Report: 441, 456
Itinerant traders
Report: 445
Letterheads etc.
Report: 456
Evidence: Board of Trade, 1594-5;
General Council Bar, 980-1; *Nat. Assoc. Trade Protection Societies*, 464 (Q. 2343-4)

C**Capital**

- Minimum subscription see INCORPORATION*
Paid-up capital statement in circulars
Report: 233, 234

Capital duty

- Report*: 163, 187

Capital expenditure

- Report*: 367, 369, 386, 389
Evidence: Baxter and Edey, 202;
Guest Keen Nettlefolds, 107 (Q. 713-4); *Inst. Chartered Accountants*, 1363 (Q. 6307-8)

Capital funds analysis

- Evidence: R. F. Henderson and Tew*, 213, 182 (Q. 936-7); *Inst. Chartered Accountants*, 1411; *Inst. Chartered Accountants Scotland*, 1284 (Q. 6126-7)

Capital reduction

(see also PREFERENCE SHARES—EXTINGUISHMENT; RECONSTRUCTION SCHEMES)

- Report*: 157-60, 167, 187
Evidence:
Accepting Houses & Issuing Houses, 404
Baxter and Edey, 162 (Q. 803-5)
Board of Trade, 1586-7
Brit. Insurance Assoc., 625
Chartered Inst. Secretaries, 820
Clore, 552
Faculty Advocates, 1301
Gower, 1062
Inst. Chartered Accountants Scotland, 1335
Law Society, 1202, 1154 (Q. 5597-5600), 1156 (Q. 5617-8)
Law Society Scotland, 1315-6, 1265 (Q. 5969-85)
E. V. Morgan, 246 (Q. 1242-3), 247 (Q. 1245-6)
H. S. Morgan etc., 1001 (Q. 4837-9), 1002 (Q. 4844-6), 1047 (Q. 5160-9)
Nat. Chamber Trade, 340
Piercy, 119

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Capital reduction—continued
Registrar Companies Court, 328, 333,
 281 (Q. 1357-63), 293 (Q. 1430-3)
Stock Exchange London, 1115 (Q.
 5310-3)

Capital return see **Preference shares**—
 Extinguishment

Capital surplus distribution
 (see also **ASSETS REVALUATION**; **CAPITAL
 REDUCTION**; **DIVIDENDS**)
Report: 155, 156, 336-9, 350
Evidence:
Baxter and Edey, 156 (Q. 772-5)
Inst. Chartered Accountants, 1418,
 1396 (Q. 6254-88)
Inst. Chartered Accountants Scotland,
 1336, 1274 (Q. 6042-3), 1275 (Q.
 6047-57), 1289 (Q. 6158-64)
Inst. Directors, 803, 759 (Q. 3765),
 760 (Q. 3767-8)
Law Society, 1202, 1154 (Q. 5601-15)
E. V. Morgan, 242 (Q. 1221-3), 246
 (Q. 1242-3), 247 (Q. 1245-6)
Nat. Chamber Trade, 340
Wincott, 55

Capitalization of profits see **Shares**—
 Issues to existing shareholders

Certificates of exemption see **Prospectuses**

Certified and Corporate Accountants,
 Association of see **Association of Certi-
 fied and Corporate Accountants**

Chairman's statement see **Activities**
 report

Chambers of Commerce
Evidence: *A.B.C.C.*, 486, 490-4, 444
 (Q. 2184-97), 448 (Q. 2220-2); *Board*
of Trade, 1594; *Nat. Chamber Trade*,
 309 (Q. 1540-1), 312 (Q. 1564-6)

Charges authorised by the Acts
Report: 306, 483
Evidence: *Accepting Houses & Issuing*
Houses, 417; *Assoc. Certified & Corp.*
Accountants, 902; *Chartered Inst.*
Secretaries, 824; *Courtauld*, 60;
F.B.I., 1452; *Law Society*, 1213

Charitable donations see **Donations**

Charities
Evidence: *Board of Trade*, 1531 (Q.
 6892-94)

Charlton, F. see **General Council of British**
Shipping

Chartered Institute of Secretaries
Memorandum: 810-30
Oral evidence: 768-82 (Q. 3839-72)

Circulars (investments)
 (see also **DEPOSITS SOLICITATION**)
Report: 231, 233, 234, 254-5, 258,
 264, 329
Evidence: *Board of Trade*, 1581-3
Take-over offers
Report: 236, 252, 268-73, 294

Circulars (investments)—continued
Take-over offers—continued
Evidence: *A.B.C.C.*, 488; *Board of*
Trade, 1582-3, 1539 (Q. 6952-4), 1552
 (Q. 7059-67); *Law Society*, 1198;
T.U.C., 993, 947 (Q. 4727)

Circulars (proxy votes) see **Proxy votes**

Clarke, G. K. V. see **Law Society of Scot-
 land**

Clarke, J. M. see **Board of Trade**

Class rights see **Shares**—**Class rights**

Classification of companies
 (see also **LIMITATION BY GUARANTEE**; **PRIV-
 VATE COMPANIES**; **UNLIMITED COM-
 PANIES**)
Report: 55-6, 64-8, 78
Evidence:
Accepting Houses & Issuing Houses,
 396, 350 (Q. 1678-84)
A.B.C.C., 486, 490-4, 444 (Q. 2184-97),
 448 (Q. 2220-2)
Assoc. Certified & Corp. Accountants,
 881-2
Board of Trade, 1567-8
Chartered Inst. Secretaries, 811
Clore, 549, 519 (Q. 2559)
Council Scottish Chambers Commerce,
 903
Guest Keen Nettlefolds, 128-30, 101
 (Q. 668-70)
Inst. Chartered Accountants, 1401-2
Inst. Chartered Accountants Scotland,
 1327
Law Society, 1189
Law Society Scotland, 1306
Nat. Chamber Trade, 337, 305 (Q.
 1514-6)
Piercy, 115, 88 (Q. 554-62)
Registrar Companies Court, 328

Clore, Charles
Memorandum: 548-553
Oral Evidence: 518-534 (Q. 2545-2707)

Cohen, M. F.
Oral Evidence: 1455-1501 (Q. 6581-
 6972)
Report: 142

Cole, K. D. see **Law Society**

Commencement of business
Report: 65, 67
Evidence: *Chartered Inst. Secretaries*,
 823; *Inst. Chartered Accountants*,
 1402-3; *Law Society*, 1186

Committee of London Clearing Bankers
Memorandum: 637-651
Oral evidence: 382-602 (Q. 3016-3114)
Report: 401, p. 214 (para. 13), p. 215
 (para. 14)

Committee of Scottish Bank General
Managers
Memorandum: 495-502
Oral evidence: 450-464 (Q. 2233-2335)
Report: p. 214 (para. 13)

Commodity pools
Report: 312
Evidence: *Board of Trade*, 1581

"REPORT" references are to PARAGRAPH NUMBERS

Companies, Foreign see Foreign Companies
 Companies Act Consultative Committee
Report: 229-30, 234, 245
 Company names see Business names
 Company purchase of own shares see Shares—Purchase by company
 Consortia
Evidence: *Board of Trade*, 1575
 Consumer Protection Committee Report (Moloney)
Report: 444
 Contracts see Ultra vires
 Contracts, Management see Management contracts
 Contracts, Pre-incorporation see Pre-incorporation contracts
 Control see Ownership and control
 Cook, W. A. see Law Society of Scotland
 Co-partnership schemes
 (see also SUBSIDIARY COMPANIES)
Report: 167, 169, 186
Evidence: *Board of Trade*, 1587;
Courtaulds, 64; *J. Lewis Partnership*,
 205-8, 170 (Q. 847-50), 172 (Q. 870-8),
 175 (Q. 893-5); *H. S. Morgan etc.*, 1022
 (Q. 4847-51)
 Corporations
 As directors see DIRECTORS—BODIES
 CORPORATE AS DIRECTORS
 Representation at meetings see MEETINGS
 —REPRESENTATION OF CORPORATIONS
 Cottis, C. P. see Federation of British
 Industries
 Council of Associated Stock Exchanges
Memorandum: 545-547
Oral evidence: 503-518 (Q.2402-2544)
 Council of British shipping see General
 Council of British shipping
 Council of Scottish Chambers of
 Commerce
Memorandum: 903-906
Oral evidence: 858-879 (Q. 4253-4420)
 Courtaulds Ltd.
Memorandum: 58-65
Oral evidence: 21-36 (Q. 202-298)
 Credit enquiries
 (see also TRADE CREDIT)
Report: 60
Evidence:
Chartered Inst. Secretaries, 771 (Q.
 3868-9)
Council Scottish Chambers Com-
merce, 860 (Q. 4275-7), 863 (Q.
 4293-7)
Law Society Scotland, 1250 (Q. 5848-
 50)
Nat. Assoc. Trade Protection Socie-
ties, 471 (Q. 2383-7)
Nat. Chamber Trade, 310 (Q. 1552-5),
 312 (Q. 1562-3)
Trade Indemnity Co., 250, 276-7
 (Q. 1263-1337)

Crump, H. see Association of British
 Chambers of Commerce
 Cumulative voting see Directors—
 Appointment

D

Davis Polk Wardwell Sunderland & Kiendl
Memorandum: 1064-1077
Oral evidence (Brownell etc.): 999-1051
 (Q. 4822-5184)
Report: 228
 Dealers in securities
Report: 223, 231, 253-62, 264
Evidence:
A.B.C.C., 482
Assoc. Certified & Corp. Account-
ants, 890
Assoc. Stock & Share Dealers, 554,
 534 (Q. 2710-93)
Board of Trade, 1579-81, 1555 (Q.
 7090-6)
Cohen & Liss, 1492 (Q. 6739-45)
Council Assoc. Stock Exchanges,
 547, 511 (Q. 2486-96), 512 (Q.
 2499-2500)
Gower, 1057-8
Inst. Chartered Accountants Scot-
land, 1334, 1335, 1293 (Q. 6197-
 6202)
Law Society, 1200
H. S. Morgan etc., 1074, 1086,
 1037 (Q. 5075)
Nat. Chamber Trade, 339
Securities & Exchange Commission,
 1507-8, 1514
Stock Exchange London, 1177-8,
 1126 (Q. 5389-97)
 Investors' compensation
Report: 257, 264
Evidence: *Assoc. Stock & Share*
Dealers, 536 (Q. 2723)
 Dean, E. W. see Board of Trade
 Debentures
Report: 163, 187, 244, 252, 296, 306
Evidence:
Accepting Houses & Issuing
Houses, 409-10
A.B.C.C., 481, 443 (Q. 2177-81)
Brit. Insurance Assoc., 620-22
Chartered Inst. Secretaries, 817,
 778 (Q. 3931-5)
Clare, 550
Fay, 785 (Q. 3990-4)
Guest Keen Nettlefolds, 136
J. Lewis Partnership, 206
Nat. Chamber Trade, 339
 Quoted on stock exchange
Evidence: *Stock Exchange London*,
 1180-81
 Receivers
Report: 298-9, 306, 501, 503
Evidence: *Assoc. Certified & Corp.*
Accountants, 888, 853 (Q. 4214-8);
Chartered Inst. Secretaries, 779 (Q.
 3940-3); *Inst. Chartered Account-*
ants Scotland, 1333; *Nat. Chamber*
Trade, 339

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Debentures—continued

Register of Charges
(see also FLOATING CHARGES)

Report: 300-305, 306

Evidence:

Accepting Houses & Issuing Houses, 401

A.B.C.C., 481

Assoc. Certified & Corp. Accountants, 888

Board of Trade, 1575-6, 1548 (Q. 7024-9)

Chartered Inst. Secretaries, 818-9, 779 (Q. 3936-40)

Faculty Advocates, 1303, 1244 (Q. 5801)

Inst. Chartered Accountants, 1409

Inst. Chartered Accountants Scotland, 1334

Nat. Chamber Trade, 339

Registrar Companies Court, 331-2, 289 (Q. 1411-2)

Register of holders

Report: 295, 306

Evidence: *Assoc. Certified & Corp. Accountants*, 887, 852 (Q. 4211-3);

Board of Trade, 1548 (Q. 7030-7);

Chartered Inst. Secretaries, 818

Trustees

Report: 297

Evidence:

Assoc. Certified & Corp. Accountants, 888

Brit. Insurance Assoc., 622

Cohen & Loss, 1494 (Q. 6755-60)

Fay, 785 (Q. 3995-7)

Gower, 1061-2

Inst. Chartered Accountants Scotland, 1333

Law Society, 1197

H. S. Morgan etc., 1076-7, 1087

Nat. Chamber Trade, 339

Securities & Exchange Commis., 1512

Debts

Subsidiary companies see **SUBSIDIARY COMPANIES—DEBTS GUARANTEE**

Deceased members

Report: 26, 31, 210, 212, 422, 423

Evidence: *General Council Bar*, 975, 987, 978 (Q. 4596-4602); *Inst. Chartered Accountants*, 1402

Deferred liabilities

Evidence: *Baxter and Edey*, 202; *Courtaulds*, 63

Dennehy, G. F. H. see **Law Society**

Deposits solicitation

Report: 255

Evidence:

Accepting Houses & Issuing Houses, 405

A.B.C.C., 485-6

Assoc. Investment Trusts, 734

Board of Trade, 1581

Economist, 266-7

Inst. Chartered Accountants, 1412-3, 1578 (Q. 6417)

Deposits solicitation—continued

T.U.C., 995

Wincott, 20 (Q. 193-5)

Depreciation

Report: 349, 350, 386, 390, 397

Evidence:

Baxter and Edey, 195, 158 (Q. 781-2)

R. F. Henderson & Tew, 211-2, 184 (Q. 948-63)

Inst. Chartered Accountants, 1366 (Q. 6328-33)

Inst. Chartered Accountants Scotland, 1281 (Q. 6092-100)

Inst. Directors, 803-4

E. V. Morgan, 248 (Q. 1249-50)

Newton, 68

T.U.C., 992

Dewar, G. D. H. see **Institute of Chartered Accountants of Scotland**

Directors

(see also **OWNERSHIP AND CONTROL**)

Report: 100-13, 122, 206, 214, 487, 495

Evidence: *Board of Trade*, 1569; *E. V. Morgan*, 237 (Q. 1190-1)

Action in dual capacity

Evidence: *Chartered Institute of Secretaries*, 813

Activities report see **ACTIVITIES REPORT**

Age limits

Report: 79, 85

Evidence: *Chartered Inst. Secretaries*, 775 (Q. 3902-3), 782 (Q. 3966-7);

Courtaulds, 64; *General Council Bar*, 981; *Inst. Chartered Accountants Scotland*, 1345; *Inst. Directors*, 809, 750 (Q. 3694-6); *Law Society Scotland*, 1267 (Q. 5987-9)

Alternate directors

Report: 83

Evidence: *Accepting Houses and Issuing Houses*, 369 (Q. 1820-1);

Inst. Directors, 808

Appointment

Report: 79-81, 85, 498, 503, 511

Evidence: *A.B.C.C.*, 477, 486-7, 434 (Q. 2078-83), 435 (Q. 2088-2107);

Board of Trade, 1538 (Q. 6940-5); *Brit. Insurance Assoc.*, 632; *Courtaulds*, 64, 23 (Q. 227); *Gower*, 1053; *Inst. Chartered Accountants*, 1405-6; *H. S. Morgan etc.*, 1068, 1085, 1011 (Q. 4906-8); *Newton*, 39 (Q. 328-31)

Bodies corporate as directors

Report: 84, 85

Evidence:

Accepting Houses & Issuing Houses, 398

A.B.C.C., 477

Assoc. Certified & Corp. Accountants, 884, 846 (Q. 4149-50)

Assoc. Investment Trusts, 730, 682 (Q. 3408-10)

Board of Trade, 1569

Clore, 549

Council Scottish Chambers Commerce, 904

“REPORT” references are to **PARAGRAPH NUMBERS**

Directors—continued

- Bodies corporate as directors—continued
Faculty Advocates, 1298, 1232 (Q. 5723-5)
F.B.I., 1445
Inst. Chartered Accountants, 1405
Inst. Chartered Accountants Scotland, 1330
Inst. Directors, 796
Law Society, 1191
J. Lewis Partnership, 206
Nat. Chamber Trade, 338
Piercy, 118

Compensation for loss of office

Report: 92-3, 99, 281, 293

Evidence:

- Accepting Houses & Issuing Houses*, 411, 358 (Q. 1740-2)
Assoc. Certified & Corp. Accountants, 889
Economist, 263
Faculty Advocates, 1301
F.B.I., 1448-9
General Council Bar, 968-9, 920 (Q. 4515-20)
Inst. Chartered Accountants, 1404-5, 1411
Inst. Chartered Accountants Scotland, 1335
Inst. Directors, 802
H. S. Morgan etc., 1022 (Q. 4990)

Compensation liability in securities transactions

Report: 89, 99

Dealing in own companies' shares

(see also SECURITIES—INSIDER-TRADING)

Report: 88-91, 99, 141, 143, 147, 150

Evidence:

- Accepting Houses & Issuing Houses*, 398, 414, 369 (Q. 1820-1)
A.B.C.C., 477, 488
Assoc. Certified & Corp. Accountants, 884, 846 (Q. 4147-8)
Assoc. Investment Trusts, 729, 682 (Q. 3405-7), 691 (Q. 3475-8)
Board of Trade, 1532 (Q. 6896-8)
Brit. Insurance Assoc., 617
Chartered Inst. Secretaries, 813
Clare, 549, 522 (Q. 2587-98), 531 (Q. 2683-93), 533 (Q. 2701-7)
Committee London Clearing Bankers 637, 583 (Q. 3028-34)
Council Assoc. Stock Exchanges, 546, 508 (Q. 2453-61), 514 (Q. 2513-7), 516 (Q. 2531-3)
Courtaulds, 59, 24 (Q. 236-7)
Economist, 232 (Q. 1146-56)
Faculty Advocates, 1297-8, 1227 (Q. 5692-5710)
F.B.I., 1445, 1386 (Q. 6483-99)
Inst. Chartered Accountants, 1405
Inst. Chartered Accountants Scotland, 1329
Inst. Directors, 795-6, 749 (Q. 3691-3)
Law Society, 1191
J. Lewis Partnership, 206
H. S. Morgan etc., 1076, 1040 (Q. 5099-5103)

Directors—continued**Dealing in own companies' shares—continued**

- Nat. Chamber Trade*, 338
Newton, 67, 39 (Q. 332-52)
Piercy, 91 (Q. 589-91)
Stock Exchange London, 1166, 1106 (Q. 5243-61)
Wincott, 51, 15 (Q. 158-61)

Disclosure of interests

(see also TAKE-OVER BIDS—DIRECTORS' INTERESTS DISCLOSURE)

Report: 95-7, 99, 467

Evidence:

- Assoc. Certified & Corp. Accountants*, 884, 846 (Q. 4151-7)
Board of Trade 1570
Brit. Insurance Assoc., 632
Chartered Inst. Secretaries, 813, 773 (Q. 3886-91)
Committee Scottish Bank General Managers, 497, 453 (Q. 2264-8)
Courtaulds, 58
Faculty Advocates, 1298, 1230 (Q. 5711-22)
Fay, 785 (Q. 4002-5)
F.B.I., 1445
General Council Bar, 969-71, 927 (Q. 4586-90)
Gower, 1059-60
Guest Keen Nettlefolds, 130, 135, 104 (Q. 694-6)
Inst. Chartered Accountants Scotland, 1330
Inst. Directors, 796, 754 (Q. 3730-51)
Law Society, 1191
J. Lewis Partnership, 206
Lyons, 114
Newton, 67
Stock Exchange London, 1166-7, 1108 (Q. 5262-66)

Disqualification see DIRECTORS—APPOINTMENT**Duties**

Report: 86, 467-8, 488, 495

Evidence:

- Accepting Houses & Issuing Houses*, 398
A.B.C.C., 477, 445 (Q. 2198)
Assoc. Certified & Corp. Accountants, 883-4
Assoc. Investment Trusts, 729
Board of Trade, 1569-70, 1531 (Q. 6894-5)
Clare, 549, 521 (Q. 2581-7)
Council Assoc. Stock Exchanges, 546
Council Scottish Chambers Commerce, 904, 867 (Q. 4324-33)
Economist, 259, 235 (Q. 1173)
Faculty Advocates, 1297
Fay, 4001
F.B.I., 1445
General Council Bar, 985-6
Inst. Chartered Accountants Scotland, 1329
Inst. Directors, 795
Law Society, 1191

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Directors—continued**Duties—continued**

J. Lewis Partnership, 205
Nat. Chamber Trade, 338, 311 (Q.
 1557-60)
Piercy, 117

Registrar Companies Court, 329

Elected by employees

Evidence: J. Lewis Partnership, 208,
 176 (Q. 902-06)

Fiduciary position

Report: 87, 89, 99

Evidence:

Assoc. Certified & Corp. Account-
ant, 884
Assoc. Investment Trusts, 729, 685
 (Q. 3429)
Clare, 549
Economist, 259
Faculty Advocates, 1297
Fay, 785 (Q. 3998-4000)
Inst. Chartered Accountants Scot-
land, 1329
Inst. Directors, 795
Nat. Chamber Trade, 338, 311 (Q.
 1557-60)
Piercy, 117
Registrar Companies Court, 329
Stock Exchange London, 1166

Insolvent companies

Report: 497-500, 503

Evidence: A.B.C.C., 484; *Board of*
Trade, 1605; *Inst. Chartered*
Accountants, 1433

Loans (private companies)—see PRIVATE COMPANIES**Loans (public companies)**

Report: 98, 99, 150, 185

Evidence: Law Society, 1191, 1143
 (Q. 5525)

Managing directors

Evidence: General Council Bar, 984-
 85

Meetings

Evidence: Chartered Inst. Secretaries,
 825-6; *General Council Bar*, 984

Minimum number

Report: 25, 31, 508, 511

Evidence: Assoc. Certified & Corp.
Accountants, 881, 835 (Q. 4062-3);
Economist, 217 (Q. 1004-7); *Law*
Society, 1214

Multiple directorships**Evidence:**

Accepting Houses & Issuing Houses,
 401
A.B.C.C., 480-1
Assoc. Certified & Corp. Account-
ants, 886
Assoc. Investment Trusts, 731
Board of Trade, 1574
Clare, 550
Courtaulds, 60
F.B.I., 1447-8
Inst. Chartered Accountants, 1408
Inst. Chartered Accountants Scot-
land, 1333

Directors—continued**Multiple directorships—continued**

Inst. Directors, 799-800, 752 (Q.
 3713-29)

Law Society, 1196

J. Lewis Partnership, 206

Nat. Chamber Trade, 339

Piercy, 118

Named in letterheads etc.

Report: 455, 456

Evidence:

Accepting Houses & Issuing Houses,
 412
A.B.C.C., 483
Board of Trade, 1596
Chartered Inst. Secretaries, 814,
 774 (Q. 3894-3901)
Council Scottish Chambers Com-
merce, 872 (Q. 4369-76)
Courtaulds, 30 (Q. 274-5)
F.B.I., 1451
Guest Keen Nettlefolds, 130, 135
Inst. Chartered Accountants Scot-
land, 1344-5
Inst. Directors, 807, 758 (Q. 3759-
 63)
Lyons, 114

Nominee directors**Evidence:**

Accepting Houses & Issuing Houses,
 400
Assoc. Certified & Corp. Account-
ants, 886
Board of Trade, 1573, 1542 (Q.
 6983)
Chartered Inst. Secretaries, 808
Faculty Advocates, 1300-1, 1236
 (Q. 5752-60)
Inst. Chartered Accountants Scot-
land, 1333
Inst. Directors, 799
Law Society, 1194-5, 1151 (Q. 5577-
 9)
Lyons, 113
Nat. Chamber Trade, 338-9, 311
 (Q. 1560)
Stock Exchange London, 1168

Notice required by Section 198

Report: 97, 99

Pensions

Report: 94

Evidence: General Council Bar, 984;
Inst. Chartered Accountants, 1421

Qualifying shares

Evidence: Law Society, 1186

Register of directors

Report: 97

Evidence: Accepting Houses &
Issuing Houses, 412; *Chartered*
Inst. Secretaries, 813-4, 774 (Q.
 3892-3); *F.B.I.*, 1452; *Inst. Direc-*
tors, 807

Registration of members

Report: 210-11, 212, 476, 483

Evidence: Board of Trade, 1573-4;
General Council Bar, 987, 928 (Q.
 4596-4602); *Inst. Chartered Account-*
ants, 1402

“REPORT” references are to PARAGRAPH NUMBERS

Directors—continued**Removal**

Evidence: Assoc. International Accountants, 423; Chartered Inst. Secretaries, 813; General Council Bar, 968

Remuneration

(see also REMUNERATION BY OPTIONS)

Report: 94, 205, 279, 293, 351, 352

Evidence:

*A.B.C.C., 437 (Q. 2111-2)
Chartered Inst. Secretaries, 821
Council Assoc. Stock Exchanges, 547
Guest Keen Nettlefolds, 135
Inst. Chartered Accountants, 1421-2
Inst. Chartered Accountants Scotland, 1345-6
Inst. Directors, 806, 753 (Q. 3718-29), 765 (Q. 3809-13)
H.S. Morgan etc., 1023 (Q. 4994-5), 1043 (Q. 5120-5)
Newton, 69*

Report to shareholders see ACTIVITIES REPORT

Share qualifications

Report: 65, 67

Evidence: Committee London Clearing Bankers, 650; Inst. Directors, 809; Stock Exchange London, 1103 (Q. 5221-4)

"Special directors"

Report: 82

Evidence: Chartered Inst. Secretaries, 814-5, 775 (Q. 3904-14); Inst. Directors, 808-9

Take-over bids veto see TAKE-OVER BIDS—DIRECTORS' VETO

Disclosure of company's shareholdings see Shareholdings of company, Disclosure of

Disclosure of interests see Directors—Disclosure of interests; Directors—Nominee directors; Nominee shareholders; Take-over bids—Directors' interests

Discount houses see Banks and banking

Disposal of assets see Assets disposal

Dissolution of companies see Register of companies

Distribution of shares see Shares—Allotment

Diversification of activities see Activities changes

Dividends

(see also CAPITAL SURPLUS DISTRIBUTION; SUBSIDIARY COMPANIES—PRE-ACQUISITION PROFITS)

Report: 158, 161, 165, 175, 180, 187, 337, 339-41, 350, 495

Evidence: Baxter and Edey, 191, 200, 161 (Q. 801-2); General Council Bar, 985; Gower, 1053; Inst. Chartered Accountants, 1367 (Q. 6338-37); Inst. Chartered Accountants Scotland, 1276 (Q. 6058-66); H.S. Morgan etc., 1067-8, 1047 (Q. 5160-2)

Dividends—continued**Unclaimed dividends**

Report: 379, 380

Evidence: Chartered Inst. Secretaries, 826; General Council Bar, 976; Guest Keen Nettlefolds, 141

Divine, T.D.D. see General Council of the Bar

Donations

Report: 50-53, 54

Evidence:

*A.B.C.C., 476
Assoc. Certified & Corp. Accountants, 883
Assoc. Investment Trusts, 728
Board of Trade, 1568
Brit. Insurance Assoc., 616
Clare, 549
Committee London Clearing Bankers, 637
Council Scottish Chambers Commerce, 903
Courtaulds, 58, 21 (Q. 205-8)
Economist, 262-3
F.B.I., 1444
Gower, 1063
Inst. Chartered Accountants, 1403
Inst. Chartered Accountants Scotland, 1328
Inst. Directors, 794, 767 (Q. 3837)
Law Society, 1190
J. Lewis Partnership, 205, 170 (Q. 851-6), 178 (Q. 915)
Lyons, 111, 72 (Q. 435-44), 84 (Q. 529-38)
E. V. Morgan, 270, 238 (Q. 1192-8)
H. S. Morgan etc., 1021 (Q. 4976-92)
Nat. Chamber Trade, 337
Piercy, 116, 89 (Q. 566-73)
Securities & Exchange Commission, 1515-6
Stock Exchange London, 1165
T.U.C., 994-5, 949 (Q. 4738-55)*

Door-to-door selling see Securities

Douglas, H. see Trades Union Congress

Du Cann, E. D. L. see Association of Unit Trust Managers

Dyson, R. G. see British Overseas Banks Association

E**Economist, The**

Memorandum: 258-269

Oral evidence: 215-236 (Q. 979-1177)

Edey, H. C.

Memorandum: 192-204

Oral evidence: 145-69 (Q. 722-845)

Edwards, J. M. see Courtaulds Ltd.

Employees, Information for

Evidence: TUC, 989, 935 (Q. 4649-60)

Exempt private companies see Private companies

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

F

- F.B.I.** see *Federation of British Industries*
- Faculty of Advocates**
Memorandum: 1296-1303
Oral evidence: 1221-1244
- Fairbairn, R. D.** see *Committee of Scottish Bank General Managers*
- Fairbairn, S. I.**
Memorandum: 735-741
Oral evidence: 695-708 (Q. 3501-3633)
- False statements**
Report: 510, 511
Evidence: *Board of Trade*, 1606
- Fay, E. S.**
Memorandum: 831-34
Oral evidence: 783-91 (Q. 3973-4052)
- Fen, W. W.** see *Gnest Keen & Nettlefolds Ltd.*
- Federation of British Industries**
Memorandum: 1443-1453
Oral evidence: 1378-1398 (Q. 6419-6580)
Report: 117
- Ferguson, N.** see *Trades Union Congress*
- Finance companies**
Evidence: *Economist*, 266-7; *Piercy*, 95 (Q. 621-3)
- Financial Times** see *Newton, Gordon*
- Fleming, P. L.** see *Institute of Directors*
- Fletcher, G. H.** see *Association of Unit Trust Managers*
- Floating charges**
Report: 300-5, 306
Evidence: *A.B.C.C.*, 477; *Committee Scottish Bank Gen. Managers*, 501-2, 461 (Q. 2319-21); *Council Scottish Chambers Commerce*, 905; *F.B.I.*, 1444; *Inst. Chartered Accountants Scotland*, 1334; *Law Society*, 1197
- Foreign companies**
Report: 377, 406, 451, 456, 512-22, 525
Evidence:
Accepting Houses & Issuing Houses, 406
Assoc. Certified & Corp. Accountants, 895-6
Board of Trade, 1596-7, 1544 (Q. 6998-7000)
Brit. Insurance Assoc., 631
Chartered Inst. Secretaries, 822
Courtaulds, 31 (Q. 276-278)
F.B.I., 1451
Gen. Council Brit. Shipping, 344, 319 (Q. 1616), 326 (Q. 1660)
Guest Keen Nettlefolds, 140
Inst. Chartered Accountants, 1429-30
Inst. Chartered Accountants Scotland, 1342
Inst. Directors, 806-7, 768 (Q. 3838)
Law Society, 1208-10
- Foreign investments** see *Investments, Foreign*

- Franks, Sir Oliver** see *Committee of London Clearing Bankers*
- Fraud prevention** see *Dealers in securities*
- Fraudulent trading** see *Directors—Insolvent companies*
- Freeman, P. W.** see *Society of Investment Analysts*
- French, H. J. S.** see *Accepting Houses Committee*

G

- Gabell, G. N.** see *Chartered Institute of Secretaries*
- Gammell, W. S.** see *Association of Investment Trusts*
- General Council of British Shipping**
Memorandum: 342-348
Oral evidence: 314-327 (Q. 1582-1663)
Report: 414
- General Council of the Bar**
Memorandum: 962-988
Oral evidence: 907-935 (Q. 4421-4640)
Report: 87, 210, 293
- German company management**
Evidence: *Economist*, 259-60, 220 (Q. 1029-30), 228 (Q. 1106-10)
- Gluckstein, I. M.** see *Lyons (J.) & Co.*
- Godfrey, J.** see *Institute of Directors*
- Gorick, H. E.** see *General Council of British Shipping*
- Gower, I. C. B.**
Memorandum: 1052-1063
- Granger, P. F.** see *Institute of Chartered Accountants in England & Wales*
- Greig, C. McNeil** see *National Association of Trade Societies*
- Guarantee, Limitation by** see *Limitation by guarantee*
- Gnest, Keen & Nettlefolds Ltd.**
Memorandum: 127-144
Oral evidence: 98-110 (Q. 641-721)
- Gunlake, J. H.** see *Institute of Actuaries*

H

- Hardman, E. G.** see *Chartered Institute of Secretaries*
- Harris, J. E.** see *Association of Certified and Corporate Accountants*
- Hatch, J. W.** see *Accepting Houses Committee*
- Henderson, R. F.**
Memorandum: 209-14
- Henderson Smith, H. J.** see *British Insurance Association*
- Henlé, N. F.** see *Law Society*
- Herbert, Sir Edwin** see *Association of Investment trusts*
- Hill, Roy** see *General Council of British Shipping*

"REPORT" references are to PARAGRAPH NUMBERS

Hills, J. H. see Association of Certified and Corporate Accountants
 Hire purchase companies
Evidence: Piercy, 95 (Q. 621-623)
 Hirsch, F. see Economist, The
 Hobson, Sir Oscar see Association of Unit Trust Managers
 Hodge, A. M. see Council of Scottish Chambers of Commerce
 Hogg, S. R. see Association of British Chambers of Commerce
 Holding companies see Accounts—Holding companies; United States law—Holding companies
 Holdings, Disclosure of see Shareholdings of companies, Disclosure of
 Hubbard, E. P. see Association of International Accountants
 Hughes, G. T. see Guest, Keen & Nettelfolds Ltd.
 Hall, A. F. see General Council of British Shipping
 Hume, Sir Nutcombe see Federation of British Industries
 Hunter, J. A. see Stock Exchange, London

I

"Incorporated partnerships" see Partnerships

Incorporation

(see also MEMORANDUM OF ASSOCIATION; MINIMUM MEMBERSHIP: "ONE-MAN" COMPANIES; PARTNERSHIPS; PRE-INTEGRATION CONTRACTS; REGISTRATION FEES)

Report: 21-31, 508, 511

Evidence:

Board of Trade, 1565, 1523 (Q. 6814-33), 1527 (Q. 6852-5)

Clore, 548, 518 (Q. 2546-58)

Economist, 258, 261, 215 (Q. 980-3), 216 (Q. 993), 225 (Q. 1087-8)

F.B.I., 1443, 1378 (Q. 6420-6)

Inst. Chartered Accountants, 1399-1400

Inst. Chartered Accountants, Scotland, 1325

Law Society, 1186-7, 1133 (Q. 5438-61)

Law Society Scotland, 1304, 1245 (Q. 5803-24)

H. S. Morgan etc., 1010 (Q. 4901-5)

Nat. Chamber Trade, 337, 313 (Q. 1574-6)

Piercy, 115

Wincott, 49

Statutory declaration

Report: 30, 31

Evidence: Inst. Directors, 792; Law Society Scotland, 1305

Independent Television Authority
Report: 246

Industrial & Commercial Finance Corporation Ltd. see Piercy, William (Baron Piercy)

Inspectors appointed by Board of Trade
Report: 141, 146, 147, 206, 213-17, 218, 322, 329

Evidence:

A.B.C.C., 480, 488, 439 (Q. 2125-9)

Assoc. Certified & Corp. Accountants, 885-6

Assoc. Investment Trusts, 730, 683 (Q. 3417-22), 691 (Q. 3479-81)

Board of Trade, 1572-3, 1607, 1532 (Q. 6899-6903), 1533 (Q. 6915-64)

Brit. Insurance Assoc., 620, 558 (Q. 2801-4)

Clore, 553, 523 (Q. 2599-2601), 524 (Q. 2608-9), 528 (Q. 2643)

Committee Scottish Bank Gen. Managers, 456 (Q. 2279-85)

Council Scottish Chambers Commerce, 870 (Q. 4345-7)

Faculty Advocates, 1300, 1228 (Q. 5698-9), 129 (Q. 5707-10), 1234 (Q. 5737-41)

Fay, 831-4, 783 (Q. 3973-89), 786 (Q. 4006-52)

F.B.I. 1446-7, 1389 (Q. 6515-22), 1390 (Q. 6425-35)

General Council Bar, 929 (Q. 4603-5)

Guest Keen Nettelfolds, 130

Inst. Chartered Accountants Scotland, 1331

Inst. Directors, 797, 751 (Q. 3704-8)

Law Society, 1193-4, 1148 (Q. 5557-65), 1156 (Q. 5616)

Law Society Scotland, 1312

E. V. Morgan, 237 (Q. 1186-9)

Nat. Chamber Trade, 338

Newton, 67, 69, 42 (Q. 359-69), 47 (Q. 417)

Registrar Companies Court, 288 (Q. 1399)

Stock Exchange London, 1168

Wincott, 53, 54, 13 (Q. 134-45)

Instalment purchase of shares see Shares—Instalment purchase

Institute of Actuaries

Memorandum: 652-656

Oral evidence: 602-614 (Q. 3115-3184)

Report: 411

Institute of Chartered Accountants in England and Wales

Memorandum: 1399-1442

Oral evidence: 1349-1378 (Q. 6212-6418)

Report: 58, 117, 333-4, 337, 370, 384, 392, 434

Institute of Chartered Accountants of Scotland

Memorandum: 1324-1348

Oral evidence: 1268-1295 (Q. 6001-6211)

Report: 58, 337

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Institute of Directors

Memorandum: 792-809

Oral evidence: 743-768 (Q. 3634-3838)

Insurance companies

(see also ACCOUNTS—EXEMPTIONS FROM LEGAL PROVISIONS)

Report: 155, 156, 408-11, 412

Evidence: *Baxter & Edey*, 190; *Brit. Insurance Assoc.*, 628-30, 633-6, 568(Q. 2905-82), 579 (Q. 2986-3015); *Inst. Actuaries*, 652-6, 603 (Q. 3116-84);*Soc. Investment Analysis*, 420-1, 379

(Q. 1921-6)

Interlocking shareholdings

(see also DIRECTORS—APPOINTMENT; VOTING RIGHTS)

Report: 151-3, p. 208 (para. 6)

Evidence:

Accepting Houses & Issuing Houses, 407*Assoc. International Accountants*, 423*Brit. Insurance Assoc.*, 632*Cohen and Loss*, 1490 (Q. 6725-7),

1491 (Q. 6730)

Law Society, 1153 (Q. 5594)*Piercy*, 94 (Q. 611-13)**International Accountants, Association of**

see Association of International Accountants

Investment advisers see Investors—Information**Investment clubs**

Report: 328

Evidence: *Board of Trade*, 1586;*Economist*, 228 (Q. 1105)**Investment trusts**

(see also OPEN END MUTUAL FUNDS; UNIT TRUSTS)

Report: 365-6

Evidence:

Accepting Houses & Issuing Houses, 358 (Q. 1743-5)*Assoc. Investment Trusts*, 727, 693

(Q. 3489-91)

Cohen & Loss, 1489 (Q. 6724-45)*S. I. Fairbairn*, 735-41, 695-708 (Q. 3501-33)*Gower*, 1062*Inst. Chartered Accountants*, 1368 (Q. 6342-3), 1369 (Q. 6352-4)*H. S. Morgan etc.*, 1077, 1087, 1049 (Q. 5176-82)*Securities & Exchange Commission*, 1517**Investment Trusts, Association of see Association of Investment Trusts****Investments**

Report: 363-6, 369, p. 215 (para. 16)

Evidence: *R. F. Henderson and Tew*

214

Company investments

(see also ACCOUNTS—HOLDING COMPANIES; SHAREHOLDINGS OF COMPANY; SUBSIDIARY COMPANIES)

Investments—continued**Company investments—continued****Evidence:***Accepting Houses & Issuing Houses*, 405-6, 361 (Q. 1768-73)*Assoc. Certified & Corp. Accountants*, 892*Assoc. Investment Trusts*, 733, 690

(Q. 3469-70), 694 (Q. 3492)

Brit. Insurance Assoc., 626*Council Scottish Chambers Commerce*, 905*Courtaulds*, 27 (Q. 253-66)*Faculty Advocates*, 1241 (Q. 5777)*Guest Keen Nettlefolds*, 107 (Q. 708-12)*R. F. Henderson & Tew*, 186 (Q. 967-8)*Inst. Chartered Accountants*, 1409,

1423-4, 1362 (Q. 6298-6301)

Inst. Chartered Accountants Scotland, 1333, 1339, 1283 (Q. 6117-25)*Inst. Directors*, 800*E. V. Morgan*, 273, 244 (Q. 1231-2)*H. S. Morgan etc.*, 1044 (Q. 5131-3)*Newton*, 67-8*Soc. Investment Analysts*, 419, 382

(Q. 1943-52), 385 (Q. 1961-6)

T.U.C., 991**Foreign investments**Evidence: *Cohen & Loss*, 1499 (Q. 6779-81); *R. F. Henderson & Tew*,212; *Inst. Chartered Accountants*,1363 (Q. 6304-5); *E. V. Morgan*,

247 (Q. 1244)

Investors

Compensation see DEALERS IN SECURITIES; STOCK EXCHANGES

Information

(see also ACTIVITIES REPORT; OBJECTS OF COMPANY; PROSPECTUSES)

Report: 13, 137, 140, 243, 245, 252,

263, 264, 317

Evidence:*Assoc. Certified & Corp. Accountants*, 890*Baxter and Edey*, 188-9, 192, 149

(Q. 735), 159 (Q. 786-7), 165 (Q. 825-6), 168 (Q. 837-45)

Board of Trade, 1569, 1581*Cohen & Loss*, 1467 (Q. 6625-7),

1493 (Q. 6746-51)

Council of Assoc. Stock Exchanges,

514 (Q. 2506-8), 517 (Q. 2534-9)

Economist, 260*Gower*, 1061*R. F. Henderson & Tew*, 209-14, 179

(Q. 923-24), 187 (Q. 978)

Inst. Chartered Accountants, 1361

(Q. 6294)

Inst. Chartered Accountants Scotland, 1283 (Q. 6113-25)*E. V. Morgan*, 273-4, 243 (Q. 1228-9), 244 (Q. 1231-43), 248 (Q. 1247-53)*H. S. Morgan etc.*, 1076, 1088, 1048

(Q. 5172-5)

"REPORT" references are to PARAGRAPH NUMBERS

- Investors—continued**
Information—continued
Securities & Exchange Commission, 1517-8
Soc. Investment Analysts, 418, 373 (Q. 1850-6)
Wincott, 48, 1 (Q. 9-23), 10 (Q. 99-108), 19 (Q. 189, 192)
- Protection**
 (see also DEALERS IN SECURITIES: PROSPECTUSES; STOCK EXCHANGES)
Report: 17, 219, 226-7, 234, 264
Evidence: *Newton*, 69; *Stock Exchange*, 1115 (Q. 5317-71); *Wincott*, 49, 1 (Q. 3-8)
- Responsibilities**
Report: pp. 208-9 (para. 7)
Evidence: *Economist*, 258, 218 (Q. 1016-26), 229 (Q. 1177); *Stock Exchange London*, 1129 (Q. 5414-5); *T.U.C.*, 952 (Q. 4762); *Wincott*, 18 (Q. 187)
- Investors' Chronicle, The** see *Wincott, Harold*
- Issuing houses**
Report: 225
- Issuing Houses Association**
Memorandum: 395-417
Oral evidence: 349-372 (Q. 1664-1849)

J

- Judicial management**
Evidence: *Trade Indemnity Co.*, 278, 254 (Q. 1305-13), 255 (Q. 1325-30), 256 (Q. 1332-33)

K

- Keighley, F.** see *Committee of London Clearing Bankers*
- Kempe, L. W.** see *British Insurance Association*

L

- Lamb, C. G.** see *National Association of Trade Protection Societies*
- Langford, W. B.** see *Board of Trade*
- Larceny Act, 1861**
Report: 466
- Laurie, R. B.** see *Law Society of Scotland*
- Law enforcement and administration**
 (see also INSPECTORS APPOINTED BY BOARD OF TRADE)
Report: 5-19, 122, 130, 147, 187, 231, 234, 252, 259, 264, 440-2, 456, 504-11
Evidence:
A.B.C.C., 485
Assoc. Certified & Corp. Accountants, 902
Baxter and Edey, 167 (Q. 832-6)

- Law enforcement and administration—continued**
Board of Trade, 1602-6, 1541 (Q. 6970-3)
Brit. Insurance Assoc., 633
Committee London Clearing Bankers, 601 (Q. 3110-12)
Economist, 234 (Q. 1162-8)
Faculty Advocates, 1303, 1238 (Q. 5764-5), 1244 (Q. 5801)
F.B.I., 1452, 1398 (Q. 6577-9)
Inst. Chartered Accountants Scotland, 1344
Law Society, 1185, 1213-4
Not. Chamber Trade, 341
Stock Exchange London, 1180-1
- Law of Property Act, 1925**
Evidence: *General Council Bor.* 983
- Law Society**
Memorandum: 1185-1220
Oral evidence: 1133-1158 (Q. 5437-5627)
- Law Society of Scotland**
Memorandum: 1304-1323.
Oral evidence: 1245-1268 (Q. 5802-6000)
- Lawson, H. B.** see *Committee of London Clearing Bankers*
- Leckie, J.** see *Board of Trade*
- Lee, G.** see *Economist, The*
- Lending powers**
Report: 170-86, 187
Evidence: *A.B.C.C.*, 477, 433 (Q. 2065-77), 448 (Q. 2216-8); *Assoc. Certified & Corp. Accountants*, 883; *Faculty Advocates*, 1297; *F.B.I.*, 1444; *Inst. Chartered Accountants*, 1404; *Inst. Chartered Accountants Scotland*, 1329; *Percy*, 117
- Letterheads** see *Business names—Letterheads etc.*; *Directors—Named in Letterheads*
- Lewis (John) Partnership Ltd.**
Memorandum: 205-08
Oral evidence: 170-79 (Q. 846-919)
- Liabilities Deferred** see *Deferred liabilities*
- Light, H. L.** see *Courtaulds Ltd.*
- Limitation by guarantee**
Report: 29, 70, 78
Evidence: *Assoc. Certified & Corp. Accountants*, 882; *Assoc. Investment Trusts*, 728; *Board of Trade*, 1568; *Committee Scottish Bank Gen. Managers*, 496; *General Council Bor.*, 979; *Inst. Chartered Accountants Scotland*, 1328; *Law Society Scotland*, 1307, 1253 (Q. 5872-6), 1267 (Q. 5993-6)
- Limitation of objects** see *Objects of company*
- "Limited", Licensed dispensation with**
Report: 69, 78
Evidence: *Board of Trade*, 1568, 1530 (Q. 6881-94)
- Lister, T.** see *Institute of Chartered Accountants of Scotland*

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Loans

(see also FLOATING CHARGES)

Report: 374, 380, 383, 397

Evidence: *Assoc. Investment Trusts*, 733; *Baxter and Edey*, 196; *Chartered Inst. Secretaries*, 819; *R. F. Henderson & Tev*, 212; *Inst. Chartered Accountants*, 1362 (Q. 6302-3); *Inst. Chartered Accountants Scotland*, 1339

To directors see DIRECTORS—LOANS (PUBLIC COMPANIES); PRIVATE COMPANIES

To officers

Evidence: *Chartered Inst. Secretaries*, 813

Loffhouse, H. E. see Lyons (J.) & Co.

London Clearing Bankers, Committee of see Committee of London Clearing Bankers

London Stock Exchange see Stock Exchange, London

Loss, Louis

Oral evidence: 1455-1501 (Q. 6581-6972)

Losses see Profit and loss account

Low, R. V. see British Overseas Banks Association

Luxton, W. J. see Association of British Chambers of Commerce

Lyons (J.) & Co. Ltd.

Memorandum: 111-114

Oral evidence: 71-86 (Q. 418-539)

M

McDaniel, C. D.

Memorandum: 1093-1097

Oral evidence: 1023-1051 (Q. 4993-5814)

McDongall, E. H. V. see Institute of Chartered Accountants of Scotland

Mackay, J. P. H. see Faculty of Advocates

Mackintosh, D. D. see Law Society

Maclean, Sir Robert see Council of Scottish Chambers of Commerce

Magazines see Press

Management

(see also JUDICIAL MANAGEMENT; MEETINGS; OWNERSHIP AND CONTROL)

Report: 125, 131, 501, 503

Evidence: *General Council Brit. Shipping*, 323 (Q. 1637-38); *Nat. Chamber Trade*, 340-1

Circulars for proxy votes see PROXY VOTES

Definition of "manager"

Evidence: *Courtaulds*, 65

Germany

Evidence: *Economist*, 259-60, 220 (Q. 1029-30), 228 (Q. 1106-10)

Restrictions on commencement of business see COMMENCEMENT OF BUSINESS

Management companies see Management contracts

Management contracts

Report: 96, 99, 122

Evidence: *Inst. of Directors*, 753 (Q. 3717-29), 755 (Q. 3739-46)

Management shares see Shares

Mann, J. A. see General Council of British Shipping

Mantle, P. J. see Board of Trade

Mathys, H. R. see Courtaulds Ltd.

Meetings

(see also DIRECTORS—MEETINGS)

Report: 102-3, 297, 306, 457-9, 465, 468

Evidence:

Accepting Houses & Issuing Houses, 406, 411

A.B.C.C., 484

Assoc. Certified & Corp. Accountants, 896-7

Assoc. Internat. Accountants, 423

Assoc. Investment Trusts, 734

Board of Trade, 1597-8, 1602

Brit. Insurance Assoc., 631

Chartered Inst. Secretaries, 824-5
Committee London Clearing Bankers, 649

Courtaulds, 23 (Q. 228-30)

Economist, 220 (Q. 1026-8)

Gen. Council Brit. Shipping, 322 (Q. 1629-32)

General Council Bar, 966-7, 976, 984, 985, 916 (Q. 4489-93)

Gower, 1053

Guest Keen Nettlefolds, 134, 140, 103 (Q. 688-93)

Inst. Chartered Accountants, 1430-1
Inst. Chartered Accountants Scotland, 1342-3

Law Society, 1210-1, 1134 (Q. 5446-7)

H. S. Morgan etc., 1068-9, 1085

Stock Exchange London, 1179

Notice of meetings

Report: 138, 140

Representation of corporations

Evidence: *General Council Bar*, 966, 916 (Q. 4494-99)

Resolutions

Report: 460, 498, 503

Evidence:

Accepting Houses & Issuing Houses, 406-7, 411

A.B.C.C., 484

Assoc. Certified & Corp. Accountants, 897

Board of Trade, 1598-9

Brit. Insurance Assoc., 631, 632

Chartered Inst. Secretaries, 825

Council Scottish Chambers Commerce, 906

Courtaulds, 64

F.B.I., 1451

General Council Bar, 966-7, 981

Guest Keen Nettlefolds, 134, 140

Inst. Chartered Accountants, 1431

"REPORT" references are to PARAGRAPH NUMBERS

Meetings—continued.

Resolutions—continued.

Inst. Chartered Accountants Scotland, 1343

Inst. Directors, 807

Law Society, 1211, 1136 (Q. 5471-2)

Lyons, 114

Newton, 69

Registrar Companies Court, 303 (Q. 1494)

"Statutory meeting"

Report: 65, 67

Stockholder-proposal rule

Evidence: *Cohen & Loss*, 1482 (Q. 6690-2); *Gower*, 1059; *H. S. Morgan etc.*, 1075

Members, Deceased see Deceased members

Members, Register of see Register of members

Membership see Incorporation; Minimum membership

Memorandum of association

(see also OBJECTS OF COMPANY; ULTRA VIRES)

Report: 35, 72-5, 78

Evidence: *Board of Trade*, 1565; *Brit. Insurance Assoc.*, 615, 633, 558 (Q. 2805-30); *Clore*, 548; *Courtaulds*, 58; *General Council Bar*, 978; *Inst. Chartered Accountants*, 1400

Minimum membership see MINIMUM MEMBERSHIP

Winding-up clauses

Report: 72-5, 78

Menzies, A. E. S. see Institute of Directors

Mergers see United States law—Mergers

Miller, O. B. see Lewis (John) Partnership Ltd.

Miller, W. G. N. see Association of Unit Trust Managers

Mines, K. see Association of International Accountants

Minimum membership

(see also "ONE-MAN" COMPANIES)

Report: 21-4, 31

Evidence:

Accepting Houses & Issuing Houses, 395, 408, 349 (Q. 1665)

A.B.C.C., 475

Assoc. Certified & Corp. Accountants, 880, 835 (Q. 4054-63)

Brit. Insurance Assoc., 631

Chartered Inst. Secretaries, 810, 768 (Q. 3840-6)

Clore, 519 (Q. 2554)

Committee Scottish Bank Gen. Managers, 495, 450 (Q. 2234-40)

Guest Keen Nettelfolds, 127

Inst. Chartered Accountants, 1339-40

Law Society, 1185-6, 1113 (Q. 5438-49)

Law Society Scotland, 1304, 1245 (Q. 5803-4)

Minimum subscription of capital see Incorporation

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Minorities

(see also SHARES—CLASS RIGHTS; TAKE-OVER BIDS—COMPULSORY BUYING-OUT; VOTING RIGHTS; WINDING-UP—"JUST AND EQUITABLE")

Report: 17, 72-5, 153, 178, 187, 193-4, 198, 199-212

Evidence:

Accepting Houses & Issuing Houses, 399-400

A.B.C.C., 478-9, 433 (Q.2070-6), 437 (Q. 2108-17), 446 (Q. 2199-2208)

Assoc. Certified & Corp. Accountants, 885

Assoc. Investment Trusts, 730

Board of Trade, 1571, 1533 (Q. 6915-64)

Brit. Insurance Assoc., 618

Chartered Inst. Secretaries, 811, 816-7, 769 (Q. 3847-51), 778 (Q. 3926-35)

Clore, 550, 523 (Q. 2599-2601)

Council Scottish Chambers Commerce, 904, 868 (Q. 4335)

Economist, 263

Faculty Advocates, 1299

F.B.I., 1446

General Council Bar, 963, 986-8, 910 (Q. 4448-50), 928 (Q. 4596-4602)

Gower, 1053-4

Inst. Chartered Accountants, 1406

Inst. Directors, 798-9, 750 (Q. 3700-13)

Law Society, 1192-3, 1147 (Q. 5549-65), 1155 (Q. 5610-5)

Law Society Scotland, 1308-12, 1320-1, 1256 (Q. 5889-5928)

H. S. Morgan etc., 1069, 1012 (Q. 4909-18)

Nat. Chamber Trade, 338

Piercy, 118, 92 (Q. 594-5)

Registrar Companies Court, 330-1, 285 (Q. 1386-1411), 295 (Q. 1445), 298 (Q. 1460), 303 (Q. 1493)

Stock Exchange London, 1167

Wincott, 52, 13 (Q. 134-45)

Molony (Consumer Protection) Committee

Report: 444

Money and non-money rights see Assets

Morgan, E. V.

Memorandum: 270-74

Oral evidence: 236-49 (Q. 1178-1253)

Morgan, H. S.

Oral evidence: 999-1051 (Q. 4822-5184)

Morgan Stanley & Co.

Memorandum: 1078-1092

Oral evidence (H. S. Morgan etc.): 999-1051 (Q. 4822-5184)

Morley, C. D. see Stock Exchange London

Mortlock, P. J. see National Chamber of Trade

Multiple directorships see Directors—Multiple directorships

Municipal and General Securities Ltd. see Fairbairn, S. I.

Murray, L. see Trades Union Congress

N

Names see **Business names**

National Association of Trade Protection Societies

Oral evidence: 464-474 (Q. 2336-2401)
Report: 60

National Chamber of Trade

Memorandum: 337-341
Oral evidence: 304-314 (Q. 1503-1581)

Neil, M. see **Council of Scottish Chambers of Commerce**

New York Stock Exchange

Report: p. 209 (para. 10)

Newspapers see Press

Newton, Gordon

Memorandum: 66-69
Oral evidence: 36-47 (Q. 299-417)

Nicol, W. A. see **Guest, Keen & Nettlefolds Ltd.**

No par value shares

Report: 17, 32-33, 34
Evidence:

Accepting Houses & Issuing Houses, 396, 416, 350 (Q. 1671-7)

A.B.C.C., 475

Assoc. Certified & Corp. Accountants, 881, 838 (Q. 4074-7)

Assoc. Investment Trusts, 728, 680 (Q. 3391)

Baxter & Edey, 198

Brit. Insurance Assoc., 615

Chartered Inst. Secretaries, 811, 770 (Q. 3851-63), 782 (Q. 3968-70)

Clare, 548

Council Assoc. Stock Exchanges, 545, 505 (Q. 2428-33)

Council Scottish Chambers Commerce, 903

Courtouls, 58, 21 (Q. 203-4)

Economist, 261-2, 230 (Q. 1124-5), 232 (Q. 1145)

F.B.I., 1443, 1380 (Q. 6442-3)

Gower, 1053

Guest Keen Nettlefolds, 128

Inst. Chartered Accountants, 1400

Inst. Chartered Accountants Scotland, 1277 (Q. 6068-9), 1294 (Q. 6208-10)

Inst. Directors, 793

Law Society, 1188, 1138 (Q. 5479-83), 1140 (Q. 5496-7)

Law Society Scotland, 1306, 1249, (Q. 5840-3)

H. S. Morgan etc., 1067, 1084-5, 1007 (Q. 4872-81)

Nat. Chamber Trade, 337, 305 (Q. 1512-3)

Newton, 66

Piercy, 115, 88 (Q. 554)

Registrar Companies Court, 328, 281 (Q. 1357-63), 292 (Q. 1423)

Soc. Investment Analysts, 422

Stock Exchange London, 1164, 1102 (Q. 5209-12)

T.U.C., 937 (Q. 4660-6)

Wincott, 49, 5 (Q. 53-62)

Nominee directors see **Directors—Nominee directors**

Nominee shareholders

(see also **REGISTER OF SHAREHOLDINGS; SECURITIES—INSIDER TRADING; SHAREHOLDINGS OF COMPANY**)

Report: 15, 141-7, 186, 193, 475

Evidence:

Accepting Houses & Issuing Houses, 400, 353 (Q. 1697-1702)

A.B.C.C., 480, 488, 439 (Q. 2130-76), 449 (Q. 2227-31)

Assoc. Certified & Corp. Accountants, 886

Assoc. Investment Trusts, 731, 684 (Q. 3423-52)

Board of Trade, 1573, 1540 (Q. 6965-95)

Brit. Insurance Assoc., 620

Chartered Inst. Secretaries, 817, 819-20, 780 (Q. 3946-57), 782 (Q. 3971-2)

Clare, 550, 524 (Q. 2602-9), 525 (Q. 2623-4), 528 (Q. 2646-9)

Committee London Clearing Bankers, 638-41, 585 (Q. 3037-57)

Committee Scottish Bank General Managers, 497-8, 454 (Q. 2269-85)

Council Scottish Chambers Commerce, 904, 869 (Q. 4338-51)

Courtouls, 25 (Q. 238-9)

Economist, 264, 221 (Q. 1043-60), 229 (Q. 1112-6), 230 (Q. 1131-4)

Faculty Advocates, 1300-1, 1235 (Q. 5742-52)

F.B.I., 1447, 1390 (Q. 6523-35)

General Council Bar, 929 (Q. 4603-8)

Guest Keen Nettlefolds, 131-2

Inst. Chartered Accountants Scotland, 1331-2, 1290 (Q. 6167-75)

Inst. Directors, 799

Law Society, 1194, 1150 (Q. 5574-6)

Law Society Scotland, 1267 (Q. 5991-2)

Lyons, 113, 77 (Q. 480-9)

E. V. Morgan, 270-1, 237 (Q. 1180-96)

Nat. Chamber Trade, 338, 311 (Q. 1560)

Newton, 67, 43 (Q. 370-85)

Piercy, 118, 92 (Q. 596-609), 96 (Q. 631), 97 (Q. 634-6, 640)

Stock Exchange London, 1168

T.U.C., 993-4, 948 (Q. 4732-6)

Wincott, 54, 15 (Q. 151-7)

Non-profit-making bodies

Report: 444, 456

Evidence: *Nat. Assoc. Trade Protection Societies,* 467 (Q. 2357)

Northern Ireland Company Law Amendment (Patton) Committee

Report: 84

Norton, Sir Charles see **Law Society**

"REPORT" references are to **PARAGRAPH NUMBERS**

Objects of company(see also **ACTIVITIES CHANGES**; **INVESTORS**—**INFORMATION**; **ULTRA VIRES**)**Report:** 36-7, 39, 43, 45-89, 54**Evidence:***Accepting Houses & Issuing Houses,*

395-6, 350 (Q. 1669-70)

A.B.C.C., 475, 430 (Q. 2046-57)*Assoc. Investment Trusts,* 727*Board of Trade,* 1565, 1530 (Q. 6881-5)*Brit. Insurance Assoc.,* 615, 588 (Q. 2805-30)*Chartered Inst. Secretaries,* 810-1, 769 (Q. 3847-51)*Committee Scottish Bank General Managers,* 495*Council Assoc. Stock Exchanges,* 545, 504 (Q. 2418-22)*Council Scottish Chambers Commerce,* 903, 875 (Q. 4388-95)*Faculty Advocates,* 1296, 1222 (Q. 5635-51)*F.B.I.,* 1443*General Council Bar,* 978*Guest Keen Nettlefolds,* 127, 99 (Q. 653-67)*Inst. Chartered Accountants Scotland,* 1325-6*Inst. Directors,* 793, 745 (Q. 3644-50), 766 (Q. 3818)*Law Society,* 1187-8, 1135 (Q. 5462-78)*Law Society Scotland,* 1305-6, 1248 (Q. 5831-49)*Lyons,* 111, 71 (Q. 419-34)*Nat. Chamber Trade,* 337, 305 (Q. 1510-11)*Piercy,* 115, 87 (Q. 543-53), 96 (Q. 632-3)*Registrar Companies Court,* 328, 280 (Q. 1347-50), 296 (Q. 1452-54)*Stock Exchange London,* 1164, 1099 (Q. 5196)*Wincott,* 48, 3 (Q. 24-52)**Ockleston, C. T.** see **Council of Associated Stock Exchanges****Offers for sale** see **Prospectuses****"One-man" companies****Report:** 21, 25**Evidence:***Assoc. Certified & Corp. Accountants,* 881, 835 (Q. 4054-62)*Board of Trade,* 1565*Clore,* 548, 519 (Q. 2555-7)*Committee Scottish Bank General Managers,* 495, 450 (Q. 2239)*Economist,* 261, 216 (Q. 994-1008), 227 (Q. 1104)*Faculty Advocates,* 1296*F.B.I.,* 1443*Guest Keen Nettlefolds,* 98 (Q. 642-53)*Inst. of Chartered Accountants,* 1399*Law Society,* 1188**"One-man" companies—continued***Law Society Scotland,* 1306*Newton,* 36 (Q. 299)**Open and mutual funds**(see also **INVESTMENT COMPANIES**; **UNIT TRUSTS**)**Report:** 241, 326-7, 329**Evidence:***Assoc. Unit Trust Managers,* 712

713, 659 (Q. 3197-27)

Board of Trade, 1578, 1585-6, 1557 (Q. 7106-116)*Economist,* 223 (Q. 1069-73)*S. I. Fairbairn,* 735-41, 695 (Q. 3501-3633)*Gower,* 1062*Law Society,* 1201-2*H. S. Morgan etc.,* 1049 (Q. 5177-9)**Options** see **Directors—Dealing in own company's shares**; **Remuneration by options****Osborne, H.** see **Board of Trade****Overheads****Report:** 351-2, 373, 383, 397**Evidence:** *Inst. Chartered Accountants,* 1423, 1362 (Q. 6297); *Inst. Chartered Accountants Scotland,* 1285 (Q. 6133-4), 1290 (Q. 6165-6)**Owen, A.** see **Council of Associated Stock Exchanges****Ownership and control**(see also **DIRECTORS**; **MANAGEMENT**; **SHARES**; **SUBSIDIARY COMPANIES**;**TAK-OVER BIDS**; **ULTRA VIRES**)**Report,** 14, 39, 100-13, 126, 132, 186, pp. 207-9 (para. 3-8)**Evidence:***Board of Trade,* 1568-9*Clore,* 549, 521 (Q. 2574-80)*Economist,* 258, 218 (Q. 1016-26), 229 (Q. 1117)*Guest Keen Nettlefolds,* 130*Law Society,* 1190-1, 1144 (Q. 5530-48)*Law Society Scotland,* 1307-8*Nat. Chamber Trade,* 338*Piercy,* 116-17*Registrar Companies Court,* 329, 282 (Q. 1364-81)*T.U.C.,* 952 (Q. 4762), 953 (Q. 4765-7)**Borrowing power** see **BORROWING POWERS****Changes in activities** see **ACTIVITIES CHANGES****Disposal of undertaking** see **ASSETS DISPOSAL****Interlocking shareholdings** see **INTER-LOCKING SHAREHOLDINGS****Issues of shares** see **SHARES—ISSUES****Lending power** see **LENDING POWERS****Nominee directors** see **DIRECTORS—NOMINEES****Nominee shareholders** see **NOMINEE SHAREHOLDERS****Shareholders' standing committee** see **SHAREHOLDERS—STANDING COMMITTEE****"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION**

P

Partnerships

Report: 71, 76-77, 78

Evidence:

A.B.C.C., 476, 429 (Q. 2038-43)
Assoc. Certified & Corp. Accountants, 881, 838 (Q. 4078-80)
Board of Trade, 1566, 1528 (Q. 6868-80)

Clore, 548

Council Scottish Chambers Commerce, 903, 859 (Q. 4262-9)

Economist, 261, 218 (Q. 1009-15), 228 (Q. 1105)

Inst. Chartered Accountants, 1400-1

Inst. Chartered Accountants Scotland, 1326-7

Law Society, 1188-9, 1140 (Q. 5498-516)

H. S. Morgan etc., 1024 (Q. 4996-5002)

Nat. Chamber Trade, 337

Piercy, 115

Trade Indemnity Co., 251 (Q. 1273)

"Incorporated partnership"

Report: 72

Evidence: Law Society Scotland, 1311-2, 1257 (Q. 5904-28)

Payments authorised by the Act see Charges authorised by the Act

Peet, W. Norman see National Association of Trade Protection Societies

Pegler, J. B. H. see British Insurance Association

Penalties see Law enforcement & administration

Pension funds

(see also DIRECTORS—PENSIONS)

Evidence:

Accepting Houses & Issuing Houses, 407, 365 (Q. 1797-1800)

Assoc. Investment Trusts, 691 (Q. 3474)

Committee London Clearing Bankers, 597 (Q. 3092-5)

Council Assoc. Stock Exchanges, 546, 514 (Q. 2513-7)

F.B.I., 1452

Inst. Chartered Accountants, 1361 (Q. 6295-6)

Inst. Chartered Accountants Scotland, 1283 (Q. 6110-2)

J. Lewis Partnership, 207, 174 (Q. 890-2), 175 (Q. 896-901), 177 (Q. 908-9, Q. 911-4)

Newton, 69, 46 (Q. 408-14)

Stock Exchange London, 1179

Periodical publications see Press

Permitted dealings rule see Stock exchanges

Petito, F. A.

Oral evidence (H. S. Morgan etc.): 999-1051 (Q. 4822-5184)

Phillips, J. F. see Chartered Institute of Secretaries

Phillips, P. see Association of Certified and Corporate Accountants

Phillips, S. E. see Trade Indemnity Co. Ltd.

Piercy, William (Baron Piercy)

Memorandum: 115-126

Oral evidence: 86-98 (Q. 540-640)

Political donations see Donations

Powell, Sir Richard see Board of Trade

Powers of company see Objects of company

Pre-acquisition profits see Subsidiary companies

Pre-emptive rights see Shares

Prefabricated companies

Evidence: Board of Trade, 1566, 1526 (Q. 6841-3, Q. 6846-9); *Law Society*, 1134 (Q. 5455-6); *Law Society Scotland*, 1304-5, 1245 (Q. 5805-15)

Preference shares

Conversion

Report: 197, 198

Evidence: Board of Trade, 1587; *Chartered Inst. Secretaries*, 822

Extinguishment

(see also CAPITAL REDUCTION)

Report: 163, 167, 187, 195-6, 198, 371, 380

Evidence:

Accepting Houses & Issuing Houses, 413-4, 365 (Q. 1749-96)

A.B.C.C., 479

Assoc. Certified & Corp. Accountants, 885, 850 (Q. 4191-6)

Brit. Insurance Assoc., 619

Chartered Inst. Secretaries, 770 (Q. 3851-63)

F.B.I., 1446, 1453

General Council Bar, 980

Inst. Chartered Accountants, 1424

Law Society, 1138 (Q. 5484-95)

Nat. Chamber Trade, 338

Registrar Companies Court, 294 (Q. 1440-4)

Stock Exchange London, 1167-8, 1113 (Q. 5297-5313)

Wincott, 53, 14 (Q. 146-50)

Pre-incorporation contracts

Report: 44, 54

Evidence: Gower, 1052; *H. S. Morgan etc.*, 1065

Press

Advertisements as circulars

Report: 255, 264

Protection under law of libel

Evidence: Law Society, 1215

Prevention of fraud see Dealers in securities

Private companies

(see also AUDIT—PRIVATE COMPANIES' EXEMPTION; CREDIT ENQUIRIES; PARTNERSHIPS)

Report: 15, 20, 22-3, 55-63, 64-67, 72-5, 211

"REPORT" references are to PARAGRAPH NUMBERS

Private companies—continued**Evidence:**

Accepting Houses & Issuing Houses, 396, 412-3, 350 (Q. 1678-84)

A.B.C.C., 476

Assoc. Certified & Corp. Accountants, 880-2, 835 (Q. 4054-63), 838 (Q. 4081-113)

Assoc. Investment Trusts, 728, 680 (Q. 3392-3)

Baxter & Edey, 161 (Q. 799-801), 162 (Q. 806), 166 (Q. 827)

Board of Trade, 1567, 1571, 1524 (Q. 6825), 1527 (Q. 6854-67)

Chartered Inst. Secretaries, 811-2, 822, 769 (Q. 3842-6), 771 (Q. 3864-85)

Clore, 519 (Q. 2359-69)

Committee London Clearing Bankers, 582 (Q. 3020-2)

Committee Scottish Bank General Managers, 496, 452 (Q. 2255-63)

Council Scottish Chambers Commerce, 903, 860 (Q. 4270-97)

Economist, 261, 216 (Q. 984-92), 225 (Q. 1090), 230 (Q. 1122-3), 234 (Q. 1169-72)

Faculty Advocates, 1238 (Q. 5762-3)

F.B.I., 1444, 1453, 1381 (Q. 6444-58)

General Council Bar, 965-6, 979, 915 (Q. 4487-8)

Gust Keen Nettlefolds, 128, 102 (Q. 671-6)

Inst. Chartered Accountants, 1401-2

Inst. Chartered Accountants Scotland, 1327, 1294 (Q. 6203-7)

Inst. Directors, 765 (Q. 3807-8)

Law Society, 1189-90, 1215-6, 1219-20, 1142 (Q. 5517-29)

Law Society Scotland, 1306-7, 1247 (Q. 5821-2), 1250 (Q. 5844-70)

E. V. Morgan, 244 (Q. 1230)

Nat. Assoc. Trade Protection Societies, 468 (Q. 2366-82), 472 (Q. 2390), 473 (Q. 2400-1)

Nat. Chamber Trade, 337, 305 (Q. 1510-3, 1516-32), 312 (Q. 1561-3, 1567-73)

Newton, 66, 36 (Q. 300-5)

Piercy, 115-6, 88 (Q. 556-65)

Registrar Companies Court, 329

Soc. Investment Analysts, 384 (Q. 1953-6)

Trade Indemnity Co., 275-7, 250 (Q. 1263-92), 255 (Q. 1314-24), 256 (Q. 1331, 1335)

T.U.C., 989-90, 938 (Q. 4667-76)

Wincott, 7 (Q. 63-69)

Profit and loss account

Report: 381-92, 397, 519, pp. 214-5 (para. 14-15)

Evidence:

Courtaulds, 61, 30 (Q. 269-73)

Economist, 226 (Q. 1095-6)

Inst. Chartered Accountants, 1419-20, 1368 (Q. 6341-51)

Inst. Chartered Accountants Scotland, 1339, 1286 (Q. 6137)

H. S. Morgan etc., 1074

Profit and loss account—continued

Securities & Exchange Commission, 1511

Soc. Investment Analysts, 418, 385 (Q. 1967-8)

Trade Indemnity Co., 256 (Q. 1331)

T.U.C., 991

Profit-sharing see Co-partnership schemes**Profits**

Capitalisation see SHARES—ISSUES TO EXISTING SHAREHOLDERS

Definition

Report: 335, 337, 340, 350, 392

Evidence:

Assoc. Certified & Corp. Accountants, 892

Assoc. Investment Trusts, 694 (Q. 3493)

Baxter & Edey, 190-1, 193-5, 196, 148 (Q. 732-41), 154 (Q. 763-4)

Brit. Insurance Assoc., 627

F.B.I., 1450

Inst. Chartered Accountants, 1419-20, 1349 (Q. 6215), 1367 (Q. 6337-8)

Inst. Chartered Accountants Scotland, 1338

Law Society, 1203

Nat. Chamber Trade, 340

Trade Indemnity Co., 277

Wincott, 56

Subsidiary companies see SUBSIDIARY COMPANIES—PRE-ACQUISITION PROFITS

Properties shown in accounts

Report: 362, 369

Prospectuses

(see also CIRCULARS)

Report: 220-2, 235-45, 252, 324, 329, 512, 520-2, 525

Evidence:

Accepting Houses & Issuing Houses, 402-4, 355 (Q. 1716-40)

A.B.C.C., 482

Assoc. Certified & Corp. Accountants, 890, 854 (Q. 4223-4)

Assoc. Investment Trusts, 689 (Q. 3456-61)

Baxter & Edey, 192

Board of Trade, 1577-9, 1549 (Q. 7039-40), 1553 (Q. 7068)

Brit. Insurance Assoc., 621, 624, 568 (Q. 2899-2905)

Chartered Inst. Secretaries, 820

Clore, 552

Cohen & Loss, 1455 (Q. 6588-6679)

Committee London Clearing Bankers, 642, 592 (Q. 3066-70), 602 (Q. 3113-4)

Gen. Council Brit. Shipping, 321 (Q. 1622-6), 323 (Q. 1639-40)

Gower, 1056

R. F. Henderson & Tew, 213

Inst. Chartered Accountants, 1412

Inst. Chartered Accountants Scotland, 1335

Law Society, 1199-1200

J. Lewis Partnership, 207

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Prospectuses—continued

- H. S. Morgan etc.*, 1071-3, 1083, 1085-6, 1090-2, 1028 (Q. 5009-74), 1039 (Q. 5090-2)
Nat. Chamber Trade, 339
Newton, 68
Piercy, 94 (Q. 617-24), 96 (Q. 630)
Securities & Exchange Commission, 1509-10
Stock Exchange London, 1172-4, 1176, 1116 (Q. 5322-41), 1123 (Q. 5362-5), 1124 (Q. 5372-88)
Wincott, 20 (Q. 196-201)

Advertising

- Report*: 246, 252, 324
Evidence: *Cohen & Loss*, 1494 (Q. 6752-4); *Stock Exchange London*, 1176-7

Board of Trade scrutiny

- Report*: 251, 252
Evidence: *Board of Trade*, 1554 (Q. 7075-7)

Certificates of exemption

- Report*: 242, 249, 252
Evidence: *Accepting Houses & Issuing Houses*, 404, 357 (Q. 1730); *Assoc. Certified & Corp. Accountants*, 890; *Gen. Council Brit. Shipping*, 324 (Q. 1640); *Inst. Chartered Accountants*, 1413; *Law Society*, 1200; *Stock Exchange London*, 1175-6, 1181-3, 1130 (Q. 5422-31)

Registration

- Report*: 251, 252
Evidence: *Board of Trade*, 1578-9, 1553 (Q. 7068); *Chartered Inst. Secretaries*, 820

Statements in lieu

- Report*: 247, 252
Evidence: *Accepting Houses & Issuing Houses*, 403, 356 (Q. 1724-40)

Unquoted securities

- Report*: 249, 251, 252
Evidence: *Board of Trade*, 1554 (Q. 7075-7); *Piercy*, 620-4; *Stock Exchange London*, 1175, 1120 (Q. 5343-61)

Provisions see Overheads**Proxy votes**

- Report*: 462-4, 468
Evidence:
Accepting Houses & Issuing Houses, 407
Assoc. Certified & Corp. Accountants, 897
Board of Trade, 1598
Brit. Insurance Assoc., 632
Cohen & Loss, 1480 (Q. 6680-89)
Council Scottish Chambers Commerce, 906, 873 (Q. 4377-81)
Courtaulds, 24 (Q. 233-5)
Faculty Advocates, 1303
General Council Bar, 976-7, 984, 988
wer, 1058-9
t. Chartered Accountants, 1431
t. Chartered Accountants Scotland, 1343

"REPORT" references are to PARAGRAPH NUMBERS

Proxy votes—continued

- Law Society*, 1211
Lyons, 114
H. S. Morgan etc., 1075, 1084, 1038 (Q. 5089), 1039 (Q. 5093-8), 1043 (Q. 5123-4)
Newton, 69, 46 (Q. 405-7), 47 (Q. 416)
Securities & Exchange Commission, 1513-4
Stock Exchange London, 1179

Pullen, W. G. see British Overseas Banks Association**Parse, A. T. see Institute of Directors****Q****Quirk, R. C. see Stock Exchange, London****R****Read, Alfred see Institute of Directors****Ready-made companies see Prefabricated companies****Receivers for debenture holders see Debentures—Receivers****Reconstruction schemes**

(see also CAPITAL REDUCTION; JUDICIAL MANAGEMENT; SHARES—CLASS RIGHTS; TAKE-OVER BIDS)

- Report*: 190, 268, 339, 491, 495
Evidence: *A.B.C.C.*, 486; *Board of Trade*, 1571; *Cohen & Loss*, 1495 (Q. 6761); *Gower*, 1062; *H. S. Morgan etc.*, 1077, 1086-7; *Registrar Companies Court*, 288 (Q. 1408-10); *Securities & Exchange Commission*, 1516

Records

Charges for extracts see CHARGES AUTHORISED BY THE ACT

Redington, F. M. see Institute of Actuaries**Register of charges see Debentures—Register of charges****Register of directors see Directors—Register of directors****Register of members**

(see also DIRECTORS—REGISTRATION OF MEMBERS; SHARES—TRANSFER AND REGISTRATION)

- Report*: 141, 477-81, 483
Evidence: *Chartered Inst. Secretaries*, 823-4; *Inst. Chartered Accountants*, 1408; *Law Society*, 1214

Dominions registers

- Evidence*: *Chartered Inst. Secretaries*, 824; *F.B.I.*, 1452; *General Council Bar*, 964-5, 914 (Q. 4476-84); *Law Society*, 1215, 1216-7

Register of shareholdings (proposed)

- Report*: 143-6, 147, 153

Registers

Charges for extracts see CHARGES AUTHORISED BY THE ACT

Registers—continued**Location**

Report: 469-70

Evidence: *Chartered Inst. Secretaries*, 823; *Stock Exchange London*, 1180**Registrar of the Companies Court**

Memorandum: 328-336

Oral evidence: 279-304 (Q. 1338-1502)

Registration fees**Business names**

Report: 440, 456

Evidence: *Nat. Assoc. Trade Protection Societies*, 468 (Q. 2363-4)**Incorporation**

Report: 440, 456, 508, 511

Evidence: *Board of Trade*, 1523 (Q. 6813), 1525 (Q. 6829-36), 1526 (Q. 6849-51); *Law Society*, 1134 (Q. 5453-4); *Law Society Scotland*, 1247 (Q. 5823-4); *Nat. Chamber Trade*, 314 (Q. 1577-8)**Registration of companies**

Report: 20, 28, 31, 39, 122, 251, 252, 270, 275, 293, 301-2, 380, 448-55, 456, 494, 495, 503, 508-9, 511, 525

Evidence: *Board of Trade*, 1565, 1601-2, 1521 (Q. 6793-6813), 1525 (Q. 6834-40), 1526 (Q. 6850-1); *Chartered Inst. Secretaries*, 826-7; *General Council Bar*, 978; *Law Society*, 1214, 1134, (Q. 5450-61); *Nat. Assoc. Trade Protection Societies*, 472 (Q. 2391-3)**Re-registration**

Report: 68, 78

Evidence: *General Council Bar*, 978**Registration of shares see Shares—Transfer and registration****Reid, Sir Edward J. see Accepting Houses Committee****Remuneration see Directors—Remuneration****Remuneration by options**

Report: 90, 99

Evidence: *Cohen & Loss*, 1498 (Q. 6771-3)**Rents (Income)**

Report: 351-2, 381, 397

Rents (Payments) see Overheads**Representation of companies in court**Evidence: *Chartered Inst. Secretaries*, 826**Representatives of deceased members see Deceased members****Reserves**

Report: 372-3, 380, 398, pp. 212-13 (para. 9-14)

Evidence:*Assoc. Certified & Corp. Accountants*, 892*Baxter & Edey*, 190, 196-8*Brit. Insurance Assoc.*, 627*Council Scottish Chambers Commerce*, 905*Courtaulds*, 62**Reserves—continued**

F.B.I., 1450

R. F. Henderson & Tew, 210

Inst. Chartered Accountants, 1419, 1422-3, 1365 (Q. 6324-7)*Inst. Chartered Accountants Scotland*, 1338, 1281 (Q. 6101-4)*Law Society*, 1203*Nat. Chamber Trade*, 340

Newton, 68

Wincott, 56

Resolutions see Meetings—Resolutions**Restrictions on commencement of business see Commencement of business****Return of capital see Preference shares—Extinguishment****Returns**

Report: 456, 484-95

Evidence:*Accepting Houses & Issuing Houses*, 406, 410

A.B.C.C., 483

Assoc. Certified & Corp. Accountants, 895*Assoc. International Accountants*, 423*Assoc. Investment Trusts*, 733-4*Board of Trade*, 1591-2, 1602, 1558 (Q. 7117-27)*Brit. Insurance Assoc.*, 630*Chartered Inst. Secretaries*, 822*Committee London Clearing Bankers*, 648*Committee Scottish Bank General Managers*, 500-1*Council Scottish Chambers Commerce*, 905, 906*Courtaulds*, 59, 63

F.B.I., 1452, 1381 (Q. 6450-2)

General Council Bar, 979-80*Guest Keen Nettelfolds*, 135, 138-9*Inst. Chartered Accountants*, 1428-9*Inst. Chartered Accountants Scotland*, 1342*Inst. Directors*, 806*Law Society*, 1205*J. Lewis Partnership*, 207

Lyons, 113

Nat. Chamber Trade, 340, 314 (Q. 1578)*Registrar Companies Court*, 292 (Q. 1425-6)*Trade Indemnity Co.*, 277-8**Ritchie, Lord see Stock Exchange, London****Robson, Sir Thomas see Institute of Chartered Accountants in England and Wales****"Rogues gallery"**Evidence: *Cohen & Loss*, 1460 (Q. 6593-5)**Russell, P. P. see National Chamber of Trade**

S

Sainer, L. see Clore, Charles**Saunders, Hugh see Federation of British Industries****"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION**

Schemes of arrangement *see* Reconstruction schemes

Schwarz, F. A. O.

Oral evidence: 999-1051 (Q. 4822-5814)

Secretaries

Report: 508, 511

"Section 19" companies *see* "Limited",
Licensed dispensation with

Securities

(*see also* SHARES)

Evidence: Gower, 1052, 1055-63;
H. S. Morgan *etc.*, 1064-5, 1070-7;
Securities & Exchange Commission,
1506, 1512-3

Advertising *see* PROSPECTUSES

Anti-fraud provisions

Evidence: Cohen & Loss, 1467 (Q.
6625-6), 1485 (Q. 6712-20); Gower,
1058, 1060-1; H. S. Morgan *etc.*,
1074-5, 1076, 1083-4, 1092; *Securi-*
ties & Exchange Commission, 1512,
1514-5

Dealers *see* DEALERS IN SECURITIES

"Dealt in" on stock exchange *see* STOCK
EXCHANGES—PERMITTED DEALINGS
RULE

Door-to-door selling

Report: 324

Evidence: Cohen & Loss, 1492 (Q.
6735-45)

Insider-trading

(*see also* DIRECTORS—DEALING IN OWN
COMPANIES' SHARES; NOMINEE SHARE-
HOLDERS)

Evidence: Cohen & Loss, 1483 (Q.
6693-6720); Gower, 1059-60; H. S.
Morgan *etc.*, 1075-6, 1090-2, 1040
(Q. 5099-5103)

Unquoted *see* PROSPECTUSES

Securities and Exchange Commission

Report: 227-8

Memorandum on S.E.C.:

Evidence on S.E.C.:

A.B.C.C., 489

Assoc. Investment Trusts, 692 (Q.
3480-1)

Board of Trade, 1553 (Q. 7069-72)

Clore, 525 (Q. 2619-22)

Cohen & Loss, 1455 (Q. 6581-6792)

Council Assoc. Stock Exchanges,

512 (Q. 2495-6), 513 (Q. 2501-3)

Council Scottish Chambers Com-

merce, 879 (Q. 4418-9)

Economist, 260, 233 (Q. 1157-61)

Gower, 1055, 1056-7

H. S. Morgan *etc.*, 1070-1, 1078-83,

1088-90, 1093-7, 1024 (Q. 5003-

74), 1046 (Q. 5154-5), 1050 (Q.

5183-4)

Newton, 69

Stock Exchange London, 1118 (Q.

5338-41)

Wincott, 53, 13 (Q. 134-45), 20 (Q.

197-200)

"Rogues' gallery"

Evidence: Cohen & Loss, 1460 (Q.

6593-5)

Share premium account

Report: 161-6, 187, 346

Evidence:

Accepting Houses & Issuing Houses,
405, 359 (Q. 1749-60)

Assoc. Certified & Corp. Accountants,
892, 856 (Q. 4238-9), 857 (Q. 4244-

8)

Baxter & Edey, 190, 198-9

Brit. Insurance Assoc., 626

Chartered Inst. Secretaries, 821, 781

(Q. 3960-5)

Courtaulds, 62

General Council Bar, 930 (Q. 4609-

40)

Gust Keen Nettlefolds, 137

Inst. Chartered Accountants, 1418-9,

1436-8, 1371 (Q. 6371-6415)

Inst. Chartered Accountants Scotland,

1336, 1277 (Q. 6067-91)

Inst. Directors, 804-5, 760 (Q. 3769).

763 (Q. 3791-8)

Law Society, 1202-3

Nat. Chamber Trade, 340

Wincott, 56

Share register *see* Register of members

Shareholders

Deceased *see* DECEASED MEMBERS

Information on take-over bids *see*

TAKE-OVER BIDS—INFORMATION FOR

SHAREHOLDERS

Minimum number *see* INCORPORATION

Nominees *see* NOMINEE SHAREHOLDERS

Register *see* REGISTER OF MEMBERS

Standing committee

Evidence: Assoc. International Ac-

countants, 423-4

Stockholder-proposal rule *see* MEETINGS

—STOCKHOLDER-PROPOSAL RULE

Shareholdings of company, Disclosure of

(*see also* NOMINEE SHAREHOLDERS)

Report: 375-8, 380

Evidence:

Accepting Houses & Issuing Houses,

401, 354 (Q. 1710-4)

Assoc. Certified & Corp. Accountants,

887, 890, 851 (Q. 4197-4210)

Assoc. Investment Trusts, 733, 690

(Q. 3463-8), 694 (Q. 3492)

Baxter and Edey, 204

Board of Trade, 1588

Brit. Insurance Assoc., 620, 626, 567

(Q. 2891-5)

Clore, 524 (Q. 2610-3)

Council Scottish Chambers Commerce,

905, 870 (Q. 4532-60)

Courtaulds, 27 (Q. 253-66)

Economist, 231 (Q. 1140-1)

F.B.J., 1379 (Q. 6427-41)

R. F. Henderson and Tew, 212, 182

(Q. 935)

Inst. Chartered Accountants, 1363 (Q.

6310-8)

Inst. Chartered Accountants Scotland,

1333, 1283 (Q. 6117-25)

Law Society, 1151 (Q. 5580-91)

J. Lewis Partnership, 172 (Q. 867-9),

177 (Q. 909-10)

"REPORT" references are to PARAGRAPH NUMBERS

Shareholdings of company, Disclosure of—
continued

H. S. Morgan etc., 1038 (Q. 5078-88)
Newton, 67-8
Piercy, 119, 94 (Q. 610), 96 (Q. 625-7)
Soc. Investment Analysts, 375 (Q. 1883-91)
Stock Exchange London, 1168-9
T.U.C., 991, 946 (Q. 4721-5)

Shareholdings, Register of see **Register of shareholdings**

Shares

Allotment

Report: 238-40, 252, 489-91, 495

Evidence:

Accepting Houses & Issuing Houses, 409, 371 (Q. 1842-9)
Board of Trade, 1579
Chartered Inst. Secretaries, 812
Cohn & Loss, 1473 (Q. 6649-52), 1477 (Q. 6666-79)
Courtalds, 59
General Council Bar, 979-80
Gower, 1057
Law Society, 1200, 1205-6, 1213-4
H. S. Morgan etc., 1073, 1083, 1035 (Q. 5048-58)
Securities & Exchange Commis., 1509

Certificates

Evidence: General Council Bar, 983

Class rights

(see also **PREFERENCE SHARES**)

Report: 188-98

Evidence:

Accepting Houses & Issuing Houses, 396, 400, 350 (Q. 1669-70)
A.B.C.C., 479, 438 (Q. 2118-24)
Assoc. Certified & Corp. Accountants, 885, 850 (Q. 4186-96)
Assoc. Investment Trusts, 730, 691 (Q. 3471-3)
Brit. Insurance Assoc., 618-9, 559 (Q. 2819-29)
Clore, 550
Council Scottish Chambers Commerce, 904, 868 (Q. 4315-51)
Faculty Advocates, 1299-1300, 1233 (Q. 5734-7)
F.B.J., 1446, 1389 (Q. 6512-4)
General Council Bar, 976, 980
Inst. Chartered Accountants, 1406-7
Inst. Chartered Accountants Scotland, 1331
Inst. Directors, 793, 745 (Q. 3653-8)
Law Society, 1193, 1149 (Q. 5566-73)
Law Society Scotland, 1313-4, 1261 (Q. 5929-36)
Piercy, 118
Wincott, 53, 14 (Q. 146-50)

Conversion into stock

Evidence: Chartered Inst. Secretaries, 812; *General Council Bar*, 983

Directors' dealings see **DIRECTORS—DEALING IN OWN COMPANY'S SHARES**

Shares—continued

Directors' share qualifications see

DIRECTORS—SHARE QUALIFICATIONS

Held in trust for company

Report: 154, 156

Instalment purchase

Evidence: Board of Trade, 1582

Interlocking shareholdings see **INTER-LOCKING SHAREHOLDINGS**

Issues

Report: 113, 119-21, 122, 163, 187, 205, 474, 483

Evidence:

Accepting Houses & Issuing Houses, 397, 352 (Q. 1688-96), 366 (Q. 1801-12)

A.B.C.C., 432 (Q. 2058-64), 447 (Q. 2209-15), 448 (Q. 2223-6)

Assoc. Certified & Corp. Accountants, 883, 844 (Q. 4135-46)

Assoc. Investment Trusts, 729, 681 (Q. 3394-3402)

Brit. Insurance Assoc., 616, 563 (Q. 2850-64), 579 (Q. 2985)

Chartered Inst. Secretaries, 812, 782 (Q. 3968-70)

Clore, 526 (Q. 2628-36), 528 (Q. 2650-5)

Council Assoc. Stock Exchanges, 546, 506 (Q. 2434-51), 514 (Q. 2509-12), 515 (Q. 2518-21)

Council Scottish Chambers Commerce, 904, 865 (Q. 4304-23)

Courtalds, 33 (Q. 288-98)

Economist, 262, 221 (Q. 1033-7), 229 (Q. 1111)

Faculty Advocates, 1297, 1225 (Q. 5663-91)

Foy, 786 (Q. 4003)

F.B.J., 1444, 1383 (Q. 6463-82)

Guest Keen Nettlefolds, 103 (Q. 682-7)

Inst. Chartered Accountants, 1404

Inst. Chartered Accountants Scotland, 1329

Inst. Directors, 794-5, 747 (Q. 3673-90), 766 (Q. 3826-8)

Law Society, 1146 (Q. 5543-8)

Law Society Scotland, 1308, 1264 (Q. 5956-68)

H. S. Morgan etc., 1014 (Q. 4952-5)

Newton, 66, 37 (Q. 309-27)

Piercy, 117, 90 (Q. 576-88)

Registrar Companies Court, 283 (Q. 1375-9), 294 (Q. 1438-9), 297 (Q. 1458-9)

Stock Exchange London, 1165, 1103 (Q. 5213-42)

Wincott, 51, 9 (Q. 87-98)

Issues to existing shareholders

Report: 338-9, 490, 495

Evidence: Clore, 552, 528 (Q. 2650);

General Council Bar, 977-8;

Gower, 1054; *Inst. Chartered*

Accountants Scotland, 1335; *H. S.*

Morgan etc., 1069, 1085, 1013 (Q.

4919-31), 1015 (Q. 4936-41);

“EVIDENCE” references are to PAGE NUMBERS and Q = QUESTION

Shares—continued

Issues to existing shareholders—continued
Newton, 37 (Q. 311-27); *Stock Exchange London*, 1174-5

Management shares

Evidence: F.B.I., 1388 (Q. 6504-8)
 No par value see NO PAR VALUE SHARES
 Offers for sale see PROSPECTUSES
 Preference see PREFERENCE SHARES

Purchase by company

Report: 150, 167-86, 187
Evidence:
Accepting Houses & Issuing Houses, 404, 413, 358 (Q. 1743-8), 368 (Q. 1813-9)
A.B.C.C., 482
Assoc. Certified & Corp. Accountants, 891
Assoc. Investment Trusts, 732
Board of Trade, 1587
Brit. Insurance Assoc., 625
Chartered Inst. Secretaries, 820, 781 (Q. 3958-9)
Clare, 552, 532 (Q. 2694-2700)
Cohen & Loss, 1500 (Q. 6782-92)
Committee London Clearing Bankers, 642, 590 (Q. 3059-65)
Committee Scottish Bank General Managers, 502
Council Scottish Chambers Commerce, 905
Faculty Advocates, 1302, 1241 (Q. 5780-4), 1243 (Q. 5797-5800)
F.B.I., 1397 (Q. 6572-5)
General Council Bar, 980, 925, (Q. 4562-85)
Gower, 1053
Inst. Chartered Accountants, 1417-8
Inst. Chartered Accountants Scotland, 1335
Law Society, 1202, 1156 (Q. 5619-27)
Law Society Scotland, 1315
J. Lewis Partnership, 207, 171 (Q. 870-8)
H. S. Morgan etc., 1065-6, 1084, 1001 (Q. 4835-71)
Nat. Chamber Trade, 340
Registrar Companies Court, 333, 304 (Q. 1499-1501)

Stock exchange quotation rules see STOCK EXCHANGES

Transfer and registration

(see also REGISTER OF MEMBERS)
Report: 206, 209, 211, 212, 471-83, 485, 495
Evidence:
Accepting Houses & Issuing Houses, 401, 410
A.B.C.C., 480, 489
Assoc. Certified & Corp. Accountants, 886
Assoc. Investment Trusts, 731
Board of Trade, 1573-4
Brit. Insurance Assoc., 620
Chartered Inst. Secretaries, 818, 782 (Q. 3971-2)
Clare, 550

Shares—continued

Transfer and registration—continued

Committee Scottish Bank General Managers, 498, 456 (Q. 2286-91)
Council Scottish Chambers Commerce, 904
Courtauld, 59
General Council Bar, 963-4, 976, 915 (Q. 4484-6)
Guest Keen Nettlefolds, 140
Inst. Chartered Accountants, 1407-8
Inst. Chartered Accountants Scotland, 1333
J. Lewis Partnerships, 206
Law Society, 1195-6
Nat. Chamber Trade, 339
Stock Exchange London, 1168

Unnumbered shares
Report: 473, 483
Evidence: Inst. Chartered Accountants, 1408; *Law Society*, 121; *Stock Exchange London*, 1180

Voting rights
 (see also INTERLOCKING SHAREHOLDINGS; VOTING TRUST CERTIFICATES)
Report: 17, 123-40, 151-6, 186, pp. 207-10 (para. 1-12)
Evidence:
Accepting Houses & Issuing Houses, 398-9, 369 (Q. 1822-30)
A.B.C.C., 478, 434 (Q. 2084-7), 448 (Q. 2218-9), 449 (Q. 2232)
Assoc. Certified & Corp. Accountants, 885, 847 (Q. 4158-85)
Assoc. Investment Trusts, 730, 683 (Q. 3411-6), 695 (Q. 3494-6)
Baxter & Edey, 163 (Q. 815)
Board of Trade, 1570
Brit. Insurance Assoc., 617, 564 (Q. 2865-90)
Chartered Inst. Secretaries, 815-6, 776 (Q. 3915-25)
Clare, 549, 529 (Q. 2657-61)
Committee London Clearing Bankers, 585 (Q. 3035-6)
Committee Scottish Bank General Managers, 497
Council Assoc. Stock Exchanges, 546
Council Scottish Chambers Commerce, 904, 868 (Q. 4333-4), 874 (Q. 4382-7), 876 (Q. 4396-4417)
Courtauld, 59
Economist, 263-4, 221 (Q. 1041-2), 229 (Q. 1118-21)
Faculty Advocates, 1298-9, 1232 (Q. 5726-33)
F.B.I., 1445, 1387 (Q. 6500-11)
General Council Bar, 975-6, 986, 928 (Q. 4591-5)
Gower, 1053
Guest Keen Nettlefolds, 130, 104 (Q. 697-701)
Inst. Chartered Accountants, 1406, 1363 (Q. 6309)
Inst. Chartered Accountants Scotland, 1330-1, 1291 (Q. 6176-92)

"REPORT" references are to PARAGRAPH NUMBERS

Shares—continued

Voting rights—continued

- Inst. Directors*, 796-8, 750 (Q. 3697-9), 764 (Q. 3802-6)
Law Society, 1192
J. Lewis Partnership, 206
Lyons, 111, 73 (Q. 445-79), 80 (Q. 501-12), 83 (Q. 520-8)
H. S. Morgan etc., 1067, 1085, 1008 (Q. 4882-9), 1010 (Q. 4896-4900)
Nat. Chamber Trade, 338, 308 (Q. 1533-9)
Newton, 67, 37 (Q. 309-27), 41 (Q. 353-8), 46 (Q. 408-15)
Piercy, 118, 90 (Q. 578), 92 (Q. 592-3), 97 (Q. 637-9)
Registrar Companies Court, 330, 284 (Q. 1382-5)
Soc. Investment Analysts, 421-2, 381 (Q. 1929-38), 384 (Q. 1958-60)
Stock Exchange London, 1167, 1109 (Q. 5267-96)
T.U.C., 994, 953 (Q. 4765-6)
Wincott, 52, 11 (Q. 109-133), 20 (Q. 196)

Shearer, I. H. see Faculty of Advocates
Shenfield, A. A. see Federation of British Industries

Shipping companies

(see also ACCOUNTS—EXEMPTIONS FROM LEGAL PROVISIONS)

- Report*: 413-6
Evidence: *Economist* 224 (Q. 1075-8); *Gen. Council Brit. Shipping*, 342-8, 315 (Q. 1582-1663); *Inst. Directors*, 755 (Q. 3740-6); *Soc. Investment Analysts*, 421, 380 (Q. 1927-8); *Wincott*, 17 (Q. 177)

Smith, P. G. see Association of Stock and Share Dealers

Society of Investment Analysts

- Memorandum*: 418-422
Oral evidence: 373-386 (Q. 1850-1969)

Solvency, Statutory declaration of

- Report*: 178-9, 187, 503
Evidence: *Board of Trade*, 1599; *General Council Bar*, 982

Sparey, J. R. see Association of Certified and Corporate Accountants

Spus formula see Preference shares—Extinguishment

Stacy, R. J. W. see Board of Trade

Statements, False see False statements

Statements in lieu of prospectuses see Prospectuses—Statements in lieu

Steven, R. C. see Trade Indemnity Co. Ltd.

Stevenson, J. W. see National Chamber of Trade

Stock

(see also SHARES—CONVERSION INTO STOCK)

- Report*: 472, 483
Evidence: *Courtaulds*, 60; *F.B.J.*, 1452; *General Council Bar*, 988; *Inst. Chartered Accountants*, 1408; *Stock Exchange London*, 1180

Stock—continued

Stockholder-proposal rule see MEETINGS—STOCKHOLDER-PROPOSAL RULE

Stock and Share Dealers, Association of see Association of Stock and Share Dealers

Stock Exchange, London

- Memorandum*: 1159-1184
Oral evidence: 1099-1132 (Q. 5185-5436)
Report: 120

Stock exchanges

- Report*: 106, 120, 130, 137, 140, 220-2, 224, 227, 230, 256-7, 264, pp. 209-10 (para. 10-11)

Evidence:

- Accepting Houses & Issuing Houses*, 355 (Q. 1717-30)
Board of Trade, 1554 (Q. 7078-89)
Cohen & Loss, 1468 (Q. 6627-8), 1488 (Q. 6720-2)
Council Assoc. Stock Exchanges, 503 (Q. 2402-16), 509 (Q. 2472-8), 510 (Q. 2483-5), 515 (Q. 2522-30), 518 (Q. 2541-2)
Gower, 1057
H. S. Morgan etc., 1074, 1086, 1027 (Q. 5006-7), 1037 (Q. 5075)

Securities & Exchange Commission, 1507
Stock Exchange London, 1159-63, 1164, 1180-1, 1110 (Q. 5189-5208), 1115 (Q. 5314-71), 1132 (Q. 5432-6)

Wincott, 20 (Q. 196-200)

Consultation with Board of Trade
Evidence: *Board of Trade*, 1554 (Q. 7073-74)

Investors' compensation

- Report*: 256-7, 264
Evidence: *Board of Trade*, 1555 (Q. 7082-3); *Council Assoc. Stock Exchanges*, 510 (Q. 2479-82); *T.U.C.*, 995

Permitted dealings rule

- Report*: 252
Evidence: *Stock Exchange, London*, 1180-81, 1183-84

Quotations granted by provincial exchanges

- Evidence*: *Council Assoc. Stock Exchanges*, 547, 517 (Q. 2540), 518 (Q. 2543-44)

Stock market manipulation see Securities—Anti-fraud provisions

Stock valuation

- Report*: 370, 380
Evidence:
Baxter & Edey, 196, 202
Courtaulds, 60
R. F. Henderson & Tew, 211, 180 (Q. 925-32), 186 (Q. 969-77)
Inst. Chartered Accountants, 1422, 1360 (Q. 6289-93)
Inst. Chartered Accountants Scotland, 1282 (Q. 6105-9)
T.U.C., 991

“EVIDENCE” references are to PAGE NUMBERS and Q = QUESTION

Stutchbury, O. P. see Association of Unit Trust Managers

Subsidiary companies

(see also ACCOUNTS—HOLDING COMPANIES; INTERLOCKING SHAREHOLDINGS; SHAREHOLDINGS OF COMPANY, DISCLOSURE OF)

Report: 21, 118, 148, 56, 378, 380

Evidence:

Accepting Houses & Issuing Houses, 401

A.B.C.C., 481, 431 (Q. 2054-7)

Assoc. Certified & Corp. Accountants, 886, 891, 892, 836 (Q. 4058)

Baxter & Edey, 204

Board of Trade, 1571, 1589

Brit. Insurance Assoc., 626

Chartered Inst. Secretaries, 822, 773 (Q. 3890-1)

Clore, 550

Committee Scottish Bank General Managers, 498, 457 (Q. 2292-7)

Courtaulds, 60

Economist, 218 (Q. 1008)

F.B.I., 1448

General Council Bar, 979, 911 (Q. 4461-5)

Guest Keen Nettlefolds, 128, 132-6, 98 (Q. 642-53), 106 (Q. 706-7)

Inst. Chartered Accountants, 1409, 1417-8, 1423-4

Inst. Chartered Accountants Scotland, 1333, 1339, 1286 (Q. 6137)

Inst. Directors, 800, 757 (Q. 3752-4)

Law Society, 1196-7

J. Lewis Partnership, 205-6, 171 (Q. 857-9)

Lyons, 113, 114, 78 (Q. 490-9), 82 (Q. 515-9)

Nat. Chamber Trade, 339

Soc. Investment Analysts, 418-9, 383 (Q. 1948-50)

Wincott, 54

Debts guarantee by parent

Evidence:

Accepting Houses & Issuing Houses, 354 (Q. 1703-9)

Board of Trade, 1565, 1546 (Q. 7006-23)

Committee Scottish Bank General Managers, 498

Courtaulds, 65, 25 (Q. 240-9)

F.B.I., 1379 (Q. 6423-6)

Guest Keen Nettlefolds, 105 (Q. 702)

Lyons, 79 (Q. 495-9)

Piercy, 94 (Q. 614-6)

Wincott, 16 (Q. 163-5)

Employees' shares in holding company (see also CO-PARTNERSHIP SCHEMES)

Report: 169, 187

Evidence: *A.B.C.C.*, 482; *Courtaulds*, 64; *J. Lewis Partnership*, 208

Identity of holding company

Report: 376, 380

Evidence: *Board of Trade*, 1573, 1574-5, 1544 (Q. 6996-7005); *T.U.C.*, 992

Subsidiary companies—continued

Pre-acquisition profits

Report, 164, 342-49, 350, 387

Evidence:

Accepting Houses & Issuing Houses, 405, 360 (Q. 1761-7)

Assoc. Certified & Corp. Accountants, 892, 836 (Q. 4240-3)

Assoc. Investment Trusts, 733, 697 (Q. 3482-8)

Baxter & Edey, 190, 199-200

Brit. Insurance Assoc., 627

Clore, 552

General Council Bar, 930 (Q. 4609-40)

Guest Keen Nettlefolds, 137

Inst. Chartered Accountants, 1419, 1438-41, 1371 (Q. 6371-6415)

Inst. Chartered Accountants Scotland, 1336-8, 1279 (Q. 6079-91)

Inst. Directors, 805-6, 760 (Q. 3772-3801)

Law Society, 1202-3

Nat. Chamber Trade, 340

Sutherland, J. see Law Society of Scotland

Sykes, P. J. see General Council of the Bar

T

Take-over bids

(see also ACCOUNTS—TAKE-OVER BIDS; UNITED STATES LAW—MERGERS)

Report: 16, 265, 294, p. 209 (para. 9)

Evidence:

Accepting Houses & Issuing Houses, 401-2, 370 (Q. 1831-6)

A.B.C.C., 481, 487-90, 433 (Q. 2070-6)

Assoc. Certified & Corp. Accountants, 888-9, 853 (Q. 4219-22)

Assoc. Investment Trusts, 731-2, 695 (Q. 3497-9)

Board of Trade, 1576-7, 1532 (Q. 6899-6903), 1539 (Q. 6950-4), 1549 (Q. 7037-46), 1551 (Q. 7056-8)

Brit. Insurance Assoc., 623-4

Chartered Inst. Secretaries, 819, 777 (Q. 3921-5), 779 (Q. 3946-57)

Clore, 550-2, 527 (Q. 2637-42), 528 (Q. 2644-5), 529 (Q. 2656-93)

Committee London Clearing Bankers, 641, 590 (Q. 3058)

Committee Scottish Bank General Managers, 459 (Q. 2305), 462 (Q. 2322-8)

Council Assoc. Stock Exchanges, 546, 512 (Q. 2497-8)

Council Scottish Chambers Commerce, 905

Economist, 226 (Q. 1091-2), 230 (Q. 1126-34), 232 (Q. 1146-56)

Faculty Advocates, 1301

Fay, 790 (Q. 4047-50)

F.B.I., 1448-9, 1392 (Q. 6535-68)

"REPORT" references are to PARAGRAPH NUMBERS

Take-over bids—continued

- Gen. Council Brit. Shipping*, 316 (Q. 1595-1601), 326 (Q. 1655-9)
Gower, 1054-5
Guest Keen Nettelfolds, 136
Inst. Chartered Accountants, 1409-11
Inst. Chartered Accountants Scotland, 1334-5
Inst. Directors, 800-3, 757 (Q. 3755), 767 (Q. 3829-36)
Law Society, 1197-8
Law Society Scotland, 1314-5, 1262 (Q. 5938-52)
H. S. Morgan etc., 1070, 1013 (Q. 4916-8), 1019 (Q. 4963-5), 1020 (Q. 4968-75)
Nat. Chamber Trade, 339
Newton, 68
Registrar Companies Court, 332-3, 290 (Q. 1413-23), 295 (Q. 1446-51), 297 (Q. 1455-7), 299 (Q. 1461-92), 304 (Q. 1499-1501)
Soc. Investment Analysts, 379 (Q. 1918)
Stock Exchange London, 1169-71, 1127 (Q. 5397-5421)
T.U.C., 993
Wincott, 54, 7 (Q. 166-7)

Board of Trade rules

(see also CIRCULARS (INVESTMENTS);
 DEALERS IN SECURITIES)

Report: 268-78, 294

Evidence:

- Accepting Houses & Issuing Houses*, 401-2, 403, 355 (Q. 1715), 357 (Q. 1731-6)
Assoc. Investment Trusts, 688 (Q. 5453-61)
Board of Trade, 1576, 1549 (Q. 7037-40), 1552 (Q. 7059-67)
Brit. Insurance Assoc., 567 (Q. 2896-8)
Chartered Inst. Secretaries, 780 (Q. 3944-5)
Committee London Clearing Bankers, 590 (Q. 3058)
Council Scottish Chambers Commerce, 871 (Q. 4360)
Economist, 263, 223 (Q. 1061)
F.B.I., 1392 (Q. 6536, 6538-46)
Inst. Directors, 801, 758 (Q. 3756-7)
Law Society Scotland, 1262 (Q. 5397)
Registrar Companies Court, 295 (Q. 1447-51), 302 (Q. 1490)
Stock Exchange, 1171
T.U.C., 947 (Q. 4726-7)

**Compensation for loss of office see
 DIRECTORS—COMPENSATION FOR LOSS OF
 OFFICE**

Compulsory buying out

Report: 283-92, 294

Evidence:

- Accepting Houses & Issuing Houses*, 402, 415-6, 417
A.B.C.C., 482

Take-over bids—continued**Compulsory buying out—continued**

- Assoc. Certified & Corp. Accountants*, 889
Board of Trade, 1571
Brit. Insurance Assoc., 624
Chartered Inst. Secretaries, 816-7
Clore, 525 (Q. 2614-8)
Courtaulds, 60
Faculty Advocates, 1301
General Council Bar, 971-5, 920 (Q. 4521-61)
Guest Keen Nettelfolds, 137
Inst. Chartered Accountants, 1411
Inst. Chartered Accountants Scotland, 1335
Law Society, 1199
Law Society Scotland, 1264 (Q. 5953-5)
J. Lewis Partnership, 207
Newton, 68, 44 (Q. 386)
Registrar Companies Court, 332, 290 (Q. 1413-5), 296 (Q. 1451), 301 (Q. 1479-82)
Stock Exchange London, 1172, 1128 (Q. 5405-7)

Directors' functions

Report: 279, 294

Evidence:

- A.B.C.C.*, 481
Assoc. Certified & Corp. Accountants, 889
Board of Trade, 1577, 1550 (Q. 7047-55)
Brit. Insurance Assoc., 624
Economist, 263
Faculty Advocates, 1301
F.B.I., 1449, 1393 (Q. 6543-4)
Inst. Chartered Accountants, 1411
Inst. Directors, 802-3
Law Society, 1198
Law Society Scotland, 1315
Registrar Companies Court, 392

Directors' interests disclosure

(see also DIRECTORS—DISCLOSURE OF
 INTERESTS)

Evidence:

- Accepting Houses & Issuing Houses*, 411
Assoc. Certified & Corp. Accountants, 889
Board of Trade, 1570, 1533 (Q. 6904-14)
Brit. Insurance Assoc., 624
Inst. Chartered Accountants, 1411
Inst. Chartered Accountants Scotland, 1335
Law Society, 1199
J. Lewis Partnership, 207, 172 (Q. 864-6)
Registrar Companies Court, 333

Employees' interests

Report: 267

- Evidence*: *F.B.I.*, 1393 (Q. 6550-2);
J. Lewis Partnership, 206, 208, 174 (Q. 885-9), 176 (Q. 902-6); *H. S. Morgan etc.*, 1022 (Q. 4982-92);
T.U.C., 947 (Q. 4728-31)

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Take-over bids—continued**Finance***Report*: 175-7, 266**Evidence:***Accepting Houses & Issuing Houses*, 402, 368 (Q. 1813-9)*Assoc. Certified & Corp. Accountants*, 889*Clore*, 532 (Q. 2694-2700)*Committee London Clearing Bankers*, 642*Economist*, 263*Faculty Advocates*, 1241 (Q. 5778-9)*F.B.I.*, 1450, 1397 (Q. 6569)*General Council Bar*, 925 (Q. 4562-78)*Inst. Chartered Accountants*, 1411*Inst. Chartered Accountants Scotland*, 1293 (Q. 6193-6)*Inst. Directors*, 758 (Q. 3758)*Law Society*, 1199, 1153 (Q. 5592-3)*Law Society Scotland*, 1263 (Q. 5940)*J. Lewis Partnership*, 206*Registrar Companies Court*, 333*Stock Exchange London*, 1128 (Q. 5408-9), 1130 (Q. 5420-1)*Wincott*, 51**Identity of bidder***Report*: 280**Evidence:***Assoc. Certified & Corp. Accountants*, 889*Brit. Insurance Assoc.*, 624*Clore*, 526 (Q. 2625)*Council Assoc. Stock Exchanges*, 509 (Q. 2466-8)*Courtaulds*, 60*Economist*, 263*Faculty Advocates*, 1301*F.B.I.*, 1449*General Council Bar*, 923 (Q. 4559-50)*Inst. Chartered Accountants*, 1411*Inst. Directors*, 801-2*Law Society*, 1198-9*Registrar Companies Court*, 333**Information for shareholders***Report*, 278, 280-2, 294**Evidence:***A.B.C.C.*, 488*Assoc. Certified & Corp. Accountants*, 889*Board of Trade*, 1550 (Q. 7047-55), 1552 (Q. 7059-67)*Brit. Insurance Assoc.*, 623*Cohen & Loss*, 1469 (Q. 6635-43)*Economist*, 263, 230 (Q. 1126-30), 235 (Q. 1174-7)*Faculty Advocates*, 1301*F.B.I.*, 1449*Gen. Council Brit. Shipping*, 326 (Q. 1658)*Guest Keen Nettlefolds*, 136*Inst. Chartered Accountants*, 1411*Inst. Directors*, 801*Law Society*, 1198

"REPORT" references are to PARAGRAPH NUMBERS

Take-over bids—continued**Information for shareholders—continued***J. Lewis Partnership*, 207, 173 (Q. 879-84)*Registrar Companies Court*, 332*Stock Exchange London*, 1129 (Q. 5416-9)*Wincott*, 51**Talbot, W. F. see Chartered Institute of Secretaries****Taxation charges***Report*: 384-90, 397**Evidence:***Assoc. Certified & Corp. Accountants*, 893*Baxter & Edey*, 203-4*Chartered Inst. Secretaries*, 822*Courtaulds*, 63*Guest Keen Nettlefolds*, 138*Inst. Chartered Accountants*, 1422, 1363 (Q. 6306)*Inst. Chartered Accountants Scotland*, 1284 (Q. 6128-32)*Soc. Investment Analysts*, 419**Taylor, C. E. see Association of International Accountants****Tew, Brian***Memorandum*: 209-14*Oral evidence*: 179-87 (Q. 920-78)**Thornton, R. G. see Committee of London Clearing Bankers****Touche, G. L. see Association of Investment Trusts****Tracey, D. B. see Association of British Chambers of Commerce****Trade credit***Evidence*: *Baxter & Edey*, 202-3; *R. F. Henderson and Tew*, 212-13**Trade Indemnity Co. Ltd.***Memorandum*: 275-78*Oral evidence*: 249-57 (Q. 1254-1337)*Report*: 60**Trade marks***Report*: 452-3*Evidence*: *A.B.C.C.*, 483; *Board of Trade*, 1561 (Q. 7138-42); *Law Society*, 1218**Trades Union Congress***Memorandum*: 989-996*Oral evidence*: 935-954 (Q. 4641-67)*Report*: 267**Trading account***Report*: 243, 252, 351-2, 393-4, 397**Evidence:***A.B.C.C.*, 482*Assoc. Certified & Corp. Accountants*, 893*Assoc. Investment Trusts*, 732, 689 (Q. 3462)*Baxter & Edey*, 189, 196, 159 (Q. 788-91)*Board of Trade*, 1588*Cohen & Loss*, 1472 (Q. 6645-8)*Courtaulds*, 29 (Q. 267-8)*Economist*, 264, 227 (Q. 1097-8, 1101-3), 231 (Q. 1136-9)

Trading account—continued

- F.B.I.*, 1397 (Q. 6571)
Guest Keen Nettlefolds, 105 (Q. 703-5)
R. F. Henderson & Tew, 210, 211, 181 (Q. 933-4), 186 (Q. 966)
Inst. Chartered Accountants, 1420-1, 1364 (Q. 6319-23)
Inst. Chartered Accountants Scotland, 1285 (Q. 6135-6)
Inst. Directors, 806
J. Lewis Partnership, 177 (Q. 906-7)
E. V. Morgan, 273, 253 (Q. 1299-1304)
H. S. Morgan etc., 1073-4, 1042 (Q. 5108-19)
Newton, 68, 69, 46 (Q. 402-4)
Soc. Investment Analysts, 418, 385 (Q. 1967)
Trade Indemnity Co., 253 (Q. 1299-1304)
T.U.C., 991, 945 (Q. 4715-20)

Trading, Fraudulent see **Directors**—Insolvent companies

Transfer of shares see **Shares**—Transfer and registration

Tribble, N. R. see **Association of Certified and Corporate Accountants**

Trustees for debenture holders see **Debentures**—Trustees

Tuckwell, W. A. see **Association of Stock and Share Dealers**

U**Ultra vires**

(see also **ACTIVITIES CHANGES**; **OWNERSHIP AND CONTROL**)

Report: 35-42

Evidence:

- Accepting Houses & Issuing Houses*, 395, 349 (Q. 1666-8)
A.B.C.C., 475
Assoc. Certified & Corp. Accountants, 881, 836 (Q. 4064-73)
Assoc. Investment Trusts, 727, 678 (Q. 3373-6)
Bard of Trade, 1566
Brit. Insurance Assoc., 615, 558 (Q. 2805), 559 (Q. 2814-7)
Chartered Inst. Secretaries, 810-1
Clare, 548, 520 (Q. 2570-3), 526 (Q. 2626-7)
Committee Scottish Bank General Managers, 495, 451 (Q. 2241-54)
Council Assoc. Stock Exchanges, 545, 504 (Q. 2417-27)
Council Scottish Chambers Commerce, 858 (Q. 4255-61), 875 (Q. 4388-95)
Courtaulds, 22 (Q. 209-15)
Faculty Advocates, 1296, 1221 (Q. 5631-45), 1242 (Q. 5785-8), 1243 (Q. 5791-6)
F.B.I., 1443
General Council Bar, 962-3, 907 (Q. 4422-65), 913 (Q. 4470-5)

Ultra vires—continued

- Gower*, 1052
Guest Keen Nettlefolds, 99 (Q. 653-67)
Inst. Chartered Accountants Scotland, 1325-6
Inst. Directors, 792-3, 744 (Q. 3638-43), 745 (Q. 3651-2), 765 (Q. 3814-25)
Law Society, 1187, 1135 (Q. 5461-78)
Law Society Scotland, 1305, 1247 (Q. 5825-31)
H. S. Morgan etc., 1065, 999 (Q. 4825-34)
Piercy, 115, 87 (Q. 543-53)
Registrar Companies Court, 328, 280 (Q. 1346-56)
Wincott, 5 (Q. 42-52)

Unit Trust Managers, Association of see **Association of Unit Trust Managers**

Unit trusts

(see also **AUDIT**—**UNIT TRUSTS**; **INVESTMENT TRUSTS**; **OPEN END MUTUAL FUNDS**)

Report: 231, 234, 307-29

Evidence:

- Assoc. Certified & Corp. Accountants*, 891
Assoc. Unit Trust Managers, 709-26, 657 (Q. 3185-3369)
Board of Trade, 1583-5, 1556 (Q. 7097-7105)
Cohen & Loss, 1491 (Q. 6731-4)
Economist, 267-9, 223 (Q. 1062-73)
S. I. Fairbairn, 735-41, 695 (Q. 3501-3633)
Gower, 1062
Inst. Chartered Accountants, 1413-4
Law Society, 1200-1
Newton, 68
Piercy, 119, 121-6, 98 (Q. 640)
T.U.C., 944, 949 (Q. 4757-8)

Accounts

Report: 324, 329

Evidence: *Assoc. Unit Trust Managers*, 716, 717, 671 (Q. 3312-3), 672 (Q. 3318-9, Q. 3323); *Inst. Chartered Accountants*, 1414-6

United States law

(see also **SECURITIES**)

Evidence: *Gower*, 1052-5; *H. S. Morgan etc.*, 1064-70

Holding companies

(see also **ACCOUNTS**—**HOLDING COMPANIES**)

Evidence: *Gower*, 1063; *H. S. Morgan etc.*, 1077, 1086; *Securities & Exchange Commission*, 1515

Mergers

(see also **TAKE-OVER BIDS**)

Evidence: *Gower*, 1054; *H. S. Morgan etc.*, 1069-70, 1016 (Q. 4941-75), 1048 (Q. 5170-1)

Unlimited companies

Report: 62, 63, 68, 78

"EVIDENCE" references are to PAGE NUMBERS and Q = QUESTION

Unlimited companies—continued

Evidence:

- Assoc. Certified & Corp. Accountants*, 882, 841 (Q. 4101-3)
Assoc. Investment Trusts, 728
Board of Trade, 1606
Chartered Inst. Secretaries, 820, 781 (Q. 3958-9)
Committee Scottish Bank General Managers, 496
Council Scottish Chambers Commerce, 863 (Q. 4290-1)
Inst. Chartered Accountants Scotland, 1328
Law Society Scotland, 1307
Not. Assoc. Trade Protection Societies, 474 (Q. 2401)
Not. Chamber Trade, 313 (Q. 1574-6)

Unquoted companies

Exemption from accounting recommendations

Report: 351-2

Unregistered companies

Report: 306, 523-4, 525

Evidence: *Board of Trade*, 1606;
Brit. Overseas Banks Assoc., 997, 954 (Q. 4771-3)

V

Voting, Cumulative see **Directors—Appointment**

Voting rights

(see also PROXY VOTES; SHARES—VOTING RIGHTS)

Report: 26, 31

Evidence:

- Accepting Houses & Issuing Houses*, 407, 416, 365 (Q. 1797-1800)
A.B.C.C., 486-7, 435 (Q. 2088-2107)
Assoc. Certified & Corp. Accountants, 897
Board of Trade, 1542 (Q. 6974-84)
Brit. Insurance Assoc., 621, 632
Chartered Inst. Secretaries, 825
Courtaulds, 24 (Q. 231-2)
Faculty Advocates, 1303, 1242 (Q. 5789-90)
F.B.I., 1452
Gower, 1053
Inst. Chartered Accountants, 1402, 1432
Inst. Chartered Accountants Scotland, 1343
Law Society, 1211
J. Lewis Partnership, 207, 174 (Q. 8902)
H. S. Morgan etc., 1068, 1085, 1011 (Q. 4906-8)
Newton, 69
Piercy, 120
Stock Exchange London, 1179

Voting trust certificates

Evidence: *Cohen & Loss*, 1497 (Q. 6769-70); *H. S. Morgan etc.*, 4990 (Q. 4890-5)

W

Wage claims

(see also WINDING-UP—WAGE CLAIMS)

Evidence: *Brit. Overseas Banks Assoc.*, 997, 959 (Q. 4811-3); *Committee London Clearing Bankers*, 597 (Q. 3089); *Committee Scottish Bank Gen. Managers*, 459 (Q. 2306-10); *Gen. Council British Shipping*, 318 (Q. 1604-5); *T.U.C.*, 941 (Q. 4687-4704)

Walker, W. D. see **Stock Exchange, London**

Walters, H. A. see **British Insurance Association**

Warcham, W. S. see **Stock Exchange, London**

Warner, Sir Henry see **Society of Investment Analysts**

Welsford, A. M. see **Law Society**

Wetherfield, S. A. see **Lewis (John) Partnership Ltd.**

Wilkinson, F. M. see **Institute of Chartered Accountants in England & Wales**

Williams, R. E. see **British Overseas Banks Association**

Wincott, Harold

Memorandum: 48-57

Oral evidence: 1-21 (Q. 1-201)

Winding up

Report: 24, 31, 72-5, 78, 496-503, 508-9, 511, 517-8, 525

Evidence:

A.B.C.C., 484-5

Assoc. Certified & Corp. Accountants, 897-902, 854 (Q. 4225-30), 857 (Q. 4249-51)

Board of Trade, 1599-1601

Council Scottish Chambers Commerce, 906

Faculty Advocates, 1303

Fay, 786 (Q. 4013-5)

General Council Bar, 975-6, 981-3

Inst. Chartered Accountants, 1432-6

Inst. Chartered Accountants Scotland, 1344, 1347-8, 1295 (Q. 6211)

Law Society, 1212-3, 1214

Law Society Scotland, 1267 (Q. 5990)

Nat. Chamber Trade, 341

Registrar Companies Court, 333-6, 280 (Q. 1343-5), 292 (Q. 1424-9)

Trade Indemnity Co., 252 (Q. 1287-91)

"Just and equitable"

Report: 194, 198, 199-201, 212, 503

Evidence:

Board of Trade, 1534 (Q. 6915-22)

Chartered Inst. Secretaries, 817, 778 (Q. 3926-30)

General Council Bar, 975, 981-2

Inst. Chartered Accountants, 1406

Inst. Directors, 799, 750 (Q. 3700-2)

Law Society Scotland, 1309-11, 1321-3, 1256 (Q. 5896)

"REPORT" references are to PARAGRAPH NUMBERS

Winding up—continued

"Just and equitable"—continued

Registrar Companies Court, 330-1,
285 (Q. 1386-92), 288 (Q. 1407)

Preference shares extinguishment *see*
PREFERENCE SHARES—EXTINGUISH-
MENT

Wage claims

(*see also* WAGE CLAIMS)

Evidence: *T.U.C.*, 995, 996, 952 (Q.
4756-61)

Woodcock, G. *see* Trades Union Congress

Y

Young, J. M.

Oral evidence: 999-1051 (Q. 4822-5184)



MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
FIRST DAY

Friday, 23rd September, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN (*Questions 1 to 201*)

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKENNON, Q.C., M.B.E.,
T.D.

MRS. M. NAYLOR (*Questions 202 to 417*)

MR. G. W. H. RICHARDSON

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. HAROLD WINCOTT *called and examined*

Chairman: Mr. Wincott, I need hardly say that the Committee are very grateful to you for your memorandum and for sparing the time to come and help us today. We are most grateful to you for the trouble you have taken.

1. We have all read your memorandum and no doubt we shall all do so again before this inquiry ends, so we need not take up time with long quotations. If there is any point in the memorandum on which you think I or any other member of the Committee unwittingly misrepresented what you said, then we can refer to it.—*Mr. Wincott:* Yes.

2. As to preliminary matters, you have had some thirty years' experience as a financial journalist?—Yes.

3. And that means that your career in this field began about the time of the passing of the 1929 Act?—Yes, May 1930.

4. The Consolidation Act of 1908 under which I was brought up had been repealed or was about to be?—Yes.

5. And the new 1929 Act was then coming into force?—Becoming effective, yes.

6. I understand it to be your view that there has been a great advance in the period of your experience in company legislation?—Yes.

7. You think the law has been improved?—Without any doubt, yes.

8. And you think that the 1948 Act has worked well and there is not the same need of major reforms as there was before that Act came into force?—That is true, yes.

9. Then a point of interest it seems to me. You call attention to the increase in the number of unsophisticated investors as in your view the main reason for considering revised legislation?—Yes.

10. That is to say there are more people now who have money to spend which they would like to invest in stocks and shares?—Yes.

11. And they are a class of person who perhaps has had less experience of investment and would find it harder to understand the intricacies of the market than the old-fashioned style of investor. That is a fair statement, is it?—Yes. I think if I may say so that the *Investors' Chronicle* is well qualified on this because

we have seen a tremendous rise in our circulation—like all financial papers over the last ten years—and also of course we are constantly getting letters from investors and we do get a good insight into their mentality and degree of sophistication.

12. Yes, I follow, but in general, though you advocate some reforms, your inclination is against what you call elaborate and restrictive legislation?—Yes.

13. And you think a more promising line of approach is to be found in measures designed to keep shareholders more fully informed in all matters affecting their company?—Yes.

14. They should know, or have available to them if they choose to use it, information telling them how the company's affairs are going forward?—Yes. It may need legislation to provide that information.

15. The giving of information you regard as one of the main remedies for such defects as there are now in the legislation?—Yes, indeed.

16. On the other hand, of course, no doubt you would welcome any practicable steps for the more effective prevention of fraud without undue restriction on legitimate business?—Certainly.

17. That has always been the endeavour in all amending legislation to make fraud more difficult without preventing business, and of course the great difficulty is to know where the line can best be drawn. —Yes, and if I might interject there, my experience has been that it is only really one or two cases that have worried me very much indeed in the last few years—I mean we saw them coming. We knew there would be trouble and they went on year after year taking money from small people, and we wrote about them.

18. Perhaps that was the kind of case in which more prompt action by the Board of Trade might in your view have saved it?—More prompt action by somebody, I am sure, could have saved it. But I just wanted to say it does seem an awful pity to have to restrict the whole business because of these one or two cases, and yet they have been so glaring that I

have got very hot under the collar about them.

19. Of course there will always be rogues anywhere where property is bought and sold—Indeed.

20. You will find the dishonest person. —Yes.

21. And the difficulty is that the character of the particular property we are concerned with now, shares, is such as to lend itself to misuse or abuse by dishonest persons?—Yes, but these cases have been so bad that I felt that if legitimate business had to be restricted then it had to be restricted to stop a repetition of these cases—much as I regret it.

22. Yes. We must not take up too much time with preliminary matters, but I think it is useful to refer to what was said in the Cohen Committee's Report as to their method of approach. I do not know if you have a copy?—No, I have no copy with me. (Copy supplied to the witness.)

23. You will find it at paragraph 5 on page 7 of the document. The Cohen Committee said this:—

“We are satisfied by the evidence that the great majority of limited companies, both public and private, are honestly and conscientiously managed. We believe that the system of limited liability companies has been and is beneficial to the trade and industry of the country and essential to the prosperity of the nation as a whole. The Companies Acts have been amended from time to time to bring them into accord with changing conditions, but if there is to be any flexibility opportunities for abuse will inevitably exist. We consider that the fullest practicable disclosure of information concerning the activities of companies will lessen such opportunities and accord with a wakening social consciousness. Accordingly, while in making our recommendations we have borne in mind the importance of not placing unreasonable fetters upon business which is conducted in an efficient and honest manner, we have included a number of proposals to ensure that as much information as is reasonably required shall be made available both to the shareholders and creditors of the companies concerned and to the general

public. We have also sought to find means of making it easier for shareholders to exercise a more effective general control over the management of their companies. The result will be, we believe, to strengthen the already high credit and reputation of British companies. We must emphasise, however, that this objective will be attained more by the selection by the shareholders of the right governing body of each company than by the provisions of any statute."

Would you accept that as broadly describing the method of approach that would be applicable today?—Yes, that is very much my own feeling.

24. Turning to more specific questions, one of the difficulties felt by everyone is this, I think. The modern memorandum of association is unrestricted as far as the objects are concerned, and more often than not the modern set of articles of association gives all the powers of management, with certain exceptions, to the directors?—Yes.

25. And the difficulty is to combine those two things. The directors availing themselves of the unlimited character of the object clause and availing themselves of the wide powers of management conferred on them by these articles may be able, in certain circumstances, to effect some exceptionally important transaction which really makes the company concerned a different company from that in which the members subscribed for or purchased shares. That is one of the difficulties that has to be faced, and we have to balance the necessity for a free exercise by the board of adequate powers of management on the one hand and the essential protection of shareholders on the other—that is the question.—Yes.

26. As to that in your memorandum—I hope I am giving the effect of this correctly, but stop me if I am not—you suggest that the object clauses in memoranda of association should be expressed in more concise and definite terms, and then you go on in effect to say that a company should be restricted to those activities, but with power to extend them by special resolution as occasion may require. That is broadly your view, is it not?—Yes.

27. And what you seek to gain from that is this: it would give shareholders a greater opportunity for keeping any departures by the directors within bounds, because the directors would find that they had no power to carry out whatever the special transaction was, and in order to be able to carry it out they would have to go to their shareholders for an extension of their power?—Yes.

28. It is perhaps not without interest to take a brief look at the form of memorandum of association which is considered sufficient for the purposes of the Act, and this form has I believe subsisted ever since 1862. I do not know if you have a copy of the Act?—Yes, I have.

29. You will find this on page 293, immediately after Table A. Have you got that?—Yes, I have it.

30. The name of the company is so-and-so; the registered office of the company will be situate in England, then this:—

"The objects for which the company is established are, 'the conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine, and the doing of all such other things as are incidental or conducive to the attainment of the above object.'"

That was considered a sufficient object clause for a shipping company, the company in the case dealt with being the Eastern Steam Packet Co. Ltd. It is not without interest for the sake of comparison to look at one of the well-known standard forms of memoranda of association. I will not trouble you—I expect you are familiar enough with the type of document. The object clause begins, "The objects for which the company is established are . . ." and then there are paragraphs extending from A to W, and I have seen some which go through the alphabet twice—And start again.

31. Yes. That of course is likely to mean that directors can, so far as the powers of the company in the memorandum are concerned, do very much as they please, of course within the delegation to them of powers in the articles. What you would do, as I understand it, is to abolish or prohibit this voluminous

form of object clause and substitute something more like Table B in the Companies Act?—I would, yes.

32. We are examining suggestions of this kind and I am not necessarily hostile to it, but might not this give rise to difficulties? As I understand it your proposal is to restrict the powers of the company by legislating so that the company can only do—if it is a shipping company, say—the things covered by the specimen form in Table B?—Subject to the fact that it can extend its activities if it gets permission.

33. Subject to extension under section 5, I think it is, of the Act?—Yes.

34. Would that be convenient? You see the company has to carry on business under modern conditions. If it has this very wide clause the result has been achieved that it is extremely rare that any project on which it embarks is beyond its power.—Yes.

35. That of course protects people dealing with the company. They are content to assume—and I suppose in nine hundred and ninety-nine cases out of a thousand they assume correctly—that the company with which they are dealing has power to carry out the transaction.—Yes.

36. You would say the remedy for that under your scheme would be a special resolution of the company?—Yes.

37. But that might be very inconvenient might it not, and I will suggest why. Every day a transaction may arise which on investigation is found not to be within the restricted objects clause—"every day" perhaps is a hyperbole—but it might quite often happen although it was something the company might quite reasonably and practicably do under existing conditions. The directors then have to go to the shareholders and ask them for the requisite special resolution. Would that not be inconvenient?—I would have thought, with great deference, Lord Jenkins, that the last phrase of the Eastern Steam Packet Company probably covers what you have in mind—"... the doing all such other things as are incidental or conducive to the attainment of the above object".

38. They have got to be incidental or conducive. That amongst lawyers is very often a vexed question—whether an object can be fairly said to be incidental or

conducive. Then again, you see, there would be questions of doubt such as arose in the old days as to whether the memorandum covered this or that object. And of course it is of the essence of your scheme that the directors should not have room to do whatever they liked.—I think in either set of circumstances there are obviously disadvantages, but the trend in recent years particularly has been for the man who thought he was putting his money into a soup factory to find in fact it has changed overnight into an artificial silk factory. This is as bad, I think, as the restrictive effects that you are afraid of, if not worse.

39. To put it rather by way of *reductio ad absurdum*, the Eastern Steam Packet Company with its existing objects might be minded to convey passengers and goods by means of aircraft.—Yes.

40. They might think that a good idea. There is no doubt that a modern form of objects would enable the company to carry passengers by aeroplanes just as much as by ship. The businesses could be conveniently combined to carry out the main objects by new and improved means and so on, but under the form given in Table B, it looks to me pretty clear that they could not claim power to use aircraft.—No. Would it be unduly restrictive if they had to ask their shareholders before they could go into the aircraft business?

41. You might have a point there. The shareholders then would have an opportunity of objecting, and in that particular case it might be quite reasonable. What I am rather putting is that, taken as a whole, this scheme would be productive of inconvenience. And you see there are the marginal cases where it is doubtful whether such-and-such a transaction would be within the narrow form of the memorandum or not, and in all such cases the directors would have to go back to the shareholders, and would it not be likely that to avoid repeated applications the company would just adopt a wide objects clause?—I realise it is going to be very difficult to make any control of this sort effective and even with a restricted objects clause—if a restrictive clause was initially set up—then shareholders being what they are, it would be very easy to widen the clause immediately or virtually without limit again.

42. I think perhaps I have taken rather a long time over this, but I think it is important. There is this consideration. The directors have to carry on the business and one assumes for the moment that they are capable, conscientious and honest men. They find a clause of this restrictive character, then they have got to decide whether it covers a particular transaction or not and they may, erroneously as it turns out, be quite satisfied that their short form of memorandum covers that. I think that is a situation against which the company should be protected at all costs. It is extremely awkward if you get involved in *ultra vires* matters.—Yes.

43. I think I have already mentioned the third parties now under the existing practice, they assume that the company they are dealing with has power to do the transaction simply, really, on the faith of the much derided modern wide objects clause.—Yes, it has that advantage.

44. May I put this to you? You know, I think, that the Cohen Committee made recommendations on the subject of *ultra vires*?—Yes.

45. And do you remember that the Act approved their suggestions as to easier alteration of objects? There was an amendment of the law there so that you could do it by special resolution.—Yes.

46. And that held good unless somebody within a limited time objected.—Yes.

47. But the legislature did not think fit to adopt the recommendation about *ultra vires*.—No.

48. The principle there sought to be applied by the Cohen Committee was in a sense the converse—the opposite of yours. What they recommended was to give the company *vis-à-vis* third parties all the powers of a natural person, and that would dispense with the long object clause. A company would then simply have a corporate entity which would have all the powers of a natural person. That disposes of third parties and protects a man getting into trouble. Behind that screen, so to speak, the shareholders and the directors manage the business. The advantage is claimed that third parties are protected, and the internal arrangements can be so framed that the shareholders have a reasonable degree of

control over the activities of the directors. That is another way of doing it, but that too might, I think, involve difficulty. I put to you the case of a proposal between the directors of the company and an outside third party to do something which was expressly forbidden by the domestic regulations of the company. You see to make the scheme work the third party must be absolutely and in all circumstances protected from notice that the shareholders have forbidden the thing. That might, might it not, lend itself to abuse?—Yes. I think if I may say so, since the Cohen Committee looked into this question there has been what I would think one of the major developments in the company world in my lifetime, and that is this modern trend to diversification, and so I think a new set of circumstances has arisen really in the post-war period, and although I agree with the case you are putting on the company's behalf I think there is an urgent case to be put on the shareholders' behalf in view of this new trend of diversification.

49. Of course a possible solution would be to adopt the Cohen recommendations all the way and make provision in the domestic constitution of the company for shareholder control in certain matters?—Yes.

50. But nothing could be more damaging to the shareholders themselves than articles giving them such control that the directors are unable to have a free hand in carrying on legitimate business of what one may call the day-to-day variety.—Quite, quite—yes.

51. That is really the problem. I think that is all I want to say on that aspect, and I think I have your answers clear for that.—I think if I may just add that this whole question seems to me to crop up under many sub-headings throughout the reform I think is desirable—on accounting, take-over bids—on many aspects.

52. You make that, I think, very clear in your report which, as I told you, we have all studied.—Yes.

53. Then the next point is this: in your memorandum you express approval of no par value (n.p.v.) shares. Have you anything to add to that? I think, putting it very shortly, the claim is that n.p.v. shares present the position as it really is, whereas

the share having a par value may be a pound share nominally, but is really worth £50 or anything you like to mention.—Yes.

54. And that gives a false picture and its falsity may be of some importance because it leads members of the public to suppose that when a 30 per cent. dividend or a 50 per cent. dividend or something of that sort is declared, shareholders having subscribed only £1 are getting a dividend of 30 per cent. to 50 per cent. without taking into account the fact that the £1 par value means nothing, and that the share is really worth—and the shareholder paid for the share—perhaps five or six pounds.—Yes.

55. That is the main attraction of the scheme, is it, in a way?—A very important attraction. I remember going round a factory during the war of a company which had originally £1 shares and had written them down to a shilling in the 'thirties. They had just announced a 100 per cent. dividend, and the workers were producing cuttings from the papers and saying "What a racket—getting their money back in one year.". I think apart from that this comes back to the unsophisticated shareholders. It confuses them. They get a scrip issue—a capitalisation issue, and that puzzles them, and I know—I have had letters from people who believe they can sell these scrip issues and be no worse off as a result of doing so. With this type of confusion you get investors saying of 5s. shares standing at 65s., "I would not buy that, it is much too expensive", or the other way round, of a £1 share standing at 15s., "There must be something wrong with that company". And in general it is the attempt to attach a fixed value to something which in the nature of things cannot be fixed which is so stupid, I think. I have lived with and been campaigning for this for so long that it is rather a hobby horse of mine; but all that anybody is asking for is permissive power and not mandatory power, and I think the response from industry now would be larger than it would have been when the Cohen Committee considered it. I cannot see any objection to allowing it, and I can see all sorts of advantages.

56. That of course is subject to the necessary safeguards by way of amend-

ment of the Companies Act to allow for these shares and to deal with such problems as reduction of capital.—Yes, I do not think there are any big problems, though.

57. Nothing major. There would be a good many drafting ones.—Yes, the draftsmen under the new Companies Act would have to proceed with great care. And perhaps every line of the existing Act is based on nominal values.

58. It was proposed in the Gedge Committee that preference n.p.v. shares should be allowed, and that was rejected. Are you in favour of extending it to preference shares?—I really have not given this very much thought because I do not regard it as terribly important.

59. It would probably be unlikely that anyone would trouble to do it.—I doubt if it would be done. To my knowledge it is done very little in the United States.

60. In the case of preference shares your rights are directly linked to the nominal value. You get your pound back on winding up and your dividend computed on your pound value.—Yes, quite.

61. It was then suggested that the side by side operation of these two kinds might be productive of difficulties.—They would be productive of difficulties to financial journalists in our share price tables. We would have to make up our minds—we would have to go no par value because you could not have a percentage dividend on a no par value share. We would have to drop the percentage sign. There would be a certain amount of confusion I think. But I would hope that enough companies would adopt n.p.v. that we would get rid of the percentage sign. I think it is interesting on this that although America has moved away from n.p.v. shares for taxation reasons, nobody ever quotes a percentage dividend in the United States even with shares of nominal value. They have become so accustomed to expressing dividends in cents per share that they never think of expressing them as a percentage.

62. I suppose the arithmetic and company drafting in the way of settling schemes of arrangement would be greatly simplified if one were dealing only with

n.p.v. shares.—Yes possibly, and of course it gets rid of the need for capitalisation issues; you just split your shares. It would take a lot of the heat out of the company world because this recent Thorn Electric dispute on the A shares—Thorns could just have split their existing shares. I just think it has everything to commend it.

63. I think that is all we need deal with on that question. Then the next one you may not want to embark on because it concerns private companies. I appreciate that you disclaim any special knowledge of private companies, but have you formed any view as to the exemptions enjoyed by an exempt private company in regard to the filing of accounts—sections 127 and 129, and provisions as to loans to directors is another, and then there is the qualification of auditors. In these matters, as no doubt you know, exempt private companies are given certain exemptions.—Yes.

64. Have you given any thought to that?—The only issue on this on which I would care to express an opinion is the exemption from filing accounts—and there I would say that if the company in any way solicits money from the public it should lose that exemption.

65. Yes, I see.—But on the other two issues I am afraid, as I say, I have no knowledge or only the slightest knowledge of private company affairs, and I would not care to express an opinion.

66. You really adopt the principle that a company which deals with the public has availed itself of the advantage of limited liability and ought to make full disclosure.—Yes. You see these bad cases I referred to at the beginning, in some of them at least we have been absolutely helpless because we have been unable to get any figures of the companies soliciting large sums of money, and without having an unduly inflated idea of our own importance, I think we can guide the public; but if we have not the raw material we are helpless, and I would think any company, as I say, which solicited money from the public investor ought to be prepared to disclose its accounts.

67. But apart from that broad view you do not want to be involved in details?—

No, I would have thought, crudely, that in the nature of things a private company's affairs were its own affairs, and what it did in the way of directors' powers was its own business.

68. It is internal business in something which is only a partnership.—Yes, a family arrangement.

69. The difficulty is to draw the line between that kind of private company and others.—Yes.

70. Passing on to heading 5 of the memorandum, (a) as to fundamental changes in the company's activities, I take it you suggest there that transactions such as take-over bids of any substance should be approved by special resolutions both of the offeror and the offeree company?—That is the gist of it.

71. I appreciate that you have got a strong case for approval by the offeror company because they are buying property, the shares, and so it is reasonable that if the directors propose to buy shares—if it is a substantial deal—the shareholders should be asked for their approval in advance. You have obviously got a case for that, although it might be a question of degree here as to whether this or that transaction was sufficiently important.—Yes.

72. But as to the offeree company, in the common case the members of the offeree company are being given shares in exchange for shares in the offeror company.—Or cash, yes.

73. In that case it would be inappropriate, would it not, to have a special resolution of the company? Each shareholder is selling his piece of property in the shape of his shares?—Yes. May I enlarge on this. My attitude to take-over bids has changed with the change in economic conditions and stock exchange prices. I was very strongly in favour of take-over bids when they had a really useful economic function to perform, when companies were under-utilising their assets, when share prices were depressed below the underlying real value of the shares, then I think that provided a take-over bid was reasonably and honestly done it performed a very real economic function to the benefit of shareholders and the community as a whole. I have been

increasingly worried recently as the post-war re-adjustment in share values has taken place, and I think personally virtually been completed—I mean we have caught up with the inflation of the last twenty years in share values now—I have been increasingly worried about the position of what I call the good small company. In stock exchange terms I think you will find that its shares are being quoted on a dividend yield of 2½–3 per cent. and an earnings yield of 6–7 per cent. In other words it is fully valued, I think; in our parlance there is no undervaluation of the shares. Then along comes a big company—and I am speaking quite frankly here—I think some people in the big company may be empire builders and they make what I regard as a stupid bid for the small company which is already very adequately valued by the Stock Exchange, and I have great sympathy with the directors of the small company. It is fine for the shareholders of the small company because they are getting a price much above an already high Stock Exchange price, but I have great sympathy with the directors and management of the small company because I do not see what they can possibly do to resist this take-over bid, and yet the whole of their life's work may be taken out of their hands by this what I would call extravagant bid, and I think that anything which would slow down the process and allow public opinion to work—allow the Press to discuss it and focus investment opinion on what seems to be the fact that too high a price is being offered—would be good, and of course it would be in the interests of the shareholders of the offeror company.

74. That is rather broader lines than I was contemplating. I was thinking of any case, not a particularly small or large company, where the opportunity is to purchase all the shares in the offeree company. I was only putting it to you that that is not a case in which a special resolution approving the transaction would be appropriate because it would be an offer to purchase each shareholder's shares.—You could not interfere with that.

75. He could say "I am all right, I am getting £20 each for my £1 shares and I never thought I would get more than £15",

and he can go off very pleased with his money in his pocket with a cash transaction. Similarly in a share transaction on proper disclosure from his board and proper disclosure from the offeror.—Yes, but I nevertheless do feel sympathy with the management and the directors of the company as I say for which an extravagant bid is made, and there is practically nothing they can do about it.

76. Is there anything they ought to do about it? You see, I suppose if they are salaried directors working on service contracts they will get the proper damages for wrongful dismissal in effect. Compensation for loss of office based on what they would recover in an action.—I am not being theoretical, I know cases where it has happened. It is not a question of financial consideration; it is a life's work that has been snatched away from them, and they do feel very strongly and very badly about it, and anything that could slow down the process. . . .

77. Of course it is awfully difficult. I have your point and it is in a sense a sentimental one?—If you like, yes.

78. Of course that kind of thing is very hard to embody in legislation.—Yes, I think the pressure must come from the shareholders of the offeror company who say, "Wait a minute—you are paying an outrageous price for these shares, we will not agree".

79. The offeror company?—Yes.

80. The offeror company, of course, settles the price; they are the people who are paying the money or providing the shares.—Yes.

81. They may be overbidding and that would not harm the members of the offeree company, at all events when the price was cash.—No.

82. So it really is that there ought to be some means of enabling the old directors to say "We have served you very long and faithfully for thirty years. We have built this company up from nothing; something ought to be done for us", but of course you cannot express that?—No, it is very difficult.

83. Then there is sub-heading (b) under heading 5, disposal of undertaking and assets. There again I take it to be your view that the disposal of a company's

undertaking or assets, or a major part thereof, should require approval of the company in general meeting? I think that is your view?—Yes.

84. Well, that is your view, and obviously there is much to be said for it, but again I would suggest, as is inevitable, that questions of degree come into it, and you might even get directors splitting the transactions up into several so that none came within the statutory definition. If the Treasury says you are not to borrow more than £20,000, if you are a keen hand you form 20,000 companies and each one can borrow up to the maximum.—Yes. This type of difficulty arises throughout.

85. That is bound to arise, but in general where a proposition is sound in principle some method can be devised.—I would have thought so, yes.

86. The Judges are not very pleased if they have to say what is a substantial part of an undertaking and so forth, but that just cannot be helped.—No.

87. Thank you. Then sub-heading (c) of 5. I take your view to be that any substantial issue of shares to persons other than existing ordinary shareholders should require the sanction of the company in general meeting, that is to say other than an issue *pro rata* to existing shareholders.—Yes.

88. Of course where for any transaction new capital is required, the shareholders are already in because any increase in capital has to be sanctioned in general meeting under the Act. But suppose for some reason there is a large lump of authorised capital, but unissued, and the directors determine to issue it—well, of course, under the ordinary article, they can issue it to anyone they choose?—Yes.

89. Is it your view that in a case of that sort before the directors issue to an outsider, an offer should be made to the existing shareholders to purchase *pro rata* to their holding?—I would rather put it this way: that shareholders' sanction should be sought for the issue of the large block of shares to a third party.

90. Yes, but of course if an offer was made *pro rata* to them, that would probably satisfy them.—It may be in the company's interests that the shares should be issued to the third party.

91. Yes, so if you made it simply requiring the sanction of the company in general meeting, that would really cover the whole point?—Yes.

92. Yes, I see. Have you any other instances of transactions which, in your view, should require the sanction of the company in general meeting other than those which the Statute requires to be dealt with in general meeting?—I do not think any others have occurred to me.

93. You have covered fundamental changes, disposal of undertaking and assets, and issue of shares. You think those are really the three main compartments into which one can divide this question?—I think so, yes.

Chairman: I think Mr. Lumsden would like to ask you a question on this.

94. *Mr. Lumsden:* I agree with Mr. Wincott that the shareholders should sanction an issue of shares, but my difficulty is when precisely do you intend that they should sanction it, because the case we have normally is that capital is increased and sanction is taken at that time to an issue of shares by the directors. Does Mr. Wincott suggest that the sanction must be given within a specific time before the issue is made? It would not always be possible to name the body to whom the shares should be issued. If you were going to have a public issue you would not know who the people were.—No.

95. I was wondering if you could be more specific on that.—I think in the first place when an increase in authorised capital is sanctioned, in most shareholders' minds there is an automatic inference that when the shares are issued they will be issued *pro rata* to existing shareholders. It is their equity, and they do not expect part of it to be ceded to a third party without very good reason and consideration that it will be of material benefit to the company. I think that is my starting point. We have had one or two actual examples where 25/30 per cent. of the equity has been issued to a third party—and I think the trouble has been exacerbated by the appearance that the shares have been issued too cheaply to a third party which has riled shareholders. Admittedly there have been benefits to the company, but I still think when it is a question of passing over 25 to 30 per cent.

of the equity to someone who has borne no heat of the day so far, the shareholder should be consulted.

96. Perhaps your point would be met if it were limited to a case where one company or individual was going to obtain a stake, say, in excess of 10 per cent. in the company?—Something like that, yes.

97. *Chairman:* Of course if at the time of the creation of these shares there was an appropriate resolution to the effect that they should be under the control of the directors and could be allotted to anyone the directors chose, that might cover it, but in a case where there is simply a number of unissued shares which have not been earmarked in any way, you think they should be dealt with in your way?—Yes. I do want, as I said right at the beginning of my memorandum, to see information and consultation greatly increased, and where a major change in the ownership of the equity is concerned I think the existing holders of the equity should be consulted—and indeed I think this is being accepted because various company chairmen have given such an assurance to their shareholders.

98. And any such provision, you would say no doubt, should be carefully limited so that it did not prevent the directors from providing qualification shares for a director or making a contribution of shares to the company's pension fund. These small transactions would not come within the burden of this provision?—No.

99. That is that point. Then here again I paraphrase you. You suggest in relation to diversification that shareholders should be kept in the picture, even though sanction in general meeting is not required. And the point I would put to you is this: is it practicable to enforce this by legislation, that is keeping the shareholders in the picture? One knows exactly what you mean by it, but how can one compel it to be done?—I do not know whether this is practicable, but I think on the accounting side you might do it by having new requirements where diversification results in, again, a percentage—20 or 25 per cent.—of a company's turnover coming under a new heading, then shareholders should be informed as to the reasons for

the new venture. Whether actually in the accounts or whether in the directors' report, I do feel that shareholders should be kept abreast of the developments in their companies.

100. Now large companies increasingly send out in addition to the accounts and the formal report of the directors a most informative booklet.—Yes.

101. Telling you everything that they are doing, but usually in an informal style.—Some of them give you the appearance of telling you everything they are doing, but when you try to get down to things they do not tell you very much—we are a cynical race.

102. That is the difficulty, you see. You say it is enacted that the directors should keep the shareholders in the picture and endeavour to do so by a document of this sort, then some disgruntled shareholder goes through this document. So far from being pleased by what he finds, he says there is a lot more behind it.—I think that is a little unfair if I may say so. You see I know cases where companies—and I am not being in the least bit critical of them and it was not false diversification, it was natural growth into a new field—that where over ten years they have probably invested £25 million in this new field, and nobody has a clue as to the progress of this investment—whether it has been profitable or unprofitable, or very profitable or just broken even—and I think it is wrong. I think that when a diversification has reached this scale and a substantial amount of money has been invested, shareholders are entitled to know, and it would be very good for the directors and the economy as a whole if there was a new standard of accounting.

103. You really cover the keeping in the picture by suggesting that accounts should be more informative than they are at present?—Yes.

104. That of course is one of the particular matters which this Committee will have to decide in due course, balancing the desirability of having highly informative accounts with the labour of getting them out, and any objection as regards competitors or from companies and so forth. One has to weigh these pros and

cons and arrive at the balance if possible. But it is difficult to legislate that the Chairman shall send out a copy of his speech to every member of the company and that kind of thing. It seems to me to provide for that kind of thing by legislation would be very difficult indeed.—Very difficult, yes.

105. There is this general point as regards obtaining a sanction in general meeting that a company may be inhibited by the need for getting consent when the directors desire to embark on some obviously advantageous transaction. If they have to say to the opposite parties of the negotiation "I am afraid we shall have to hold this up for a month to get the sanction of our shareholders—in the meantime we can only give you a conditional agreement", a company in that condition might be at a disadvantage in competing with a company whose directors are empowered to do such things without reference to their company. You see what I mean?—I have seen this difficulty. Could it be overcome by imposing the equivalent condition on all companies?

106. Yes, then if this applied to all companies . . .—They all start level on it.

107. Of course the ordinary way is to do a conditional contract, but they are very difficult to frame.—Yes.

108. But that is just another of the problems. The shareholders may have to choose between a lesser degree of control and a possibility of untoward interference in the directors' transactions.—Yes.

109. Next we come to something which is very near your heart and it is this: I appreciate the force of your objections to shares with restricted or no voting rights, but there are arguments the other way both as to the need for and the practical difficulties involved in abolition. Then I would refer you in particular on this to the memorandum contributed by J. Lyons & Co. Ltd. We did supply you with that?—Yes, I saw that.

110. That is an example where it is claimed that voteless shares served a very useful purpose.—Yes.

111. Have you any further comments to make on this? You deal with it fairly fully in your memorandum, do you not? —Yes—If I might say this? I find it difficult to express this, and I certainly do not want to become political, but if the taxation system of this country is wrong—as I would call it wrong—I do not think the company law should be framed to protect people from the consequences of a wrong taxation system.

112. Voteless shares?—Yes, this I think comes into this, you see.

113. Is this a death duty point, income tax?—Income tax and death duties, you see. People say we must have voteless shares because of death duties because we shall lose control of the company. I think it is Utopian to say so, but the thing to do is to put the taxation right and not to have what I regard as a wrong feature in the company world, which is these voteless shares.

114. That is a ground underlying your objection to voteless shares, a general as opposed to a preliminary ground?—Yes.

115. I appreciate that point.—But in the case of Lyons, until quite recently—whether as a result of most of the shares being voteless or not—the equity of that company was virtually a fixed interest stock. It had caused considerable hardship to the public shareholders. Further, on this question of the particular value of a certain man or group of men to a company—and we have heard this argument quite recently in connection with Thorn Electrical—that if they had had all voting shares they would have been taken over through a take-over bid—I think the answer to that is that the take-over bidder does not want the physical assets of the company, he wants the man. They wanted Jules Thorn without any doubt who is a genius in that company, and if Jules Thorn had said "I am not going—if you buy my business you do not get me"—they would not have bought the business.

116. Yes, but of course the old-fashioned view on this is that a share is no more than a bundle of rights. The subscriber, for the purchase of a share, becomes a member of the company; he

has a contract of membership which confers on him certain rights.—Yes.

117. Of course those rights may vary infinitely. There is no limit to the power of the company draftsmen to evolve new kinds of shares every day, and a shareholder is not entitled to a vote simply because he is a shareholder; he is entitled to a vote because his contract with the company said "You shall have a vote". That is the old-fashioned basis of discussion?—Yes.

118. Very well then. If one is going to combat that condition on the ground of unfairness, one might say that everyone must have a vote in respect of each share which he holds. And that will not carry you very much further because of divisions and splitting and having so many pound shares and so many shilling shares.—I am not very expert on the Indian and South African Companies Act, but I understand in both countries they have made non-voting shares illegal, and I am not aware of any of these difficulties having subsequently arisen.

119. I think they are inherent.—I am aware of the danger, yes.

120. You can abandon the system where everyone has a vote per head. That obviously is a very rudimentary arrangement. If in order to get rid of the difficulty about splitting and having some pound and some shilling shares and so on, you say each shareholder shall have one vote for every one pound nominal ordinary share of which he is the holder, that perhaps is a little advanced, but why should one differentiate between an ordinary shareholder and a preferred ordinary shareholder, or preference shareholder or deferred shareholder—each with different rights in the equity. Where does one draw the line?—I think the difficulty would arise on participating preference or preferred shares. But I would have thought that on the usual preference or preferred it is a clear-cut contract with a limited risk with no stake in the equity benefits, or only a limited stake in the equity risks . . . I would have thought that it really is the equity that matters. It is only the equity.

121. Yes, but you see the equity can be notionally divided into slices. On

what principle or basis should one say an ordinary shareholder should have a vote whereas a preferred or deferred or participating shareholder should not have a vote?—I have said that there is this difficult shadow territory between the fixed interest and the equity. I do not know whether it would be possible to gear the voting element to the degree of equity in the participating preferred.

122. It might be extraordinarily complicated.—Extraordinarily complicated, yes.

123. You dislike these shares so much that you would uproot them?—I would.

124. And retrospectively?—Yes. It is the only case where I would favour retrospective legislation.

125. Would these palliatives, I suppose you might call them, be of any help? I think it is only one point really. Might it not be true to say that the objection is really against having voteless shares, as it were, afloat on the market rather than objecting to the original issue of such shares?—No. I think my real objection to them is that you can get a situation where two companies control each other and are responsible to nobody in this country at all.

126. I see. So it would not meet your objection if, for instance, one confined the objections to quoted shares?—Yes it would.

127. So is it not right to say that your objection is basically against such shares being dealt in?—Yes. I think really I might say this. My objection is to people making a convenience of the capitalist system through the medium of voteless shares in public companies.

128. Yes?—They get all the benefits of it without really the responsibilities.

129. Of course I think there are methods—or methods could be devised—of financing a company by means of securities framed in this way or that, which would put them very much in the position of a voteless ordinary shareholder.—I think I did touch on this and I think I tried to put the responsibility on the

Stock Exchange once the slate had been wiped clean, to watch any share that they thought was getting round the legislation.

130. It has been suggested to me that your intention here runs counter to what you say about the position of the directorate in a small company.—I would like that elaborated.

131. If the shareholders had no votes the directorate would be protected.—They would be protected, but the shareholders of the company would suffer.

132. You cannot have it both ways.—No, we cannot have it both ways, but what I was trying to get at on the question of the smaller companies and the take-over bid was to allow time for public opinion to bring pressure to bear. I do not really think it is inconsistent.

133. But it may sometimes work out one way and sometimes another.—Yes.

134. That I think is all we need say; you have made your position clear in your memorandum and what you have said this morning. Then the next one rather goes to the New World to redress the balance of the old. If I might elaborate; you suggest the setting up in this country of a body analogous to the Securities and Exchange Commission (S.E.C.) in the United States, to which, e.g., "stranded minorities" could refer their complaints. That is the suggestion, the setting up in this country of a body analogous to the Securities and Exchange Commission to deal with minorities who find themselves in a disadvantageous position. Have you had any reasons for saying that such a project would be an improvement on the Board of Trade and the Stock Exchange as a watchdog?—If I may go back a little; it may not necessarily be entirely relevant to the Companies Act and this committee, but I would like to see somebody, whether an S.E.C. or a branch of the Board of Trade, somebody to keep an overall watching eye on all solicitation of money from the public in whatever form, by shares or deposits through building societies. We have sat watching and writing articles for two to three years and nothing happened. Officialdom was powerless. The consequences were disastrous. I cannot help feeling it could not have happened in the United States with

the S.E.C. Then there is rigging of Stock Exchange markets which one knows goes on to some extent, I am not sure to what extent that is really effectively covered. Again, I do not think it is as effectively covered as in the United States.

135. Would it be too much to ask for some details of how this body would work?—Since I wrote this memorandum the Board of Trade has in fact acted in quite a number of these incidents of stranded minorities. Had that action been taken before I wrote my memorandum it would have been written differently. I think the Mias Group and the State Building Society, and indeed the setting up of this committee, has already had its effect, and maybe an S.E.C. is no longer necessary. I am not arguing exclusively for an S.E.C.; if the Board of Trade can tackle these things—that is fine! But there have been very great gaps through which these people have operated. These complaints to which I refer here are really a dreadful business, the small unsophisticated shareholder, not in a minority, very often in a majority, but these people who make the bid just get 30-35 per cent. of the capital, the Stock Exchange very rightly withdraw permission to deal, the public shareholders are left with an unquoted security, the funds of the company taken over are being diverted to projects of which the shareholders are ignorant and to which they have not given any conscious consent. Nothing is done from month to month—although the power is there in the 1948 Act.

136. The question might be put in this way. Do you think the Board of Trade's action in such a case as that to which you have referred was adequate in fact...? —I do not want to be unfair...

137. I did not mean to be unfair. You criticised the Board of Trade in a fraudulent transaction.—We do not know that it was fraudulent.

138. A suspicious transaction?—Yes.

139. And on that ground chiefly you would say we ought to have some counterpart of the S.E.C. You suggested that might work better.—I cannot help feeling that if somebody was concentrating

all their attention on to this type of transaction, or on to a company like the Mias Group which is advertising to pay 12½ per cent. on deposits; if somebody was concentrating on this type of transaction they would get a lot of co-operation from the financial press. We have co-operated, and do co-operate, with the Board of Trade. If somebody from this body went knocking on the door of Mias and said: "How exactly do you pay 12½ per cent. on your deposits?"; if somebody had the right to ask this and to say: "Can I look at your books? What do you own?", I think within three weeks the Mias Group would have stopped. Instead, it went on.

140. It may be desirable, I am not saying it is not, to have a special supervisory body; but might not the same result be achieved by strengthening the department of the Board of Trade which deals with such matters?—I would be delighted with that.

141. That might be a way of arriving at the same result.—Yes; it is probably unnecessary to set up a new body, but to give the old one new powers.

142. No amount of powers or formalities are any good if the body has not got the manpower.—No, and this is often a very specialised field.

143. On the other hand, you do not want the credit of honest companies to be injured by interference, perhaps unjustifiable.—No.

144. Under the existing law I imagine the appointment of a Board of Trade Inspector to go into a company's affairs does not have an exhilarating effect on its credit.—No, I am sure.

145. So that you might get cases where action was too precipitate and grave injustice was done. All these things have to be considered.—Yes.

146. The next one is on your heading (9), page 10 of your memorandum. The heading deals with protection of special classes of shares. The context is the getting rid of preference shares on terms which are unfair to holders, that is to say, to repay at par a high coupon preference share which would otherwise command a premium in the market. You say generally speaking the protective organisations

of the institutional investors can be relied upon to prevent unfair treatment of this kind. You conclude your remarks by saying, "It remains to be considered, however, whether there may be a case for statutory protection of preference shareholders by requiring that they shall be given the option of being repaid either at par or at an average of market values before the proposal for repayment arose." Can you amplify that statement?—What I had in mind here is that I know there are some companies in which the institutional investors are not interested and there the preference shareholders may be in a pretty wretched position.

147. The kind of thing would be where a company got rid of the preference shares simply by winding up and reconstructing?—Yes, I believe following the nationalisations, it was laid down that companies not only had the right but a duty to repay preference shareholders if they had surplus funds.

148. I was concerned in a case years ago about 7 per cent. preference shares, I think, and the company had plenty of money so they petitioned to pay them off. In those circumstances their rights in a winding up of the company applied; so that these preference shareholders could be paid off and lose their 7 or 8 per cent. It was not considered an infringement of their rights because it was exactly in accordance with the legal position, and so it is in the case of winding up.—And they may have paid 35s. for a £1 preference share, and yet all they get is £1.

149. In your view that would be worth looking at.—I always have a great sympathy for preference shareholders, because I can never understand why anybody buys preference shares and they always get the sticky end of every transaction. So I would just like to do what I can to make life a little happier for them in these circumstances.

150. I think the committee would agree that this is a point worth looking at. But again, as in so many cases, one has got to walk warily because all these shares have their rights, and if something special is done for their protection there may be another man in a different class who says, "I would not have subscribed if I had known that these people were going to be

favoured." There are two sides to the question.—Yes. Of course conditions have changed here greatly with the rise in interest rates.

151. Then there is the vexed question about disclosure of nominee holdings. You would be in favour, but you do not think it is practicable?—It is practicable if the penalties for non-disclosure are sufficiently penal. What I can foresee is sufficiently nasty-minded people building up a whole chain of nominee companies and making it virtually impossible to get at the true ownership. I certainly do not want to do away with the convenience of nominee holdings; by all means let them continue, but ownership should be disclosed in these circumstances. I am not a legal expert and I think I know what I want done but not yet how it should be achieved.

152. You say in principle you are in favour of the disclosure of nominee holdings so far as it can feasibly be done, and the exact method by which it might be done to some extent you leave to the lawyer?—Yes; I believe the Cohen Committee recommended that there should be disclosure and Parliament rather than away from it.

153. There was a breakdown on the complications of the particular draft provisions.—Yes.

154. We have had a number of suggestions as to how this might be done to some extent. One is that when anyone holds, say, 5 per cent. or more of the capital he should be required to disclose the fact if his holding is held through nominees. That would achieve the result to some extent?—Yes; but again you could have it split, and split with members of the family.

155. One of the troubles is that it is so difficult to evolve a scheme which would not give a lot of work.—Yes.

156. The next possibility is that the directors should be empowered to enforce disclosure by some particular individual if it occurred to them that there was nominee buying going on; they could compel him to say what his beneficial interests really were. That could cause a certain amount of annoyance to people who have no intention of doing anything underhand.—Yes.

157. Thirdly, it has been suggested to us that companies should not be allowed to hold any shares of which they were beneficial owners otherwise than in their own name. It is suggested that this would possibly deal with most of the cases where it is claimed that disclosure is desirable because so many of these nominee cases do involve companies.—That is quite true; on buying for take-over bid control it is invariably companies.

158. I do not know if we can carry that much further; you would welcome any feasible scheme. Then you make an observation about the directors' dealings in the company's shares, Section 195, and you say, I think, it ought to be extended so as to cover shares not directly held by a director but in which he is beneficially interested. Looking at Section 195, it does occur to me it is wide enough to apply to shares held in trust and shares in which a director has indirect interests as well, and I was wondering whether this point was not really covered by the Section as it stands?—Would it cover shares held by a director's wife?

159. I should think it might be said the director has a beneficial interest.—Or his children?

160. Do you mean to include both? The words I was commenting on suggest a case of trust, where the shares are held by someone in trust.—I have already said we are a cynical lot, financial journalists, and one has reason to believe that the shares are not always held in the obvious name.

161. What that comes to is that you suggest the possibility of extending Section 195 to cases such as those as shares held by members of the director's family?—I do not know whether I would go as far as that, it might be unduly restrictive; but I would like to be quite satisfied that any shares in which a director is beneficially interested ought to be on this register which should be available throughout the year.

162. The section says, "the shares which are held by or in trust for him or of which he has any right to become the holder (whether on payment or not)". That includes holdings in his own name and holdings in a trustee's name or any persons on whom he can call?—Yes.

163. We might have a look at the question and see what emerges. On heading 14, carrying on business through associated and subsidiary companies, have you considered the suggestion that holding companies should be liable without limit for the debts of their subsidiaries, or a proportion thereof corresponding to their shareholdings? This is a revolutionary suggestion and it is intended to deal with the kind of case where a company acquires a number of other companies and they all carry on business for the benefit of the holding company, yet the holding company is under no liability to settle their debts.—I am more concerned, not with the company that comes to grief, but the company that does terribly well but nobody knows how well it is doing. Really I am being very broad-minded about this because this present set-up gives us great fun and tremendous scope for detective work, finding out exactly what these associated companies are doing; all that would go if they disclosed what they were doing. But it is true there have been some rather shocking things, where you find an interest in an associated company which was valued in the Balance Sheet of the holding company at £31 and that is what it was thought it was worth, but when it comes to a take-over bid you find it is worth £30,000. This sort of thing has happened quite frequently recently. I think this is one of the major accounting deficiencies of the 1948 Act in the light of our recent experience.

164. The particular suggestion made you say you are really not concerned with, the suggestion that holding companies should be liable without limit for the debts of their subsidiaries, or a proportion thereof? Obviously it is an original suggestion.—Yes; it seems to me to be reasonable. I have not come across it before.

165. It might be difficult to carry out; but do you think it is worth looking at? —I would think so, yes.

166. Heading 16, take-over bids. The point there is just whether you have anything to add on that in view of the new rules made by the Board of Trade? —No, I thought they were admirable.

167. Most people seem to be well content with them.—Yes.

168. Heading 21, accounts. On that I take your main points; first, that turnover should be disclosed; and secondly, fixed assets should be valued periodically. You make those two points?—Yes.

169. As regards disclosure of turnover; you appreciate that it is thought by some companies that this would be prejudicial to their interests. May not the answer be that such disclosure may be desirable in some cases but undesirable and even impracticable in others according to the circumstances, (size and nature of business, sphere of operations, and so forth) of the particular company concerned? That is really putting it as to whether you think an obligation to disclose turnover should be applied rigidly in every particular case or whether one might look at each case with regard to the character of the business.—I would have thought it had to be either black or white on this; that you could not really differentiate.

170. You have to have one rule?—I would have thought so, yes.

171. And the other one, that fixed assets should be valued periodically. On that might not the question of expense be a serious consideration for the smaller company? A periodical valuation of their fixed assets will attract considerable fees, probably.—Yes. I am not a valuer, but I would have thought the fee would be proportionate to the size of the company, and in any case I imagine most businesses must have some sort of valuation periodically for insurance purposes.

172. On current or realistic values?—From the shareholders' point of view it would be more appropriate than the Balance Sheet assets in many cases.

173. Then there is a suggestion as to whether this requirement of valuation might be confined to companies whose shares are quoted, leaving out the private companies.—I am sorry; here again I am concerned with the public companies, quoted companies.

174. Do you agree that any legislation would need to contain some guidance as to the method of valuation adopted, or at all events require the method used to be stated? That would be necessary or people would not know what they were talking about.—Yes.

175. The next one is the exemption of banks, and so forth, from certain requirements as to accounts in the Eighth Schedule to the Act. The Cohen Committee found there were sufficient grounds for granting the exemption of banks, insurance companies and discount houses; it was extended by the Board of Trade under their rule-making power to shipping companies. My question is whether you rely on any particular change of circumstances to make it now desirable that these exemptions should be withdrawn?—I think I do. I think on banking and insurance companies I rely on the change in general monetary and economic conditions. I think historically the banks' case has been the fear of a run if their investments have depreciated and there is nervousness on the part of depositors. Quite frankly, I do not think at this present time that the bank depositor runs; it is only changing one piece of paper for another, one book entry for another. He might run to another bank. I think that would not be a bad thing if it brought about better banking or better investment policy by an insurance company. But I think the old classical concept of a run on the banks has much less force in these days. We know in recent years most of the banks have had to qualify their investment valuations in their accounts. I do not believe any depositor had the slightest qualm; if it was pretty widely known that big investment losses had been suffered I do not believe any depositor would have the slightest qualm.

176. On the other hand, is there not something to be said for the view that if it is advantageous or might be advantageous to their interests abroad, and so on, it would be a mistake for the sake of completeness to withdraw this exemption of these bodies if there is any solid ground for supposing that concealment enables them to carry on their business.—I think the force of what I said is that the good banker or good insurance company may be robbed of the benefits of their good judgment and good management, which seems to me to be rather regrettable.

177. Shipping companies seem to be in a class by themselves.—I think I know the background to the shipping companies' exemption, and that was the fear of

Japanese competition in particular. I am not very convinced by this argument. I am sure most shipping companies know pretty well what their competitors are doing, and I think the case for continuing exemption has been made very much weaker by reason of the fact that the P. & O. does not take advantage of it now.

178. Your conclusion on this matter of the banks and discount houses is on the whole that you think the exemption is not warranted?—I do not think so. I do not think it is in accordance with modern conditions. The American banks do not have it; they have much more informative accounts. They do, it is true, have a Government scheme for insurance of deposits, which is another consideration.

179. There is one general observation. It is fair to say that views on accounts are divided into two, one in favour of standardisation and the other in favour of dealing with each case on its merits.—Is this standardisation for all banks?

180. No, of accounts generally—questions like valuation and what is meant by profits, and so forth, matters on which there is some divergence of opinion. Do you think all accounts should be required to be drawn with set headings?—I have not thought very much about this so far as companies are concerned, but it has been a very great convenience in examining building society accounts, the standardisation there. You do know within very minor limits that you are looking at the same thing when you are looking at a certain item. With a building society you can do it; whether it would be feasible to do it over the whole range of companies is another matter.

181. I do not think we can carry that much further. As to your watchword, "Consultation and Information" the question is, can you make any suggestions as to its enforcement by legislation? I think we have really covered that.—Yes. The only way to do it really is through accounts. I know the arguments that the accounts are already so complicated that you cannot go any further, but I do not accept that argument, because the next thing on the public relations side is to publish a child's guide which the directors send out with the full accounts.

182. *Mr. Watson:* I have a question on banks, if I may. You obviously do not

agree with the findings of the Cohen Committee on this. You do not accept their statement that the interests of the depositors and insurance company policy-holders override the interests of the shareholders?—I do not altogether accept that the interests of either depositors or policy-holders are served by what I would call obscurantist accounts.

183. Your feeling is that there has been a set of circumstances and events since the Cohen Committee's consideration of this matter which has tended to alter your view?—Yes. This has occurred to me. I remember in the 1930 General Election the Post Office scare when one of the parties put about the fact that deposits in the Post Office Savings Bank would be snatched away somehow or other. I do not believe anybody would believe such a story these days. I think the whole attitude towards paper money has so changed these days. Possibly a withdrawal of overseas deposits might be dangerous, but so far as the domestic depositor is concerned, I find it very difficult to believe he would line up outside his bank to withdraw deposits. What can he do? Stick it in another bank which may be as badly off as the one he has drawn it out from? I do think there are new underlying conditions here to-day.

184. And you feel the absence of full disclosure is to the detriment of the interests of the shareholders?—I think it may be, yes. I do not know what the true position is, so it is rather difficult to say. What I would say about this is that I hate obscurantism because you always get exaggeration; the risks get exaggerated, the merits get exaggerated. I am all in favour of having the facts. People get unduly nervous if they are not given the full facts; they get unduly optimistic if they are not given the full facts.

185. You give an example in your memo of a comparison between two banks. Is it not possible that you could have two banks of identical size so far as deposits are concerned and the customers of one bank may be large borrowers and have borrowed say 50 per cent. of the deposits in that bank, whereas the customers of bank B are not such great borrowers, have not such a great appetite, and they may have only borrowed 30 per cent. of the deposits from bank B.

As a result of that bank B has much larger investments than bank A, and yet both banks as suggested may have been following identical policies on investment policy, but when there is a fall in values the total depreciation in the investments of bank B may be doubled.—Having regard to their different circumstances I would say, should they have followed the same investment policy?

186. You would agree that possibly this question of the amount of depreciation shown may not be altogether an exact measure of the responsibility or the ability of management?—No, it may not.

187. *Chairman:* I think that almost concludes the questions I had in mind to ask you; but I conclude with the hoary dilemma as to how you make the shareholders take an interest? People will throw notices and so on in the fire and say, "I suppose it is all right". How can you change that? What can you do about it?—That worries me tremendously. Take, for instance, a company such as Bowaters. They got a large attendance of shareholders at their meetings through a series of gimmicks; they dropped the gimmicks and this year they still got three thousand shareholders without any gimmicks. I think that if a company deliberately goes out to do a job on these lines something can be achieved. But take, on the other hand, a company where there is obviously something wrong and fifty shareholders turn up at the meeting; they never ask a question and yet the whole thing is shrieking out for shareholders to ask questions. It saddens me a great deal. I think we tend to overlook the fact that in this day and age shareholders are working people and very often they cannot leave their jobs to go to company meetings. And I think the shareholders in fact are more effective than people are willing to allow. Certainly when things start going wrong, shareholders can and will act. Also it is analogous with the position in the trade unions and local elections; it is a problem of democracy really. The only thing we can do is push ahead and try to educate and encourage shareholders in their responsibilities. It is a heart-breaking slow process.

Chairman: Thank you very much. I think Mr. Lawson has a question to ask.

188. *Mr. Lawson:* I have one question about valuation arising from your earlier remarks about current values. Do you think there is any danger, if you have the general practice of valuing fixed assets, that the shareholders would feel that those assets had that value and if anything goes wrong they could be realised at that figure, whereas of course in so many cases the value of a particular asset is ultimately bound up with the working of the company?—I know. I think I would say on this that again it is a question of public relations. I think boards can put it over. Secondly, I would say a company like L.C.I. has had two revaluations in the post-war period and seems to have handled this problem. I do not think people have got any false ideas about the L.C.I. asset values. I am a maze of inconsistencies on many of these questions because I am a fairly cautious individual. There are some new issues—some prospectuses—I have had to criticise, where the fixed assets have been written up to current values and I am rather allergic to the shares. Nevertheless from an economist's point of view I can see a very strong case for realistic valuation of assets.

189. *Mr. Bingen:* I have a couple of questions. All the evidence you have given is really from the angle of a financial journalist anxious to see that the companies are being informative, and also acting really as a watchdog. People read your articles in the paper and discuss them. You were asked by the chairman how you would make the public more interested in shares. Some companies have trips of shareholders to their works. I know the P. & O. also give selected shareholders a ballot to visit ships. But you must admit that although the shareholders in P. & O., or the shareholders in some other business admittedly get a day's outing at the works, it does not help you as a financial journalist to know more about the running of the business.—Personally I would rather be left alone with the accounts. But I think it does help the average man; I think it gives him a better idea of the scope of the company's interests. But I did use the word "gimmick" and I think it very largely is that.

190. Another question relates to what you were saying in answer to the Chairman about telling shareholders the truth. One

of the points was making a fundamental change in the company's business. I wonder how you would define what is a fundamental change. It is very difficult in a case where you develop a new line of product which comes on the market, quite a new branch which comes to fruition. How would you have a measure of that?—I am in very great difficulty. I know what I mean by fundamental change and other people would not have the same definition. If I may say so, I would hate to give the impression that I am mistrustful of directors; I am not. The stand I take is accountability. I do think when there is a fundamental change in activities then the directors ought to be willing, after a reasonable period—obviously it may take five years or more for the diversification to mature—at some point they ought to be willing to have a new standard of accountability.

191. That is a different question. You are dealing subsequently with the question of accounting. What you were saying earlier was that you have to tell your shareholders what you are doing about the business.—I think all I had in mind there was on the objects clause, that if you started off with a fairly clear-cut objects clause and then you wanted to change direction rapidly, you should consult your shareholders.

192. *Mr. Lumsden:* At the beginning of your remarks you said what troubled you in recent years was that there had been one or two cases where shareholders had been led up the garden path. I am not clear from your evidence what legislative action you are recommending should be taken to prevent these cases. You make a number of suggestions for better relations, but what legislative action?—I did make one remark that a private company should not solicit funds from the public without showing its accounts. Indeed, I think this is the crux of the whole business. You will never stop a fool being a fool with money, but he should have the fullest possible information about the project he is being invited to support so that someone advising him, perhaps a bank manager, can provide him with useful advice. The cases I had in mind I do not think fit neatly into the Companies Act legislation; one was soliciting deposits and the other was a building

society—those were the two really glaring cases where it seemed to me the real trouble could have been avoided if protective action had been taken earlier. But on the Companies Act I must come back to the fullest possible provision of information.

193. *Mr. Richardson:* The glaring cases, apart from the building society, have really been solicitation of deposits; there has been a gap in the law in that the offer of shares is restricted under the Companies Act but solicitation of deposits is not. It is now proposed to cover that under the Act. That will probably cover most of those glaring cases you have in mind.—This is where I come back, not necessarily to the S.E.C., but the law takes so long to act in these cases. This glaring loophole is there and still there two years later and we get very impatient as journalists about it, that the law cannot act more quickly. We knew what was going on in the State Building Society; we wrote articles about it, but the law was pitifully slow in moving to stop it. The Registrar knew what was going on. It seems a dreadful thing to me that twelve months after I write a very critical article, taking considerable risks under the law of libel, twelve months later that building society is still operating, still taking money from the public.

194. *Chairman:* There is a way to proceed by a petition with supporting affidavits; I should have thought financial journalists might have no difficulty in finding persons who had got the necessary standing and suggesting to them that they might take proceedings.—Generally one of the difficulties we find is that people are not always willing to come forward. They go and make an ass of themselves and they do not want publicity. They will come to us or write to us privately and we can pass it on to the Board of Trade, but I think very often they do not want to appear publicly.

195. *Mr. Lawson:* I do not think it is quite fair to say that the Registrar knew what was going on with the State.—Of course you know better than I do; but my impression was that he did know. I am not being critical; he had no power to act. I do not say he knew everything. It was not only the State; there were several other similar building societies.

196. *Mr. Althaus:* Is it your impression that Stock Exchange vigilance in these matters on the whole has tended to become keener over the years? Clearly it is a wide field. But I am obviously an interested party in asking this. I had a great deal to do with it and I wondered what your impression was.—I think it has; where real fraud has taken place I think the Stock Exchange is much more keen. I do not want to be offensive in any way. I do think the Stock Exchange should have acted a long while ago in the matter of voteless shares. The New York Stock Exchange has prohibited them and I would like to have seen our Stock Exchange take the same line; I think they cannot now take that line as so many horses have gone through the stable door. On the question of prospectuses I think the Stock Exchange is much more vigilant and I think general standards are rising too in the City on this.

197. *Professor Gower:* Do you think the scrutiny by the Stock Exchange of prospectuses is as effective as the S.E.C.? —I do not think it is. The objection to the S.E.C. is that it is too thorough, you are forced to produce such a monumental prospectus that nobody can get through it. That is a criticism I do not accept. I would have thought, by and large, that the Stock Exchange scrutiny of prospectuses was quite adequate. It cannot guarantee all along the line, but I think it is pretty thorough.

198. Are you alarmed by one or two prospectuses published recently by companies which are not seeking a Stock Exchange quotation. I have one here dated 21st January, 1960, something described as an 8½ per cent. cumulative participating 5s. preference share, with rights up to 12½ per cent. per annum.—Yes, I am indeed.

199. The difficulty of leaving it to the Stock Exchange seems to be this kind of thing.—Yes, I am very worried. They carry out massive circularisation campaigns and it must cost a great deal of money. There have been one or two very bad ones, or at least I think they are; the trouble has not come yet.

Chairman: That invites subscriptions to shares and it does not say it is going to come on the Stock Exchange.

Professor Gower: It has never come on the Stock Exchange.—I think they did make a misleading statement which they subsequently corrected when we drew attention to it.

200. *Chairman:* The point is if promoters do not seek a Stock Exchange quotation then the prospectus does not come under the scrutiny of the Stock Exchange.

Professor Gower: The point I am making is this, that there is no real scrutiny so long as the promoters publish a prospectus which complies with the Companies Act; nobody will scrutinise this.—That would not have got through the S.E.C.

Professor Gower: Nor the Stock Exchange either.

Chairman: A prospectus could be a perfectly honest prospectus without being of the standard required for the Stock Exchange. The point here is that this prospectus, whether good, bad or indifferent, has never come under the scrutiny of

the Stock Exchange because they do not want a Stock Exchange quotation. The prospectus may be perfectly good. So this point is really relevant only on the question of scrutiny.

Professor Gower: Yes, definitely.

Chairman: If it is untrue the authors of it are liable to penalties attracted by people who put out false prospectuses.

Professor Gower: I am sure nothing here is untrue; but had the Stock Exchange scrutinised this they would have wanted a lot more than is here.

Chairman: The public do not have the benefit of the Stock Exchange view on this.

201. *Professor Gower:* Could I ask how many of these there have been recently? —To my knowledge two; there was another one within the last two months.

Chairman: Thank you very much; we are very much obliged for your attendance and help.

(The witness withdrew)

(Adjourned until 2 p.m.).

MR. H. R. MATHYS, MR. H. L. LIGHT, and MR. J. M. EDWARDS, called and examine

202. *Chairman:* Mr. Mathys, Mr. Light and Mr. Edwards, I understand you are Director, Secretary and Deputy Legal Adviser of Courtaulds respectively?—*Mr. Mathys:* That is correct, Sir.

203. Before we embark on the questions, I would like to say how grateful we are to Courtaulds and yourselves for assisting us in this difficult matter. The members of the Committee have all studied your memorandum, so it will be unnecessary for us to take up time by going through the whole of it at length; but there are various matters on which we would welcome your views. The first one is on shares of no par value. You say in your memorandum that the company has no objections to the recommendations of the Gedge Committee on shares of no par value. Are we to take it from that that

your company has no interest in this matter one way or the other, or have you any positive view?—Insofar as we have a positive view, we would favour no par value shares.

204. Although you are not particularly concerned one way or the other?—No.

205. Yes, I see. Then there is the question of the contributions to charities and benevolent objects. I understand your present policy to be one which I take it is adopted by many companies, that you contribute to charitable or benevolent objects where it may reasonably be said that it is in the company's interest, for one reason or another, to do so?—That is broadly the policy, yes.

206. And what would be your view of a power to subscribe to such objects,

irrespective of their advantage to the company?—It would certainly help us to a certain extent if we had power to contribute. At the moment the way these things are worked by most companies of our size is that we have a board committee who are charged with deciding whether or not these things should be done, and there are inevitably a number of borderline cases where it is not always easy to say whether one should or should not; obviously in these cases one has to decide in relation to the interests of the company and of the shareholders.

207. Subject to that, you would like to have as free a hand as possible?—Yes: that is for charitable donations, not for political ones.

208. It is really benevolent objects generally; and the political, of course, is rather difficult to define?—Yes.

209. Then you support, I understand, the recommendation of the Cohen Committee on the question of *ultra vires*?—Yes, that is so.

210. That is to say the recommendation that any corporation should have all the powers of a natural person, and the position as between directors and shareholders as to the powers of the directors and control by the shareholders would be left to a document which simply had domestic effect within the company but which did not concern any third party?—We would subscribe to that, yes.

211. Do you see any difficulty from this point of view—you invest a company with all the powers of a natural person, and that would enable the company to do anything whatever it chose, without regard to any particular business?—In practice, of course, I am not conscious myself that we have ever felt any limitations, because one's articles of association are so widely drawn one just does not feel that limitation.

212. You feel really that it would not make much difference, if any, in practice if you gave the company all the powers of a natural person, in the position as it stands, where the company operates under a wide memorandum?—I would say no difference whatever.

Mr. Light: I would agree with that, Sir.

213. On this recommendation I was somewhat impressed by the possibility of a third party dealing with the company entering into some transaction with the company which was *ultra vires*. Might that not create difficulty if the Cohen Committee's recommendation were adopted? Your third party might enter into some transaction knowing full well that the members of the company had forbidden the directors to embark on that particular transaction. It seemed to me that if the natural person principle is adopted that could be done with impunity by a third party.—Mr. Mathys: Yes. I think it is rather difficult for us in our position to visualise that sort of problem arising.

214. You think there is no practical significance?—Not from the point of view of a big organisation like ours, which deals in so many things and naturally enough has so many checks to ensure that we do not get, and are not likely to get, into deep water.

215. So you would be quite happy for the present rather curious situation to continue, under which the objects of the company are expressed in the widest possible terms?—We would be quite happy because it does not inconvenience us, but we think it logical and reasonable that the recommendations of the Cohen Committee should be accepted.

216. Yes. Then the question of the fundamental changes in a company's activities: you express the view that such changes should not be brought about without reference to the shareholders. Am I right in taking that to mean without the prior approval of the shareholders?—Yes. Our feeling would be that one should not enter into any fundamental change to the company without reference to the shareholders at a meeting.

217. And the difficulty there is really deciding what is a fundamental change?—If one tries to put it down in writing I think it is very difficult: in practice, one ought to be able to gauge. It is really a matter of the relative size of the operation and of the company.

218. As regards your own directors, would they say "We feel this matter is

one of such importance that we really ought to refer it to the shareholders?"—That has been our way of working in the past, and where we have taken a big step we have always done it on the basis of the outcome of a general meeting or a special meeting.

219. But if it was necessary to draw a strict line between fundamental changes and non-fundamental changes, it would be a difficult task?—It would be not only difficult but embarrassing, because there are some things which might in their nature represent a fundamental change to the business but which are so small in size that obviously they would not be made the subject of a special meeting.

220. The suggestion has been made of a change that, over a period, produced something fundamental, but it is a gradual process.—I would find it difficult to say how one could draw a line. This is the sort of thing which is probably more appropriately in a code of practice than written into a section of an Act.

221. Then there are three matters which, it has been suggested to us, are proper subjects for reference to shareholders: (a) additions to, or disposal of, the company's undertaking; (b) borrowing powers of the company and issue of new capital within the nominal capital of the company; and (c) directors' remuneration for executive office. What would be your view—would you think that additions to or disposal of the company's undertaking, or a substantial part thereof, ought to be approved in advance by shareholders?—I think that is emphasising my point. If we are disposing of a holding of 10 per cent. or 25 per cent. or something like that, we would feel we ought to do it.

222. But again no hard and fast rule can be drawn between the sufficiently important occasions and the smaller ones. Then as to borrowing powers, the total amount that can be borrowed or be outstanding at any one time is usually regulated by the Articles dealing with the directors' powers?—Yes, and indeed we have just recently fallen in with proposals which have come from the Stock Exchange to clarify this.

223. I think the ordinary Articles of Association (Table A) impose a limit on borrowing; and the Stock Exchange insists on a limit on borrowing power in one form or another as a condition of quotation. That is right, is it not?—That is my understanding, yes.

224. Do you consider that a satisfactory arrangement?—It seems to me entirely satisfactory. Of course, our total powers are very high and we have very large liquid resources.

225. Of course, this Committee is now engaged in looking at the Company Law in its application to every kind and degree of company.—Quite.

226. And we welcome your advice from your general experience and not only from the standpoint of whether the question is likely to arise in your own business.—Some limitation seems to be desirable, particularly in smaller units. The present scheme seems to us to be quite satisfactory.

227. Now the question of remuneration for executive office: that means such things as the appointment of the managing director and managers from members of the board. So far as my experience goes, it is the universal practice for those matters to be left to the board.—Yes. It is a management matter and a rather difficult question for written rules. If one had to go to the general meeting to settle these matters, one might do it by an overall figure, such as we do with directors' fees.

228. The next point is, in considering the practical value of increasing shareholders' powers in the respects mentioned and other respects, it is reasonable, is it not, to have regard to the probable response of shareholders? If shareholders have enlarged control in matters of that kind is it your experience they will be likely to exercise it?—Perhaps we might ask the Secretary about this. We have more than 150,000 stockholders, and we certainly are not conscious of any control at all from those stockholders, except in a general sense as it appears on a question raised at a general meeting and matters raised in correspondence. But we would not visualise that the stockholders

collectively were really in a position at all to control these matters. That is what we feel the directors are there to do, as the stockholders' representatives.

229. Is there any step you can think of, if it was desirable, which would be calculated to stimulate shareholders' interest and make them appear at general meetings?—There is only one thing which would bring stockholders to meetings, and that is if our results were bad.

230. So in a way one would have achieved nothing by saying that shareholders would be enabled to vote at a general meeting on a fundamental change, if the shareholders did not attend the meetings?—Quite. I think you might be interested in some figures we have of the numbers of persons who attend meetings and the number who sign proxy forms.

Mr. Light: We have 155,000 ordinary stockholders. We recently had an extraordinary general meeting. About 120 appeared at the meeting, of whom about 20 were co-partners—we have a co-partnership scheme in which everyone other than directors can share. That might be taken as evidence of apathy: on the other hand, proxies were filled up by some 25,000. Out of 155,000 that is rather small. As regards your earlier question to Mr. Mathys, on stimulating the interest of stockholders—it is a difficult thing. We have tried, and the Board continues to try to stimulate interest, believing it to be fundamentally wrong to do nothing: but it has proved to be long, unrewarding toil, and there is not much evidence that it is stimulating interest. On the other hand it is quite true that where results are bad you get very much improved attendance. As long as results are good, you get a small attendance. I would not necessarily take that to mean that the system is wrong and needs changing.

231. Thank you. Certain suggestions have been made to the Committee bearing on this matter of shareholders' interest; amongst other things the possibility of members voting by postal ballot has been suggested. Have you ever considered that possibility?—*Mr. Mathys:* I am

not conscious that we have ever considered it. In one way the proxy forms which are sent are a form of that.

232. Of course every proxy form is in a way inviting members to vote by something resembling a postal ballot, in the sense that they cast a vote by returning a form, although not present.—And it indicates the way they hope the vote will go on a resolution.

233. There is a suggestion that a full explanation of the proposals made by the board should be circulated with the proxy forms. Some resolutions or proposals obviously would not merit very much extra explanation: they might be reports on purely routine matters?—Yes, a lot of these things are routine. Where we have had a special point to put, such as the increase of authorised capital or matters of that kind, then it has been the custom to give some explanation to indicate what the resolution means, but not in the case of straightforward routine matters such as the acceptance of accounts.

234. And perhaps it would hardly be right to lay down a universal rule for all cases, important and unimportant, to the effect that an explanatory circular should be sent out?—I would think it would be very unwise to try and do it by rule. This is another matter on which we feel, as Directors, we have a responsibility in certain circumstances to make sure the stockholders fully understand what they are being asked to do. If we feel further explanation is required, we give it.

235. That is a matter for your judgment and not for strict rule—that is the way you look upon it?—Yes.

236. This point has been raised, that in the United States companies may claim against the directors any profits the directors make in dealing in that company's shares: that is to say that if a director bought some shares in that company on 1st January, 1960 and the company finds him selling them in June at a profit, then the company can ask him to pay over the profit he has made. That apparently is the case in American law. I was wondering what you thought

of the possibility of applying it in this country.—In our own case, none of the directors ever deals in our own shares without consultation with the Board, and none of us ever takes any steps which could be interpreted as speculating in our own shares. That is something which is right outside our ideas. Here again I would find it difficult to see how one could draw a line. We are shareholders and we have to be shareholders and, subject to holding our special qualifying shares, it seems difficult to draw a line as to whether one can or cannot sell them. But it is our practice, and I expect it is the practice of companies similarly placed, not to put ourselves in a position where we are suspected of speculating in our own shares.

237. And of course if one considers every kind of company, great and small, the considerations to be looked at in deciding whether some deal is an improper speculation in the company's shares will depend on the circumstances of a particular case?—Yes.

238. What do you think of the question of disclosing beneficial interests in shares which, as I expect you know, was much discussed in the Cohen Committee, where a recommendation was made which was finally jettisoned in the course of the debate on the Bill on the grounds that it was impracticable?—Our general feeling is that if it were practicable we would like to know who were the shareholders, but we believe it probably is not practicable to try to establish precisely who owns the shares. We recognise there are certain advantages, not only to the shareholders but indeed to the company, where blocks of shares owned by a number of different people are handled by one nominee. That sort of thing we would not wish to eliminate. It is not big enough to influence our transactions.

239. And there is no ulterior motive behind it?—None whatever: it is an act of administrative convenience.

240*. And there is a suggestion that a parent company should be made legally

responsible for the debts of a subsidiary. What do you think of that, as a general proposition?—In our own case we would accept that that was normally an essential part of our business. In the ordinary way, we would not allow one of our subsidiaries to get into difficulties which we did not recognise as our own responsibility. The problem comes down, to some extent, to what is a subsidiary?

241. Take the wholly-owned or almost wholly-owned subsidiary. The suggestion in a hypothetical case is that it is hardly fair that a company should be allowed to form, say, six other companies, own all the shares in them and let the companies carry on distinct businesses and, if one or other of them fails, do nothing to save them and let the creditors suffer.—We certainly would not entertain that.

242. No: so your answer on that would be that in practice your company would not allow that situation to arise?—We certainly would not allow it to happen. The only problem I can see is the varying nature of one's holding in subsidiaries. If one is talking about wholly-owned subsidiaries or subsidiaries owned in a substantial way the position is quite clear. If one is talking of subsidiaries where there is a very small holding, and no control, one can see that difficulties could arise.

243. Of course it is all getting very hypothetical, but given a company that would do such a thing, do you think it is practicable or desirable that a company of that kind should be put under liability for its subsidiary's debts?—As a business man, yes certainly; because I would hate to think I was likely to do business with somebody and find that by some technicality they were in a position to go back on their word.

244. But it might be difficult from a legal point of view to enforce a law of that kind?—I would hesitate to express a view on the legal side, but I would imagine so because there is the question of the limited liability of a company, and it would be introducing a theme which would cut right across that.

245. That is perfectly true; and also the company we are talking about might, by a little scene-shifting, be able to escape

* A supplementary note submitted by Mr. Mathys in response to this question, is printed in Appendix II, page 65.

the blow?—Might I say this—that in this sort of thing my belief is that if you stop up one way out for a really dishonest operator he will find another way.

246. Yes. On this topic, would there be, in your view, any advantages from the commercial point of view if the Companies Act provided that a company's Articles could state that it would be responsible for the debts of its subsidiaries and that such a provision would be effective?—I do not think that would take us any further, would it, if it was stated in the Articles.

247. *Professor Gower*: This suggestion has, I know, been made in Australia and business interests there, or some of them, have said "We would favour this because at the moment if our subsidiary enters into an obligation we have to enter into a formal guarantee every time, and this is a nuisance; whereas if we could put in our articles that we would be liable we could dispense with separate guarantees". That is the argument there.

Chairman: Then the suggestion is this, that it may be quite a good commercial proposition to guarantee the debts of your subsidiaries. It might be easier for a company who had improved the credit of their subsidiary in that way with a view to dealings with their customers, and so forth.—Yes. It is difficult not to be a little pompous on this. We would like to feel—and I am sure we do feel justifiably—that the credit of our subsidiaries is intimately bound up with the credit of the parent company. I find it a little difficult to give any guidance or help on this point, but on the legal side I gather we do give certain guarantees from time to time. Mr. Edwards might be able to help you a little on this.

Mr. Edwards: We do in fact enter into quite large contracts through comparatively small subsidiaries from time to time and we do, as a matter of practice, give a guarantee by the parent company not only of the payment of money but of a full performance of the contract. I think that is generally what the other side wants. They are not so worried about the actual money credit of the company, but they want to feel the parent company is backing the full performance; and I am not sure

that is covered by the sort of article Professor Gower has in mind.

248. The proposition is this, as I understand it: given a practice of guaranteeing the debts of subsidiaries, it would be a convenient short cut to have a provision in the articles if that could be given contractual effect between the parties, rather than prepare a special guarantee on each occasion.—But as far as our practical experience goes, that would only go part-way. We should still find ourselves being asked to give a guarantee of the actual performance in addition.

249. And that would depend on each particular contract?—Yes.

250. Then on accounts we have had a large number of suggestions. It is suggested that land and buildings should be required to be re-valued every five or ten years, at least in the case of public companies. What is your view about periodic re-valuations? There must be some difference of opinion on that.—

Mr. Mathys: We feel it is not a practical proposition to be tied to re-valuing at any one time or period. A great deal turns on the question of what one is valuing it as—valuing it as a going concern or valuing it on its break-up value; and in an organisation, certainly one as big as ours, at the end of the day it is very difficult to say exactly what we are talking about. We, like every other company, keep a constant watch on the value of our assets. We are constantly working on this, and constantly deciding and having to vary from time to time our policy on depreciation. We would not welcome a periodic re-valuation on all our vast assets to a set date: in fact we would find it very difficult indeed.

251. Yes. The other branch of this proposal was that, I suppose as an alternative, there should be an estimate of the current value of fixed assets, possibly based on the value for fire insurance, and that this should be made a matter to be compulsorily noted on the balance sheet. I suppose the same considerations apply to that?—Exactly—who makes the valuations and when? If I might add this: If one is talking about one single piece of property, a house or factory building, the thing is fairly simple, but the minute

one starts talking in terms of complete factories or—as in many of our cases—the complete assembly of a number of factories on one site, some inter-related and some working on their own, it becomes extremely difficult.

252. I think it is said in connection with the re-valuation of assets that if assets were under-valued in a company's accounts it might increase the possibility of a take-over bid being made on inadequate terms. Do you think there is anything in that?—In some special circumstances I think that might be so. This would seem to be a matter primarily for the responsibility of the directors to ensure that the accounts do show a true reflection. Of course, as far as the shareholders broadly are concerned, and presumably therefore the value of their shares on the Stock Exchange, one would feel that the current results and the trading results are of far more importance than the value which might be put on some part of the property.

253. Yes. The next one is also on accounts. Suggestions have been made that a breakdown of investments in a company's balance sheet should be given. In order to give to the public generally a clearer idea of the scope of the company's interests, it has been strongly recommended to us that information should be given about the size of holdings in subsidiaries and associated companies (including all concerns in which the company holds at least 10 per cent. of the capital). It is proposed that such holdings should be shown separately—holdings in subsidiaries and associated companies. The idea being, as I understand it, that it would be valuable to the shareholders to have more information than they at present get as a rule about companies in which the company has invested its funds, which are not technically subsidiary companies but in which the company has a substantial holding.—It is my belief we are required to report annually on any major changes which take place in the company's business, and at that stage it is our practice to make it clear where we have taken on a new interest, or to report on those in which we have an interest as to how they are going, or if indeed we have disposed

of our interest in a company, as happens occasionally. I think that, to go further than that, as in all these things, it is a question of relative size. Though as a group we do not favour a lot of companies, nevertheless we find now we have investments in something like 200 or 300; and whether it would mean anything to the shareholders to give precise holdings and sub-holdings—because many of these are sub-subsidiary—I doubt very much. We report broadly on the activities of our main and associate companies; and a lot of detailed shareholding information, particularly with regard to overseas companies, I should have thought would add very little, if anything.

254. The next point under this same heading was as to giving information about the names and business activities of such companies: that is to say in which the company holds at least 10 per cent. of the capital. You say to list by name every one of 200 companies would not really help the shareholders much?—None whatever. As I say, we do publish, not just as required by law in our annual reports, but, in the interests of all concerned, various documents, indicating the names of our main subsidiaries and our associated companies and their businesses. We might give information about perhaps 10 or 20 units, perhaps more—but to go beyond that would add nothing.

255. You do in substance comply with these two points I have been putting to you and in your view no useful purpose would be served if you provided information in greater detail? Is that right?—Yes. I do not know if it would be of any interest to you to see a pamphlet which we issue, which will show you the way in which we deal with these matters. (Document produced.)

256. Yes, I see it is an impressive list of member companies, and you say these are really the only ones which would be of any interest and require separate mention in your documents?—Quite, Sir. If I may take an instance: if you take one or other of these major groups such as British Cellophane, that has a number of overseas sales companies, partly for commercial reasons and partly because national requirements in certain

territories where we sell overseas make it desirable. I cannot see that it would add anything whatever to the knowledge of the shareholders of Courtaulds to give details of those companies.

257. Then the next and third point is information as to the net assets of each of these companies, their profits and the percentage of profits paid in dividends. —Here again it is a relative matter. With regard to major subsidiaries the information is available and it is in fact published. As regards British Nylon Spinners, which is one of the biggest and the most important from the point of view of dividends because it is a 50-50 company, the information is published and is well-known to everybody. In the case of a number of other companies, the actual operations and the payment of dividends are reflected in the consolidated accounts of the group. The question of the payment of dividends is in many cases an act of convenience. Normally speaking, we try to run on a basis of a regular dividend from all our units; but there are certain commercial, and sometimes temporary financial, reasons why one varies the rate of dividend. Whether the money is kept in the unit or brought to this country or, if it is a subsidiary in this country, brought from one account to another, does not affect the position of the ordinary shareholder because it is merely a question of location of funds; and it does not alter the tax position.

258. You have told us what you do in Courtaulds with respect to these matters, and I am far from saying that your procedure is not perfectly reasonable; but if you perform a feat of imagination for the whole field of groups of companies, do you think these points we have been discussing would be a proper matter for legislation?—I would think that any legislation, if it was thought desirable, should not be too specific: in other words, I can see no advantages in trying to lay down in detail the answers to these three questions you have put.

259. Because in your view the answer might vary from company to company? —Exactly: the requirement for the directors of the parent company to give a true and proper picture would seem to be the appropriate way of going about it.

I am not suggesting those are the legal words, but that is indeed what we try to do.

260. The opening words in Section 149—"A true and fair view . . ." embraces the object of the accounts of a company?—Yes.

261. *Mr. Lawson:* Could I ask a supplementary on that? The point that is made to us is that there are quite a number of companies who would have an investment—perhaps a 50-50 investment—like your investment in British Nylon Spinners. Their shareholders would not know that investment existed, and if the company was paying only a very small dividend there might be a big secret reserve, in the sense that large sums were accumulating in this 50-50 company. I think the point is made—would it not be desirable for the Act to prescribe a minimum of information that should be given about that type of situation, whether it really is enough to leave it entirely to the "true and fair view"?—I would have thought that first of all the hypothetical company you have mentioned would have to file its accounts.

262. In my hypothetical case the shareholders would not know the parent company owned shares in that particular company.—If it were an operation of any size, the information must, with respect, be available under present circumstances.

263. We had a case mentioned to us this morning which was based on this experience: an interest in a company was put at £31 in a company's accounts; later in connection with a takeover it was found there was a 50-50 investment worth £30,000 or £40,000. That type of situation arises, you know, in smaller companies?—I am sorry: I was not really thinking in those terms. I can see the reasons and the risk on a relatively small scale; but I have the feeling that the relative disadvantages in other cases might well outweigh the advantages of these relatively few cases. Perhaps Mr. Edwards might like to add something?

Mr. Edwards: I think Mr. Mathys's view about this is that if the investment were sufficiently substantial in relation to the group as a whole, under present

circumstances we would disclose it fully. The suggestion, as I understand it, that has been made to the Committee is linked to the size of the investment in relation to the company in which it is held. I am not sure, if the suggestion is being considered, whether that is the right test. For example, Courtaulds might hold a 20 per cent. interest in a very, very small company indeed; and I cannot myself see that it would be of any help to Courtaulds' shareholders to know about that. It is another question whether, as far as the other shareholders of that small company are concerned, Courtaulds' holding in it, if a nominee holding, ought to be disclosed; but as far as Courtaulds' shareholders are concerned it is quite possible for the parent company to hold a sizeable shareholding in a very small company which makes no practical difference to the group as a whole. I would myself suggest that if large groups are to be required to disclose shareholdings in other companies at all, the proper measure is the amount which those holdings contribute to the group: in other words, if Courtaulds had a shareholding in a very large company, so that that holding was a sizeable part of the group's whole assets, then there would be a case for disclosing it, and in practice we would disclose it. But I do not myself see that the measure should be related to the proportion of the associated company's total equity which the group holds.

264. *Chairman*: I think the underlying idea was this—perhaps I have got this wrong—the existing legislation makes provision as to the disclosing of certain facts of certain subsidiary companies within the meaning of the Act. A subsidiary company is one of which the majority of the shareholding is held by another company. It is suggested that it does not throw the net wide enough, because there might be companies where the parent company has a substantial interest which does not rank as a subsidiary company; and it is said that if such companies were lumped into the balance sheet together with any other investment, that might not give a true view of the company's position. I understood it rather in that way.—Yes, but all I am saying, Sir, is whether, from a practical point of view, that information

should be included or not must depend on the size of the associated company concerned. If Courtaulds were required to disclose every investment in every tiny company, it might be meaningless to the shareholders and confuse them; but certainly if they were required to disclose a holding in a substantial company which was not a subsidiary there might be a point in it, but it depends on the size of the company concerned.

265. It is a question of *de minimis*?—Exactly.

266. A company may have a subsidiary dealing with trust accounts, and so on, which may be a very small concern and might make a relatively large profit. If it only had £2 capital contributed, even though it paid 100 per cent. dividends, it would not be worth bothering about—that is the underlying note, is it?—Yes.

267. I see. Then the next suggestion made is that every company should be made to disclose its turnover, showing details of its sales of main products and services separately, and details of manufacturing and distributing costs. Would you have any objection to the compulsory disclosure of these details?—*Mr. Mathys*: Although at the present time Courtaulds do not give their turnover figures, it is a matter to which we have given constant attention. The problem, as we see it, is in big operations, many of them involving inter-divisional and inter-subsidiary company operations, how one reflects in simple major figures what really is the company's turnover. Our present thinking is in terms of the probability of having to give two or three sets of figures. We feel it would not be desirable to have to give a breakdown, such as is suggested in the second part of the point you put, of distributing costs and manufacturing costs on individual lines. Commercially this might be very dangerous if it went too far.

268. In what way would it be dangerous?—When one is in competition not only with other people in this country but elsewhere, to have to indicate in too great detail the costs of production and distribution of one or other of one's main items places in the hands of other people knowledge of just how far one can change

one's prices or what is going to be one's expansion policy in the future. But as regards turnover, it seems to be the general practice, and one which we would not wish to stand out against, to give broad and general information. Might I say just one more thing on that, which is that there is a very noticeable tendency of people with low capital investments to give the maximum publicity to their turnover figures. Whereas those with high capital investment, such as in our company, watch this rather more carefully, because for obvious reasons, in calculating investment these figures can be very misleading, unless the position is properly appreciated.

269. Yes. Then there is a question that quarterly or half-yearly statements of profits should be published.—This again is a growing custom—to give half-yearly reports. We ourselves adopted it for the first time last year in giving some information. Half-yearly would seem to be appropriate, though in the United States quarterly statements are required. I think here again it depends on the industry. Some industries have seasonal fluctuations and some have a steadier line of business, and half-yearly or quarterly figures would have more or less meaning according to the industry.

270. Yes, and I suppose the fluctuations would vary more in some cases than in others?—Quite. When one has a large share-holding such as we have, we are very conscious that what we say may have—in a matter of hours and certainly in days—a big influence on the prices of shares; and naturally we take no steps which would cause such fluctuations on a short-term scale. We are very careful that the information we put out is for a long-term period.

271. How does that bear on your half-yearly report?—We believe that the information we are giving in that report is helpful and that it gives some guidance as to the picture; and at the same time we also make it a custom to make some statement by the directors because it coincides with the issue of the interim dividend. One gives some indication of what is happening, but we do give it very careful thought because we are conscious

that with possible seasonal fluctuations it may be misinterpreted, and especially when you have a large number of shares on the Stock Exchange as we have.

272. Yes: also on the half-yearly statement, if it was going to be made compulsory and a matter of legislation for every company to send out such a statement, I suppose the legislation would have to include some regulations as to what this document was to contain?—Yes.

273. That might make it an onerous obligation or not, according to the information required?—And the end-of-year consolidation of our accounts and auditing is a very big operation. We certainly would not welcome having to do that twice a year. We are very careful to indicate that the figures we put out half-yearly are, of course, unaudited—as they must be. We believe that they are right, but consolidation of accounts including overseas operations, when handled by the ultimate accountants, is a very difficult business. We certainly would not welcome having to do every six months the same operation as we have to do now every twelve months.

274. Thank you. Now under a different heading: do the provisions of Section 201, requiring particulars of directors to be carried on trade catalogues, circulars, showcards and business letters, cause you any inconvenience? It has been suggested to us that it should only be necessary to state those particulars on business letters, invoices and accounts.—It does not cause us any inconvenience because it does not apply to our main company, which was registered before the date prescribed in the Act. It does apply to certain of our subsidiaries and there it is a minor irritation.

275. As regards the suggestion that it should only be necessary to state these particulars on business letters, including invoices and accounts—that is to say, omitting the trade catalogues, circulars, showcards and so forth. Would you welcome that, or is it a matter of indifference, a small matter?—We would welcome anything that reduces paper work. On the matter of broad principle, I

should have thought having to name directors in this way was out of date. One finds that this sort of thing adds to one's printing and the size of documents, particularly if there are a large number of directors.

Chairman: That finishes the questions I wanted to ask. Mr. Lawson, I think you had a question?

276. *Mr. Lawson:* I should like to ask about one or two things on accounts. It has been suggested to us that it would be valuable for the shareholders to have information as to the proportion of the assets held in different foreign countries and the proportion of the profits arising from those countries. Do you think that is a desirable or practicable thing to do?—My feeling is rather along the lines I have suggested in other connections—as long as one is required in a broad way to indicate it I am sure it is the sort of thing one should do, and in fact it is what we do. I cannot believe that a precise statement of every detail would be of help. It is rather difficult to state precisely what are the value of the assets, for example, of a factory in South Africa and another factory in Mexico: these things have a value which must vary from year to year, and probably more frequently, according to certain circumstances.

277. And I suppose it can be said that the ordinary consolidated account, where you have businesses in foreign countries, does not mean a lot. You have to give assets all over the world, and it would perhaps be of some value to shareholders to have it split down, not perhaps into detail but to net assets in countries or groups of countries, and the profits derived from those countries: it is an arguable point of view, is it not?—If one looks at it the other way—if it were not for taxation and national pride, a large number of these overseas operations would still be (as indeed some of them were originally) branch operations of the home business—the consolidated accounts do reflect the overall business which is being done, whether it is partly here or partly overseas. I feel that to start trying to specify certain things merely because they happen to be across the water is not logical when you think of a large number of units in this country, as

in our case, and how far you would want us to specify whether this or that factory is operating at a profit or what are its assets.

278. And it might even be difficult, might it not, to say what part of the profits was derived from a particular country and what part might be contributing to activities on this side of the water?—It is very difficult indeed, particularly as our operations here and operations overseas are in most cases co-ordinated to supply certain markets. It is a joint effort and not a separate one.

279. Thank you. There is another point of a somewhat obscure nature. There has been a suggestion made that where a business has a number of quite separate and distinct activities on a fairly large scale, the results of those activities should be disclosed. I think the question arises partly out of take-over bids and partly out of diversification, and the thought behind the question is, are not the shareholders entitled to know how these transactions are worked out and whether they have proved a good thing for them. I think that is the thought behind it.—In previous years in our Directors' Report we had by and large taken the big units company by company and to a certain extent country by country. This year we have set out to describe our operations by products. In doing so we have started with fibres, both in this country and overseas, and have then gone on to describe the various fibres that we deal in; and then to take textiles, chemicals, packaging, plastics, pulp, paint, engineering; and then we go on to research and personnel. We have done that because we believe that this is probably giving a better overall picture of the operations to the shareholders.

280. You have probably done, to a large extent, what the people who have put in these suggestions would probably want done. I think the question is whether it would be practicable or desirable to put anything of that kind into an Act of Parliament.—One does wonder what it is that the shareholder does in fact want. As already indicated, we give a great deal of thought to supplying the shareholders with information. We have examined

what has been done by many other companies to see whether we give enough, or perhaps even too much. In fact it has been suggested that even our present report is not in fact read by many of our shareholders, and that it might be a more practical proposition to send to them a summary of the report such as we now put into the papers about the time it is issued and a business reply card saying in effect—"If you want a full report, send the postcard back". I feel that by and large our examination of this subject has shown that really the shareholder is interested in the overall results, what money is available for dividends and what money in fact is paid as dividends. Beyond that shareholders can only be guided by the general statements made by the directors and the general statements that are made by the financial press in analysing results—and even, of course, in questioning us when the chairman has a press conference once a year.

281. It would not really be practicable to put this sort of thing into a report?—The only person who might gain from it is one's competitor.

282. *Chairman*: I would like to ask one other question arising out of that. You say all this detailed information is really above the head of the average shareholder: he is not going to take time to master it even if he has the ability to do so, but apart from the ordinary man-in-the-street shareholder there are stock-brokers, accountants and others, and they, by delving into these very highly developed accounts, get very valuable material for the purpose of advising their clients, and in that way this information may serve a useful purpose?—If these experts want to know more we are ready to give, and in fact do give, a good deal more information. Our experience, let me say, in relation to the financial press, is that there is no limit to their questions, and obviously we could never entirely satisfy them.

283. You think there is enough information there already?—I believe so and, as you gathered, we endeavour to move certainly with and probably ahead of the times in giving information of this kind. What we are considerably concerned about in all these suggestions is that we

might be required to carry out a great deal of work, which we believe would not really help the ultimate shareholder at all.

284. *Mrs. Naylor*: I would like to go back to this geographical background, and I think it would be helpful if you would imagine yourself to be not an investor in Courtaulds but in a much smaller company, which operates in this country and in Cuba. Would you not feel that an investor should know the rough proportion of profits that were drawn from Cuba, or any other country which is in the news, either happily or unhappily?—May I say, first of all, before answering, that I hope you will not take my comments on the financial press personally. My answer is that it is all relative. If, indeed, a substantial part of the profits of the business come from a certain district, then I think it is desirable that that should be shown, and in fact I feel it would be shown in my experience of ordinary company business.

285. It should not be a statutory obligation?—There again I feel that once you get a statutory obligation, it may go to absurd lengths. I have already indicated that we have got something like 300 companies. Now a statutory obligation might include, for example, a minor operation which we have just started in Rhodesia, with literally 10 men, in connection with the sales of cellulose film in that country. I really cannot believe that details of that kind can be of any help. On the other hand, where we have, as we have now, a substantial business in the United States of America we give information of this kind, and indeed further information can be obtained by anybody who really wants it. In South Africa again we are building up considerable investments, and we always refer to that and that information is given; again further information can be obtained if it is wanted.

286. It would not be a nuisance to you to give details of investments, the nature of the industry and the geographical location, where the profits amounted to, say, 10 per cent. of the revenue for that year? Would that be a nuisance if it were 10 per cent. or more?—Lots of details might be required, I think. We

start operations in certain territories, because we find that our export business there, which is profitable, will only be maintained if we manufacture there and a time comes when it is desirable to manufacture there. It very frequently happens that, at that particular critical moment, it is not really a paying proposition by itself to put up a factory in that territory. We are frequently talking in terms of plants which are going to cost several million pounds. We take these decisions quite often, based on what we think is going to happen in perhaps five or ten years time, knowing that perhaps for the first period the operations are not going to be substantially profit-making in themselves. This is a very delicate situation with our competitors, particularly from the Continent, from Japan and elsewhere. If they knew in too great detail how well we were doing or how delicately we were balanced, it would influence the sort of attack they might make on us in that market. From that purely commercial point of view, I think we would feel it was not in our shareholders' interests to give details such as that.

287. And your competitors would not be able to get similar information to what you would give in the directors' report from other sources?—They try, as no doubt we try, to find out as much as they can. You will bear in mind that there is a difference between giving the information in a controlled way, and having to give a lot of details because the law says you must. It is not that we do not want to give the information; we do not want to find ourselves forced into the position, on a technical point, of giving a lot of information which is really not relevant, certainly not to the shareholder, and which could only be of help to our competitors, and therefore would be a hindrance to our own shareholders. On this general position, it is very significant how little, if any, further information we are asked for by our shareholders, and our shareholders are not just the men in the street; they are investment and financial houses and, in a few cases, big individual holders.

288. *Mr. Lumsden*: Could I ask one question about the shareholders' control

over the issue of shares? As you know, it is quite a common feature in companies that shareholders should be asked to create a substantial block of authorised capital, which is then made available to the directors to issue as and when they please, and to whom they please. It has been suggested to us that there should be some greater control in the hands of the shareholders and that their specific authority should be required, perhaps within a limited time before the issue, before any of those shares are issued to people other than the shareholders themselves. In other words, if you were issuing them as part of a take-over, to take over a company, or issuing to the public, you would have to get the specific authority of the shareholders. Would you have any views on that?—Yes. I feel that this would be unrealistic. The procedure is that the shareholders in a general meeting must authorise a certain capital and a certain share availability, and presumably, if they have any concern as to how that is going to be used, it is at that time that they will either wish to put a limit on the numbers, or they will wish to make some observations about the directors concerned, who are elected by the shareholders to administer the company. It would appear, therefore, that once authority has been given—again it is so relative—to have to come back just would not be in keeping with their original authority to issue those shares.

289. Do you feel it would be positively harmful?—I can see many circumstances where it would be very harmful, if one had to do it literally for every case. If you refer to a take-over, if it was of a certain magnitude then it would be the type of operation which we certainly would refer to the shareholders before we thought we could do it. But there are other cases which, we would think were matters which must be dealt with by the directors promptly, because when it comes to a take-over, these things cannot be held over too long.

290. *Professor Gower*: You are saying, as I understand it, that you think that managements should be entitled to ask the shareholders to increase the capital and authorise them to issue it to whom they think fit, and that this gives you

carte blanche then to issue it otherwise—if not a rights issue to the existing shareholders—and you would not regard it as reasonable that, unless the shareholders had authorised you to issue it for a specific thing at the time, you should go back and get the shareholders' consent?—The present position is that the shareholders can approve, and in fact do approve, a certain authorised capital without any specific qualifications. I am saying that I believe that in so doing they are showing confidence in their board of directors to deal with those shares in a manner which is to the advantage of the company. I would think it was a disadvantage to the company if the directors then had to go back in every specific case. If, indeed, the shareholders would only give authority to issue the shares for specific purposes, then of course we would accept that the directors could not issue those except for those purposes.

291. It was put to us this morning that normally capital will be issued to existing shareholders on a rights basis, so as not to upset existing shares in the equity, and if, in fact, there is going to be a substantial issue for another purpose, shareholders' approval should be obtained.—This year, in fact, we asked for authority for more shares. In so doing we indicated that this would cover the scrip issue and that it would leave opportunity for further operations, such as we have done in the past few years where we have issued shares for the shares of other companies. It was on that basis that the shareholders gave us this authority. In other words, I feel the control comes at the time of the general meeting authorising the shares.

292. *Chairman*: Does this not depend, really, on the terms of the memorandum and articles, and in particular the articles? I have before me a common form of memorandum and articles, which is quite generally used, and that provides, as regards increase of capital that "Subject and without prejudice to any rights for the time being attached to the shares of any special class, any shares in such increased capital may have attached thereto such special rights or privileges as a general meeting resolving upon the creation thereof shall direct, or,

failing such direction, as the Directors shall by resolution determine". It then goes on to the rights attached to the shares—what I take to be the point we are now discussing—in this way: "The Company in General Meeting may direct that any new shares shall be offered to the existing members in proportion as nearly as the circumstances admit to the number of existing shares held by them" and so on. The next article goes on to say that "Subject to any directions that may be given in accordance with the powers contained in the Memorandum of Association or these Articles, any capital is to be deemed for all purposes to be part of the original capital". That illustrates one method of dealing with the transaction. Of course, there may be quite a broad variety of forms in use, and does it not to some extent depend on the shareholders' contract of membership?—Yes, I think it must do so. We have got some limitations in our Articles on what we can do.

293. *Professor Gower*: But, of course, the argument put forward this morning was that, irrespective of the articles, it should be a mandatory provision that directors could not have these powers in the absence of shareholders' approval at a general meeting.—One does wonder whether the people who put forward these proposals are either thinking of some specific case—because one can always find an example—or are not really facing up to the fact that the shareholders do elect the directors as their representatives and do entrust them with certain obligations. If, having done so, the shareholders are then going to look over our shoulders all the time or, worse than that, are going to demand that every time we make a decision it should be referred to them, I do not think the thing is practical. As I have already said, our experience is that the shareholders' real interest is in the overall results of the company. I am happy to say that so far they have always accepted the recommendations of the board of directors and re-elected the directors as they came round in rotation, and presumably they are satisfied with the results.

294. Yes, but that, surely, is the point, is it not? As you, yourself, have said,

while all goes well the shareholders have no interest, and you, yourself, said that "we are never conscious of their control", and you have implied that, really, it is not realistic to suggest that they elect you. While all goes well you are a self-electing body, I am quite sure, except if there is a dispute as to the election of a nominee which you put forward to replace somebody. One envisages the situation, if something goes wrong and the company has made a loss and is doing rather badly, where the directors decide that they will try and put the thing right by going into another business with the issued capital available, and then they make a take-over bid. The argument, as I understand it, is that in those circumstances they should be made to refer to the shareholders who, presumably, since things have gone wrong, will now take an interest. Is not that a reasonable argument?—With great respect, I feel the premise is wrong. I do not accept that we are a self-perpetuating body. It is perfectly true that, if things were going wrong, that would be the time when the shareholders would take a more active interest, possibly collectively, and presumably at that stage, if they were not satisfied with the way we were operating, then they would exercise the power which is with them at all times to elect such directors as they saw fit. But I cannot accept that, whether things go wrong or go right, having elected the directors they must be looking over our shoulders all the time. If they have told us we can do a certain thing such as issue some capital, then before we do so we should not have to go back and say that we want to do it.

295. *Sir George Erskine*: Could I ask a question bearing on this? Many boards, who are now asking their shareholders to increase the authorised capital, are giving the shareholders an assurance at the time the capital is authorised, without this being written into the resolution—but they have given the shareholders an assurance that they will not issue the shares in a way which would alter the control of the company or the nature of its business. That is becoming quite common. Would you go so far as agreeing with action of that sort?—Yes. It is

common form, when one asks for an increase in authorised capital, to give some indication, as to what one is going to do, and by inference an assurance that one will not do something else. As I indicated earlier, that is what we did ourselves this year. We were issuing one for three extra shares. We indicated that we did intend taking further action, as opportunity offered, also to issue shares for other purposes.

296. *Mr. Richardson*: These assurances began to be given as a result of agitation which was aroused in cases where the board, within the powers conferred by the articles, had got unissued capital which had been authorised by a general meeting, and which they then proposed to issue to an outside body of persons not being shareholders. In one case it was 30 per cent. and in another case 25 per cent., and that is the reason why these assurances are now being given.—Is there not a cumulative effect, in that certain happenings would no doubt urge certain people to do things which they might not have done otherwise? But equally well, as ideas progress and business progresses along certain lines, you find that if it is a worthwhile thing many people do it, and I hope that is the case with many of the things we do, and indeed other companies do.

297. *Mr. Mackinnon*: In Courtaulds paper at the foot of page 1—we discussed this earlier on—you say in the very last sentence "It is felt, however, that fundamental changes in a company's activities should not be brought about without reference to the shareholders" and I think you followed that up by saying that you saw the practical difficulties of giving effect to this sort of proposal. What I would like to ask you is this. Would not this sort of restriction on the issue of shares be a very real way of extracting some sanction, which might achieve the object you had at the time, but which there would be administrative difficulty in dealing with? I have in mind a particular case. Supposing a block of shares are to be issued in exchange for a new business, it could well be said that it would be wrong to allow the directors to take advantage of existing authorised capital, without going back, if it was a

reasonable proportion of the capital involved—10 per cent. or something like that. I am only suggesting that you cannot just brush this off and say that it is interfering with the powers of the directors. It is a little inconsistent with the statement you made at the foot of page 1, because this would in fact be a method of stopping a change in fundamental activities to some extent.—A fundamental change in the company's activities would not necessarily involve shares at all.

298. I quite agree it would not, but it might, and this would be one way of stopping that aspect of it.—I am not sure that that is necessarily so. I suppose every fetter you put on the activities of a board of a company might stop them doing something in some hypothetical conditions, but I come back to my point.

(The witnesses withdrew)

MR. GORDON NEWTON *called and examined*

299. *Chairman:* Mr. Newton, I need hardly say that we are very grateful to you for your assistance. There appears to have been a very large increase in recent years in the number of so-called "one-man companies". The Board of Trade have informed the committee that approximately 70 per cent. of all companies registered at present fall into this category. The question is do you, in your experience as a financial journalist, see any dangers in the proliferation of these "one-man companies" and do you think there is a case for checking it, or do you hold no particular view on that?—I hold no particular view here, my Lord, because I and the paper are concerned mainly with public companies, for public companies receive public money. It seemed to me that these "one-man companies" are mainly a matter of tax, and therefore I have nothing to say.

300. You are not interested in that. We can then pass on to our next point, which is that you suggest that exempt private companies should in future file their accounts. Could you tell the committee what advantages you think this

I think that if the shareholders are really worried about their board of directors, then presumably they will limit the amount of capital they will let them have in the box, as it were, at any one time. But, as I have indicated, I feel it is not in the shareholders' interests to put these limitations on as a matter of law, because at that stage there is always the question, which runs through the whole problem, of where the line is drawn.

Chairman: Are there any more questions? We are very much obliged to you all for coming and helping us today. I think everyone has now troubled you with all the questions they can find. We are indeed grateful for your assistance. Thank you very much.—Thank you very much, Sir. I would say we were pleased to be asked and pleased that we have been able to be of any help.

would bring? Do you think it would, for example, give any real protection to creditors, and are there any other respects in which you think the publication of those accounts would be advantageous?—In particular no, but in general one has the feeling that this exemption can provide loopholes. Sometimes I know that when you are trying to track something back, you come up against a blank wall, because you can find no details about a private company. It is a general thing, that here you have a system under which information cannot be obtained when sometimes it is quite important to obtain it. That is all.

301. Do you hold any view on the sort of general principle that a company, which has the benefit of limited liability, ought to take the disadvantages as well?—Yes, I hold that view in general.

302. If Mr. and Mrs. Jones set up in partnership selling sweets and tobacco on the Station Approach, then while they are partners they are liable for all the debts which may be incurred. Then, if they turn themselves into a company their creditors can only get at the company

assets, and it is a view that in those circumstances the company should make a full disclosure of its position.—I would agree with that view.

303. The Cohen Committee thought that there was something in the view that publication of the accounts of small companies such as these might give valuable information to their competitors, and assist their more powerful competitors and perhaps put them out of business.—I think that view is overstressed, Sir. I find it difficult to believe that publication of information does weaken a company. That is a general statement, and there may well be particular instances where it is wrong. But in general I find it so.

304. Have you any views as to whether the other exemptions accorded to exempt private companies, that is to say, the qualifications of the auditor, loans to directors and so forth, should be continued?—I have no view on that.

305. You are interested only in the question of filing accounts?—Yes.

306. In general, I take your opinion to be that directors should be given full discretion to manage the business of the company as they think fit, but should keep the shareholders fully informed as to the position. That is your view?—That is my view, yes.

307. And you have made some suggestions under Heading 5 of the questionnaire about keeping shareholders informed, and for requiring in some cases prior reference to them.—Yes.

308. These are suggestions that information should be given, but they fall short of requiring prior sanction by the shareholders in general meeting. That accords with your view that directors should be given full discretion.—I think we must be very, very careful not so to circumscribe the directors and the board that they feel they cannot act in what they genuinely believe to be the best interests of the company without referring everything back to the shareholders. That, I think, is something which is very important and must be kept in mind.

309. You attach great importance, I think, to the position as to the issue of new shares, which may alter the voting

rights in a company.—Yes. There have been one or two instances of a board issuing at a low market price a very large block of shares to outside interests, which of course materially changed the whole position of existing shareholders. I am not saying that in those instances I have in mind the existing shareholders did suffer, but I think they could have suffered. I think the principle that is involved here is quite important, and if a board were to issue to outside interests 25 per cent. of the existing equity capital then I think that that would be going beyond what I consider to be the board's freedom to act without consulting the shareholders. I do not know where the line should be drawn. I am not suggesting that 25 per cent. is the ideal figure. But I think there must be some limit placed on the board's freedom of action.

310. You cannot say where the line should be drawn?—I think there is an argument that it should be drawn fairly high and another that it should be drawn fairly low, but on the whole anything above 25 per cent. I would consider went beyond the board's proper power to act without consulting the shareholders.

311. What is your view as to the proposition that where new capital is to be issued for a cash consideration it ought to be offered in the first instance to existing shareholders *pro rata*? How far would that meet your difficulties?—On equity capital that would meet my case, yes.

312. But you would still have to fix the limit of shares at which it is applicable, would you not?—Yes.

313. Circumstances may vary to any degree, and can one say that there would not be cases in which it would be very inconvenient to impose this fetter on the directors?—Yes, of course, there would be inconveniences in buying other assets for shares, but if you were buying assets of a major character—there is one particular case which comes to mind—then once again I think the board should consult the shareholders.

314. Of course, the difficulty is to express provisions of this kind in terms of legislation.—I quite see that point.

315. And any general rule produces an exception. Is there not a risk that, if

this were enacted as a hard and fast rule, it might do almost more harm than good, or not?—It is quite possible, but it depends how the rule is drawn. I would like to return to the point which I mentioned at the beginning, that I think it would be bad for the conduct of business if the board were too circumscribed, and I feel, therefore, slightly diffident about suggesting the sort of figures which a board should not exceed. I think, if figures were suggested, they should be relatively high rather than relatively low. I think the danger here can easily be overstressed. I think the cases of a major character, which occur to one over the last few years, are relatively few.

316. Would it be putting your point too low to say that in your view it is theoretically desirable that there should be such a right to the ordinary shareholder?—I think that is going too low—not only theoretically, I think it is practically desirable, provided that in practice it can be done without, as you say, drawing a rule which does more harm than good.

317. You cannot really carry that point any further than that?—I would rather not. All I can say is that that is what one feels. Those are the principles. Whether they can be put into practice, whether they are too Utopian, I do not know.

318. But this would be the way you would suggest for preventing the whole voting balance of the company being upset by the issue of new shares?—Quite.

319. If the existing shareholders had an opportunity of taking them up, then that is all they can reasonably expect?—Yes, but of course there can be cases where the whole object of the exercise would be frustrated.

320. In that case, you would say that the consent of the shareholders in general meeting would be needed for this departure from their ordinary right?—Yes.

321. That point just depends on which view you take as to the balance of advantage.—Quite. As I said, I think the figures should be put relatively high, rather than relatively low.

322. Then you deal with the cases of preference and preferred shares, and the

effect on them of the issue of new shares ranking in priority or *pari passu*. Is not that kind of difficulty now met in a great many cases by the modification of rights clause in the Articles of Association, which requires any alteration in or abrogation of the rights of any special class of shares to be permissible only with the consent in writing of a requisite proportion of the holders of the shares of the class affected? That article, I think, appears in most modern Articles of Association, with a view to giving the preference shareholder protection against the kind of thing you have in mind.—What one had in mind here was a large issue of preferred stock, ranking *pari passu* with an existing issue.

323. Of course, the circumspect draftsman says that preference shares should carry the right of a fixed preferential dividend of X. You put in the words to make it cumulative, and you say ranking before the dividend of any other class of shares for the time being issued.—Yes.

324. If that is not done, then there is the possibility of an issue of *pari passu* shares, but if there is a modification of rights clause, providing for a separate meeting of the class affected, you would not have very much ground for complaint, would you?—No. The only point I had in mind was that if you had a million preferred ordinary shares, and another million were issued, then of course the status of the first million would be bound to be affected by the second million.

325. It cannot be done without the consent of the appropriate class, if there are appropriate provisions about class rights in the way of modifying?—No.

326. So if anything required to be done to meet this part of your memorandum, I suggest it might be—I am not saying it is possible—the introduction of a statutory modification of rights clause, irrespective of anything contained in the articles.—Yes.

327. So that in every case, the class of shareholders would have a chance of voting on the matter. I am not putting that forward as a necessarily practicable suggestion. I am only suggesting it as a possible way in which your point might be met. Would you regard that as reasonable?—Yes.

328. Our next point is a suggestion that shareholders might be given control over the directors' powers to appoint additional directors and to fix their own remunerations. I think our question has got a little telescoped, because I think the real reference is intended to be to the power of the directors to appoint members of their own body to salaried offices and to fix remunerations. Of course, in the large companies, it is invariably done by the board itself.—Yes, invariably done.

329. Is it your view that that power should be remitted to the general body of shareholders, or do you think the existing arrangement is satisfactory?—I do not see anything wrong with the existing arrangement.

330. You would not disturb the existing arrangement. Is that your view?—I do not think so, no.

331. Of course, in some small companies one hears of cases where the surviving members of the family, who started the business, continue the business occupying the positions of managing directors or managers, and that kind of thing, and it is suggested that by that means they may really lift the whole of the profits out of a business to the detriment of the other members, the minority. For example, one hears of cases where a father and two sons carry on a business. The father dies and the sons go on carrying on the business and they have a majority of the shares. Naturally, they are not going to carry on the business as whole-time managers or managing directors without some remuneration, and in that kind of setting the fixing by the directors of their own remuneration might possibly produce an unfair result.—Yes. It is a subject to which I have not really given much thought.

332. That hinges on the affair of the private and the family company, and you have told us that you are not really interested in that, so we might as well pass from that point. In your memorandum you refer to a provision in American law whereby a company can compel its director to account for any profits he makes by buying and selling shares in that company. Are you suggesting that any such provision should be introduced into United Kingdom company law?—No. I

think that might go too far, Sir. I am suggesting that present arrangements about holdings of directors in the firm, and dealings in shares, should be extended. I have in mind, particularly, option dealings.

333. I am not sure that that is not covered by Section 195, which is couched in very broad terms.—Option dealings, Sir?

334. Yes.—Supposing I, as a director of a company, took out an option on my company's shares and the option fell in, and say I exercised that option, would I have to disclose it?

335. The Section seems to extend to all shares which are held by the director, or in trust to him, or of which he has any right to become the owner, whether on payment or not. I would have thought an option would give him the right to become the owner, either on payment or not on payment, and if so then by definition it would require inclusion in the register of directors' shareholdings, would it not?—I must profess ignorance on this point, but it never occurred to me that, if I were a director of a company, and during the period of the financial accounts I took out a three months option and I exercised that option, but did not take the shares up and merely took the profit on the transaction, that I would have to disclose that.

336. I am not sure. I would have thought the language of the Section looks as if you might have to.—I have never seen it done, and perhaps that is because no one has ever exercised such an option, though I doubt that.

337. But I should have thought shares held by or in trust to him, or of which he has any right to become the holder whether on payment or not, would be apt to describe an option, would it not?—I accept your ruling, Sir.

338. It is not a question of ruling.—Your interpretation then.

Chairman: I just wanted to find out what we were talking about.

Mr. Althaus: If a man pays for the call of shares and those mature to his advantage, he can make money out of it, but in

order to do it he must call the shares first. There has to be an actual specific act of calling those shares. He cannot exercise that unless he specifically calls them, but he can deal against them. He may have dealt against them in the meantime, and I should think it very seldom happens—unless a man wishes to acquire the shares on cheap terms—that he takes them up in a physical sense, and it may well be that an operation of the type Mr. Newton mentions might never see the light of day on the company's register.

Chairman: But if those shares answer the description of shares of which he has any right to become the owner, then they would have to go on the register, would they not?

Mr. Althaus: He would merely call them. He would not have entered into possession of them. I am not an authority on share dealings, but I think that he could close them in the same way as he can close something which he has bought in a 14-day account, without ever appearing on the register of the company as the owner of them.

339. *Chairman:* These are the registered directors' shareholdings. I do not want to take up time on this, but it does seem to me to be couched in language sufficiently wide to include an option, because if a man has an option on shares then he has the right to become the holder of them on payment of a price. Actually, the question I was trying to ask, and I put it very badly, was what you thought of the provision to be found in American company law, under which, if a director within a period of six months, a year, or whatever it may be, buys shares of that company and then sells them at a profit, he has to be accountable for that profit to the company. I think you referred to that in your memorandum.—Yes, I do refer to that.

340. In the United States, we understand that companies are able in certain circumstances to reclaim short-term dealing profits made by directors in the company's shares.—I am hesitating because I am thinking of the phrase "short-term dealing".

341. That was your own language.—Yes. I was just wondering how to define it, as opposed to investment.

342. If a director bought some shares in a company when he was 30 and sold them again on his hundredth birthday so that he could give a party to his descendants, that would not be short term.—That is one extreme. The other extreme, if he bought them in one account and sold them in the other, would be short term. I was just wondering how to define short term in this context.

343. *Professor Gower:* It is six months in America. Does that help you?—I should think six months would probably be as good as anything. I personally think it is the right principle that directors should be accountable to the company for short-term dealings in its shares, including option dealings, and I think it is probably fair to say that a short term would be six months. Anything over a year, to my mind, would rank as an ordinary investment, and once again you risk interfering in the free rights of a director, which is an important issue.

344. *Chairman:* The ground for making a director accountable, I suppose, is that in the United States dealings so close together as that would be classed as improper speculation by the director in the shares of the company which he is managing for the shareholders.—Quite, and it is the same principle over here.

345. Would it not be rather a strong thing to make that rule of accountability apply to every case?—I do not think so. One has in mind this point, Sir, that time and time again on the Stock Exchange you know there is a bid coming along, and when it comes the market is just right. It is remarkable how, again and again, you see a share rising and after a time you know instinctively that something is going to happen. Obviously—I think obviously is the right word—information does come out in one way or another; it must do, because the market is so often right. If it were acting at arm's length it could not possibly be right so frequently; and so the market is not operating at arm's length at all times, and one must accept that. One is not saying that the boards are not completely honest; but all one knows, as I said, is that if the market were always at arm's length it could not be so often dead right, and I think the principle should be that, if a

director has made profits—I do not know what you would do about losses . . .

Professor Gower: In America he bears the losses himself.

346. *Chairman:* I suppose it is based on some kind of a presumption that the resale was effected through abuse of confidential information, or something like that.—It must be so.

347. The director buys the shares at £5 and then they go up to £100, and he takes his profit and says that he had no idea they were going up, but the Americans say that must be taken with a grain of salt.—I think it must be, too.

348. *Mr. Althaus:* Very often these rises in the market might be accompanied by purchases for the specific purpose of acquiring control. Continued over a period they would be reflected in a rising market, would they not?—Yes, I quite agree. What I have in mind is the case where two companies are going to merge and when the merger terms come out you find the prices are very close to them.

349. But generally they are based on some shareholding having been acquired by company A in company B. That is a very frequent element in it, is it not?—Would you say very frequent?

350. I cannot quote you chapter and verse. I am thinking of the published facts when EMI tried to acquire Morphy Richards.—Everybody knew everything.

351. Yes, but nevertheless they had acquired shares and acquired them in the market. The same thing happened with British Aluminium. There was keen buying by competing interests and so on.—Yes.

352. I do not want to press it, but I thought we ought to get it right that there are various elements which go to establish the balance between buyers and the market.—I am not disputing what you say.

353. *Chairman:* That is that question, and the next one concerns shares with restricted or no voting rights—what have been called voteless shares. I gather you share the opinion of Mr. Wincott that that

type of share should not be allowed.—I do not think I am quite as extreme as he is.

354. You would not rule them out immediately and retrospectively?—No. I think that if you tried to make action retrospective you would raise very difficult problems of equity, of compensation. Take the particular case of Marks and Spencer. How do you do that? Great Universal Stores, how do you do that? Do you give compensation or do you not? If you give compensation, how much compensation should you give? I think that in that direction there would be endless arguments. I think in principle non-voting shares are wrong. I think Mr. Wincott may overstress the amount of abuse to which they have given rise, because it is undoubtedly a fact that some people who bought voteless shares have done extraordinarily well out of their investments. On the other hand, voteless shares are capable of abuse like other things. They are used to consolidate the existing board in their position, and this runs counter to what quite a large number of people are trying to do at the moment to reach a sort of shareholding democracy. I think in principle this kind of thing is wrong, and if it is possible to do away with it—and this does not just stop at doing away with voteless equity shares, because if you did away with them you would still be wide open to the participating preferred ordinary—if it is possible so to frame legislation that the voteless equity were banned, then I think it would be good legislation.

355. Do you not think that the votes attached to a share depend on the contract of membership? The contract of membership depends on the memorandum and articles of association, and do you really see any justification for making it illegal for somebody founding a company to divide the capital into voting shares and non-voting shares?—There is nothing illegal in it.

356. You wish to make it illegal then?—I wish to make it illegal, yes.

357. Is there any justification for that? It is an interference with the ordinary rule that shareholders' rights are measured by the contract of membership.—Yes. I think there is force in the argument that

a person knows what he is doing, and you do not force him to take up a non-voting share. He buys that of his own free will, and pays the price for it. I think there is great force in that argument but, on the other hand, the non-voting share can be used to perpetuate the same form of control in a company, which I think can be bad. With things like cross-holdings between different companies, it can make one company, two companies or a group of companies completely isolated from any form of outside control.

358. That is your view, and there are others who think the same. There is the contrary view which stresses the free right and also points out the enormous difficulty of equating the voting rights to the stake in the company.—Yes. I am not saying that this is an open and shut case. I think, as I said, that there is force in the argument that you know or should know, —I do not think that everyone does know by any means—what one is paying for. On the other hand, I do feel that the balance of argument does fall down in favour of doing away with voteless equity shares.

359. I do not know that we can carry that much further. It is a matter for the committee to decide, having considered the evidence either way. Then there is the question of the appointment of Board of Trade inspectors, and you suggest in your memorandum that the position with regard to the appointment of inspectors might improve if the Board of Trade were to take more account of what you call practical financial considerations in deciding whether to investigate. We would welcome an explanation of what you mean by practical financial considerations.—Can I take two examples, Sir, which have recently been in the news; when I say recently I mean in the last two or three years. If a company advertises for deposits offering a very, very high rate of interest, then I think that there is a *prima facie* case for someone to look into it closely. Another example which comes to mind is that there were a large number of property deals of considerable magnitude, and it was impossible for anyone outside—I know because we tried—to discover where the money was coming from. Suddenly an unknown name came into the news

bidding large sums of money for property companies, and I asked two people to see this person and find out where the money was coming from. Of course, we got nowhere until it eventually came into the open. That is the sort of thing that one has in mind when one thinks of practical financial considerations—anything which is out of the ordinary.

360. I should have thought that that type of evidence belonged more to criminal investigation than to a civil one.—I do not think it does necessarily, Sir. You are obviously right in the sense that the two cases to which I have just referred were criminal cases. But this thing is linked up in my mind with a further argument for the existence of some other body—the question of speed. It is speed of action, really, which is required to stop some of these things. There should be general knowledge that somebody was there to act quickly.

361. Before we leave this question of Board of Trade inspectors, you do rather accuse them—I do not use the word in an offensive sense—of over-caution and being too slow to move.—I do not accuse them, because I do not know the organisation sufficiently well to accuse them, but all one feels—looking back over the last few years—is that if there had been some organisation or individual who could have acted more quickly, and could have seen that something was odd, and said “This cannot be normal. I would like to know more about this”, certain things might have been stopped before they reached the magnitude they did reach.

362. Have you considered this side of it? I apprehend the appointment of a Board of Trade inspector certainly does not do very much good to the credit and standing and reputation of a company.—Yes, I agree.

363. Is it not right in those circumstances to wait for something in the nature of a *prima facie* case?—Your point is, of course, completely valid. In the same way the Stock Exchange Council has one action only which it can take—to suspend dealings—which again is a sledgehammer. When this happens the company is not finished but may find things very difficult. In the same way, I

agree that the appointment of a Board of Trade inspector appears in all the newspapers and immediately that company is suspect by everyone. On the other hand, I think it is a fact that, if there were some organisation—possibly part of the Board of Trade—to watch these things, to know what is going on in the financial and company world, to have their own sources of information, to be able to say that something must be wrong because Mr. X is offering a 12½ per cent. rate of interest in advertisements . . .

364. This is the body you suggest might be set up for the purpose of supervising the financial scene as a whole?—Yes. That is the sort of tentative suggestion that emerges from one's thought on this subject, that something in addition to what we have now does seem to be necessary. It might be an extension of the Board of Trade's functions, it might mean asking the Board of Trade to bring in a new type of expert, but I think there must be something extra which can be done.

365. One does not know how this body will be incorporated, who will be responsible for its financing, or what powers it will have.—I do not think it needs all the powers of the S.E.C., which has powers to do almost everything.

366. It would surely be intolerable that everything done in a company, which appeared to be a variation from the normal, should be made the subject of investigation by a body invested with a special power.—Yes, I agree.

367. I suggest that such a thing might find a very different reception in the newspapers than it does in the financial papers.—I am not suggesting that we should have the S.E.C. I think the powers of the S.E.C. go too far.

368. Yes. Of course, if an omniscient body could be found, a body of supermen who could judge each company in the twinkling of an eye, this would be a very valuable suggestion, but just another board or another committee might not aid matters very much.—I wonder, Sir, whether this in fact would happen.

369. There it is. The committee must bear this suggestion in mind, but it seems

to me, as at present devised, that it raises considerable difficulties.—Yes, it might well raise difficulties.

370. Then there is the question, which has been much discussed, of disclosure of beneficial interests, and your suggestion is that any shareholder who has a beneficial ownership of 5 per cent. or more of any class of vote-carrying capital should be obliged to notify the company. Do you agree that there would be great practical difficulty in carrying out such a provision?—I do not quite see why, Sir.

371. No one who is seeking to obtain control for an ulterior motive—and it is that sort of fellow whom you are after—no such person would tell a company about his holding, would he?—If he were bound to do so by law, I suppose he would have to, would he not?

372. Of course, if everybody complied with the law we could tear up the Companies Act, I suppose, but I am only suggesting that it is the rascal you are after.—Not exactly the rascal.

373. Someone with an ulterior motive.—No, I am not after the rascal. It is not the rascal I am thinking of.

374. Do you object to the holding of shares by nominees, on principle, lock, stock and barrel?—No. What one is thinking of is this. There are one or two cases which come to mind where there has been heavy buying of shares on the market, all of which are disappearing into a nominee holding. I think a good example was Massey-Harris. I think that was an outstanding case where such buying of shares went on over a long period, and Standards were worried, and everybody was worried about what was happening to the company. I think the whole of the organisation must have been disturbed, because they knew that this was happening and that all the shares were going into this nominee holding. I cannot see that that is good for the company. I can think of two other cases where something similar has happened.

375. You think that damages the company in some way?—Yes, it does. I cannot conceive that it does not damage the morale of the company, to know all

the time that someone is buying you up and you cannot know why. I do not think there is any doubt about it at all.

376. *Mrs. Naylor*: If the nominee's real name was known, would it not be just as disturbing?—I do not think so. Of course it might be, because the company might not know what they were doing it for. But it does give the board the opportunity of going to the buyer and asking "What exactly is happening?"

377. *Chairman*: I am not seeking to belittle your suggestion at all, and what I am asking is does one need to enact that anyone becoming beneficially entitled—not on the register but beneficially entitled—to 5 per cent. or more of the shares of the company, should be obliged to notify the company. I only intended to suggest that it is one thing to enact that and it is another thing to see that is carried out.—Yes.

378. And the type of man one is after, probably, would not be very forthcoming as to which shares he held beneficially. It might be inconvenient.—Yes. I am not disputing what you say, Sir.

379. There is another recommendation that any shareholder might be required to disclose to the company what if any interest he represented, and that would enable the company to demand information from the shareholder, as distinct from putting the onus on the shareholder to inform the company. It is another method of achieving your result. What do you think of that second suggestion?—I think it is quite a good one.

380. And that, probably, would be less difficult to carry out.—Yes, it probably would be. I think it is important that one should think of the morale of the company in this particular instance.

381. I am not sure I follow what you mean by the morale of the company.—The morale of senior executives, the morale of the board when they know that something is taking place and do not know what.

382. They would find out. That sort of case, you say, would be met by one or other of these proposals?—Yes.

383. *Professor Gower*: Might it in fact be met quite so clearly, because if a man

were operating through a large number of different nominees it would not be so easy to get the information as it would be if you were under an obligation to disclose if you had 5 per cent.?—Yes, that is correct.

Mr. Lumsden: There is also the point that the beneficial interest might be acquired without any transfer being registered at all.

384. *Chairman*: I think the objections to this suggestion are really centred round the difficulty of making such a provision effective against people who wanted to operate through nominees and keep their own identity undisclosed. The splitting up of your holding into several nominees, of which the illustration has been given, shows at once one way of getting out of it?—But if the one man was beneficially the owner of 5 per cent. it would not matter how many nominee companies he split himself up into.

385. It would make it more and more difficult to pursue, would it not?—Yes, it would.

386. I think that is all we can usefully say at the moment on that point. Then there is the suggestion that Section 209, the amalgamation section, should be amended so that all acquisitions of shares of a dissenting minority should require the sanction of the Courts in every case. I do not know if you think there is anything in that suggestion?—I have nothing to say on that.

387. Then I think you are in favour of abolishing the exemptions in regard to the Act conferred upon banks, insurance companies, discount houses and shipping companies?—Yes, Sir.

388. Could you tell us briefly your reason for that view?—I do not think anyone is harmed by publishing true and correct information. There is the particular case of the shipping companies. I do not think you can argue that their position is really different from that of a large number of other companies today. I do not see why, if you give this concession to shipping companies, it should not be extended. On the question of banks and insurance companies my position is this, that where strength exists strength

should be shown, and where weakness exists weakness should be shown. I do not think, I cannot conceive, that any of the major companies—when I say major companies I mean major insurance companies and banks—would suffer in any way if this exemption were withdrawn. If there were any weakness, say, in one or two of the smaller insurance companies, then I think it is right that the weakness should be shown. I do not see where the advantage is in concealment. If there is anything to conceal, if it is strength I think you lose; if it is weakness I think you lose again.

389. All the bank does is to show itself a little worse off than it really is?—I would not know what their true position is, but it is possible that it is so. If you are strong, let us know you are strong: If you are not strong I think it is right that your depositors, your policyholders or shareholders should know. I do not see in this modern world where we lose.

390. *Sir G. Erskine*: If you were weak you would not be able or want to build up any reserves. Would you put anything into them?—There is the supposition you might not be doing so; that is all. You would be putting in everything you have but an outside person might think there was something tucked away.

391. *Chairman*: If the banks and insurance companies can make out grounds for this exemption which are valid today, would you agree that they should be accorded those exemptions? In other words, exemptions should not be withdrawn merely for the purpose of conformity.—I quite agree. I am not saying that because 99 per cent. of companies have to do this that it is necessary for all to do it, but I think the onus of proof must lie on the one per cent. who are exempted.

392. The trouble might be that the shareholders would demand a bigger dividend?—I do not think in the modern financial world that is a matter of any concern to a bank or insurance company. I cannot conceive the shareholders of the Midland Bank summoning a meeting to force the Board to declare more than it should do in the interests of the depositors. It is a somewhat theoretical position: I do not think it practical.

393. *Mr. Watson*: This exemption to banks and insurance companies has persisted for a long time?—Yes.

394. It would be a major step to remove it?—Quite.

395. Would it not be a step that would require justification?—I would put it the other way and say the maintenance of the exemption should require justification.

396. Yes, but if you were to attempt that when no-one has suffered why should it be necessary?—I do not think that is a conclusive argument because you cannot prove no-one has suffered. Once again I think that the onus of proof lies very definitely on those that have exemption to show that exemption should continue, rather than that we should accept the fact it should continue because it has been allowed for the last fifty years. After all, this committee is sitting because the world has changed.

397. The Cohen Committee considered that in these companies the interests of depositors and policy holders outweighed the interests of the shareholders. Do you consider circumstances have changed in regard to that in the period of years that has elapsed?—No, but you imply the view that if banks and insurance companies disclosed their true position the depositors and policyholders would suffer. I would not accept that, because it would imply that insurance companies and banks were not so strong as we have imagined they were.

398. There is a possibility that this information might be misinterpreted, might it not?—There is always a danger that any information may be misinterpreted, but that is a question of public relations.

399. I gather you do not have any other leg on which to put forward this proposal?—No.

400. *Chairman*: Might not the mere fact that the banks and insurance companies were deprived of this exemption suddenly in the year 1960 or 1961 in effect be rather detrimental to their credit abroad? Would it not be said there was something wrong with these insurance companies and banks that they

have had to make full disclosure?—I do not think so.

401. You do not think there is anything in that?—I do not think so.

402. You have suggested that turnover figures and figures of manufacturing costs should be disclosed in the annual accounts. Could you give your reasons very briefly for that?—Very briefly, any information that helps an investor to assess the profitability and the progress of his company is worthwhile.

403. One has to take into consideration matters of expense and so forth, the question of disclosing information which might help competitors and those sorts of consideration?—I think that if you fear disclosure will help your competitors you under-estimate the intelligence of your competitors. I think they know if they want to what is going on in your business.

404. They can find out anyhow?—I think so.

405. Then you make a suggestion that all circulars soliciting proxies should be cleared for accuracy and adequacy with, for example, the Board of Trade?—I think all one really needs there is to lay down definite *pro formas* of what should be done. What one is trying to get away from is the sort of vote in which you put three or four things together, and the proxy really is only made out so that the shareholder can vote yes. He has to vote if he wishes to vote no. If he completes the proxy form he automatically votes in favour. We want something clear and something quite different. There is a very different type of shareholder today.

406. That really goes to the form of the circular?—Yes.

407. The circular should contain instructions—suitable instructions as to what he should do in order to cast his vote effectively?—I think so. Mainly at the back of my mind is the fact that you are getting today a most inexperienced, inexperienced type of investor. I do not know how many there are: certainly there are quite a large number.

408. Then you have a point about the voting power attaching to shares for the

time being in the company's pension fund?—Yes.

409. You say those shares should be voteless. Is not the answer that somehow or other, if not by law, these investments in pension funds ought to be vested in independent trustees?—Yes.

410. It is all very well to make the shares voteless, but that means the trustees are powerless to protect the interests of their beneficiaries.—What one has in mind is the pension fund of company "X" buying the shares of its own company, which could be used if necessary—I do not know any example where it has been used—to support the board or to put the final control in the hands of the board or the family.

411. That would be met would it not if independent trustees were appointed and the shares vested in them then, like any other trustees, would have voting rights?—Yes. It would depend on the weight we put on the word "independent". They would at the start have to be appointed by the board.

412. I should have thought you could have got some people who were independent of the board, but if we are out to catch the rascal, to use your expression, and we are thinking of a board which is using this method in order to perpetuate control in itself they might not search very hard for independent trustees. There may be other ways of getting over the difficulties. You say on the whole it would not be effective?—I am not saying that. It is just this, how do we interpret this word "independent"?

413. Public trustee?—Public trustee of course.

414. But you never know in these difficult days what is going to happen?—No.

415. I think the only other point I have got on your evidence is the suggestion that sizeable cross-holdings of shares, say, 25 per cent. or more, should be prohibited. Would you like to amplify that suggestion?—I think there are two types of cross-holdings which come to mind. First, you have companies A and B.

Company A holds, say, officially 20 per cent. in company B; company B holds 20 per cent. in company A. That gives them effective control of each other, and if they have common boards, which they often will have, very largely it perpetuates the power of control. They can both issue A voteless shares as capitalisation issues. Each company sells these shares and buys the voting shares. They therefore without any expense to themselves have stepped up their holdings, their control in each other, and you get a situation where the outside shareholder can in fact do nothing. That is one example that comes to mind. Another is where you have a group of companies—if you like say eight or nine—with each holding about five per cent. of each other. I think possibly 5 per cent. in that case would be enough. You might make it absolutely certain by going up to $7\frac{1}{2}$ or to 10 per cent. Then once again if there is a common board they are in complete control of all these companies and no outside shareholder can do anything at all.

Chairman: It certainly will be a point the committee should investigate further.

416. *Professor Gower:* Could I ask two questions? First on your remarks about circulars soliciting proxies. I rather understood from your memorandum you were suggesting something comparable to the American S.E.C. practice, but I rather gathered from your reply to the Chairman you would not go so far as that?—No, I would not go so far as that.

417. The second question is in connection with your suggestions about a supervisory body to intervene if things appear to be going wrong. Would it meet your case that the Board of Trade would get power to ask for information or call for the production of books, a power they could exercise without the same publicity which would attend the appointment of an inspector?—Provided there were the right people in the Board of Trade and the Board of Trade had adequate information coming into it, then that would satisfy my point. The whole thing would depend on the type of people working at the Board of Trade.

Chairman: We have no further questions. I am very much obliged to you for coming to help us.

(The witness withdrew.)

APPENDIX I

Memorandum by Mr. Harold Wincott

Before submitting my comments on the matters under deliberation, I should like to be allowed to make some preliminary observations.

(1) I am neither an expert on company law, nor a qualified accountant. It may well be therefore that there are technical difficulties in the way of implementing the reforms for which I am pleading, of which difficulties I am unaware.

I am merely putting forward the impressions of a financial journalist who has had a long experience of the manner in which the existing legislation has worked, and who has had perhaps unusual opportunities of seeing all sides of the questions involved—for example, the inherent disadvantages from which the small, personal shareholder often suffers; the difficulties even the most enlightened company director and executive encounter in presenting a true picture of the condition of the company with which they are connected; the opportunities which the existing legislation, albeit unwittingly, affords to the director and executive who are obscurantist either from habit, temperament, or cold intent; and the scope which such obscurantism affords to the sharp-witted to score over and make profit out of the small shareholder.

(2) In general, I must record my impression that there has been a very great advance in the legislation under consideration during the thirty years of my journalistic experience. There does not seem to me to be the need for major reforms such as, for example, those implemented in the Companies Acts of 1929 and 1948, or in the Prevention of Fraud (Investments) Act, 1958.

Company accounting standards of today are vastly higher than those of the middle twenties. And whereas before the first provisions of the Prevention of Fraud Act came into force in 1939, the *Investors Chronicle* published a regular weekly feature "Cautionary Notes" warning its readers against the activities of the "bucket-shop" and the share-pusher, the need for such warnings is much reduced today. Again, the abuses which marked the operations of some sections of the unit trust movement in the thirties have been made virtually impossible by the regulations for unit trusts issued by the Board of Trade under the Prevention of Fraud Act.

At the same time, because certain of the reforms which I now feel to be necessary amount to fairly sophisticated refinements of the present law, I find myself in some difficulty in suggesting how these reforms should be achieved without making the law unduly restrictive.

(3) My memorandum does not attempt to cover all the headings set out in the annex attached to Mr. P. E. Thornton's letter of 15th January, 1960. I have no experience of the workings of the Business Names Act, 1916, and, in the nature of things my working experience has been confined almost exclusively to public companies so that I have little to say concerning private companies.

In other directions, too, where I have no strong feelings on the questions raised, I have refrained from expressing any view.

(4) I would be obliged if the committee would regard the views expressed in my memorandum as my own personal views. In particular, the opinions expressed therein cannot necessarily be taken to represent the editorial policies of the papers for which I write.

(1) Incorporation of Companies—Memoranda of Association

(b) *Limitation of objects*

The question of any restriction placed upon the scope of a company's activities by its objects clause seems to me to be bound up with Heading (5) of the committee's annex, "Exercise of Powers of Companies by Directors and Degree of Control Retained

by Shareholders"; Heading (14) "Practice of Carrying on Business through Associated and Subsidiary Companies"; Heading (16) "Take-over Bids"; and Heading (21) "Accounts".

I shall in consequence be making comments on this question of limiting a company's objects under all these headings. Here, however, I would like to make some general observations which may serve as an introduction to my detailed comments later.

I would say that the modern practice of making the objects clause in the memorandum of association as wide as is common today, hence permitting a company to carry on virtually any kind of business, does accentuate many problems of company-shareholder relationships.

If it should be thought desirable, therefore, that a company's activities should not become too diffuse there is a clear case for attempting to achieve this at the source, namely by making the objects clause more meaningful, thereby clearly defining (and restricting) the scope of a company's activities.

To do so would not to my mind be unduly restrictive, as a company could expand the scope of its activities quite simply by getting the approval of shareholders to any widening of powers under its objects clause the directors desired to obtain.

In my opinion, the thought expressed in the preceding paragraph should run through any and all revision of the existing legislation governing companies and shareholders. I would submit that the right approach in these matters today can be summarised in the phrase "Consultation and Information".

We face the fact of a "share-owning democracy" in this country for the first time in our history. Inevitably, therefore, the number of unsophisticated investors is increasing and this to my mind is the main reason for considering revised legislation.

There is a great temptation to believe that these new and unsophisticated investors can be protected by elaborate and restrictive legislation. My experience is that this is not so, nor would I consider this to be the right approach if it were feasible. While obviously every step should be taken to prevent fraud, the best approach to the problems raised by modern trends in the company world is to bring shareholders in in a consultative capacity whenever possible and on every possible occasion, and to provide them (or their advisers) with the fullest possible amount of information on which to base a judgment.

(c) The company as a legal entity distinct from its members

I am not altogether clear what is involved in any consideration under this sub-heading of the Annex. I am aware that following the judgment of Lord Justice Evershed in July 1947 in the appeal of Short Bros., over the question of compensation to shareholders on the nationalisation of the company, a school of thought has grown up which argues that, in the words of Lord Justice Evershed, "The undertaking is something different from the totality of its shareholdings".

It is easy to get involved in metaphysical argument on such questions. As a matter of practical politics, however, it has always seemed to me that so long as a majority (let alone the totality) of shareholders has the legal power to remove directors, appoint their own representatives as directors, and if necessary realise a company's assets, pay off its liabilities and put it into liquidation, it is difficult to see what real force the Short Brothers judgment has. And it would, of course, be a major revision of our company legislation to take away from a majority of shareholders the powers to which I have referred.

In my own philosophy, any company which forgets that it has three co-equal interests to serve—those of its shareholders, its employees and its customers—will be failing in its duty and could not achieve the maximum degree of success, and it seems to me to be sterile to attempt to rank the claims of any one of these interests above those of the others.

(d) Shares of No Par Value

I have for something like 20 years now been strongly in favour of shares of no par value, and gave evidence before the Gedge Committee which considered the matter.

That committee, with one dissentient, did of course recommend that such shares should be made permissive and as the Annex records the Government has announced its intention of implementing the Gedge Committee's recommendations.

Nothing that has happened since that committee reported has made me change my view that the making of no par value shares permissive is a desirable reform. Indeed, the considerable growth of the number of small shareholders in recent years seems to me to make this reform even more desirable.

From my experience as a financial journalist, I know that unsophisticated investors have great difficulty in understanding why a share which stands at, say 65s. in the Stock Exchange has a nominal value of, say, 5s., and I have positive evidence that the "capitalisation issues" which are a necessary feature of nominal capitalisations in fact do damage by encouraging investors to believe that they can consume capital without being any worse off.

Now that it appears probable that there will be a clause-by-clause revision of the 1948 Companies Act, it seems to me essential that the opportunity should be taken to give powers to companies to issue shares of no par value, and to make the many consequential alterations in the Act which will be necessary.

(5) Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) *Fundamental Changes in Company's Activities*

I have already made some comment on this matter under (1) (b). This whole question has come much to the fore in recent years, largely but not exclusively because of the vogue of take-over bids, which have been one of the main means by which "a fundamental change"—difficult though this may be to define—in a company's activities takes place. The other means by which such a fundamental change can take place is, of course, by the gradual building up of new "divisions" of the business as the result of the use of ploughed back profits, or new issues of capital.

The modern trend towards "diversification" seems to me to be one of the most significant developments in the company world since the last revision of the Companies Act. Much diversification is natural, although it may involve a fundamental change in a company's activities.

Such natural diversification is inevitable in an age of great and rapid technological progress, and has in any case been greatly expedited by two major wars in which much industrial capacity which was formerly devoted to "non-essential" purposes was perforce turned over to new processes.

I do not think any reasonable person would object to or want to stop such diversification which, being a gradual or a natural development, should stand every chance of being successful. But I do think that however gradual and natural such development may be, shareholders should be "kept in the picture" from the earliest possible moment, even if their sanction is not sought through an approval of the widening of a company's objects clause. I also think that this trend calls for new standards in accounting to shareholders (and the public) which is a matter to which I shall return subsequently.

The second way in which diversification occurs these days is through the industrial holding company but since no fundamental change in the holding company's activities is involved I do not propose to say anything about such companies except to say that here too new standards in accountancy may be called for.

The most difficult case involved in diversification is undoubtedly where a fundamental change in a company's activities takes place through take-over bids. I am, of course, aware that even here it may be argued that it is impossible to define with any exactitude what a "fundamental change" is.

But even if this difficulty be conceded—and too much can be made of it—diversification by such a method does raise basic issues of the exercise of powers of companies by directors and the degree of control retained by shareholders.

There seem to me to be two main considerations here. First, there is the danger that a company over-anxious to expand and diversify may bid an uneconomically high price for a second company it wishes to acquire, and may do so without giving its own shareholders any opportunity of saying whether they approve, either of the general decision or of the price (and hence the extent of the dilution of their own equity) to be paid for implementing it.

It would appear to me that on general principle there is every reason in such circumstances to require that the company making the take-over bid shall only make it subject to the action of the directors being approved by their shareholders by special resolution before the bid becomes operative.

There may well be a case for excluding from such a requirement quite small take-over transactions. But I think the needs of the situation would be met if it were required that any take-over bid which involved the issue of more than, say, 10 per cent. of the bidding company's equity capital should be subject to confirmation by the shareholders of the company making the bid.

The second major consideration concerns the company for which a bid is made at an uneconomically high price. I make some remarks concerning the broad economic effects of take-over bids later in this memorandum, and in general I would do nothing to stop them.

But I must say that I am worried by the possibility that the directors of an efficient, well-run company might be confronted by a take-over bid for the company's shares on a recklessly generous basis. It might be impossible for the directors of the company being bid for to take any effective action to forestall it.

In general, I consider it not unreasonable that shareholders of the company being bid for should also be required to approve of the offer by special resolution. (This, of course, brings us on to the heading *(b) Disposal of Undertaking and Assets* in the Annex.) It is doubtful in the nature of things whether this would prevent the reckless bid from succeeding, but the slowing down procedure and the publicity resulting from the meetings of shareholders of both companies concerned could result first in the shareholders of the company making a bid which seems uneconomically high not ratifying it, and secondly in making directors in general more cautious over making such bids.

(c) Issue of Shares

Here again recent happenings have raised the question of share issues being made to finance a take-over bid and/or a "fundamental change" in a company's position without shareholders of the company issuing the shares being consulted.

Considerable criticism has been aroused where a substantial block of a company's equity capital has been issued, on terms which appear to be very favourable to the company taking the shares up, without any consultation of the shareholders of the company issuing the shares. Where an increase in authorised capital is necessary before the deal can be completed, shareholders are, of course, required to sanction the increase. But it would seem to me desirable again to require that any issue of equity shares to an "outsider" involving more than, say, 10 per cent. of the equity capital of the company making the issue to be ratified by the shareholders of that company.

(6) Directors' Duties

(c) Directors' and Officers' dealings in their own companies' shares

In my opinion, the existing requirement that the register of directors' shareholdings should be available for inspection by any member of the company for a period of fourteen days before the date of the company's annual general meeting and ending three days after the date of its conclusion should be extended so that the register shall be available for inspection by any member at any time during normal business hours, and that copies of the register should be available on payment of an appropriate fee. I think there is also a case for extending such provision to cover any shares not directly held by a director but in which he is beneficially interested.

(7) Shares with Restricted or No Voting Rights

I feel strongly that all such shares should be made illegal. I am familiar both with the circumstances which have brought them into being and with the classical arguments in their favour, e.g. "that no-one is forced to buy them or hold them".

But it seems to me to be nonsense for a society to have the declared aim of establishing a share- (or property-) owning democracy and then to permit the existence of a type of share which disfranchises the holder.

Moreover, the issue of such shares by way of "capitalisation issue" facilitates the securing of control over the years, by cross-shareholdings, of companies by persons with little or maybe no financial stake in them. Company A starts off with a relatively modest holding of voting shares in Company B; and *vice-versa*. Over the years, both companies make capitalisation issues in non-voting shares, sell them and use the cash proceeds to buy voting shares.

Such shares have been acceptable in my view solely because of the general prosperity of the country over the period during which they have become so prevalent. Should companies issuing non-voting shares fall upon evil days, however, literally nothing could be done, in the case of companies controlled by cross-shareholdings, or where the voting equity is concentrated in the hands of one man, one family, or one hoard, to change the management or the policies of the company concerned. The question of non-voting shares thus goes beyond the fortunes of shareholders to the economic well-being of the country as a whole.

I believe I am right in saying that South African company law makes such shares illegal, and insists that a member's votes shall be proportionate to the ratio which his equity shareholding bears to the whole equity capital. I would welcome similar legislation in this country.

There remain the questions whether such legislation could or should be made retrospective and whether holders of voting shares are entitled to be compensated if non-voting shares are enfranchised.

I am in general opposed to retrospective legislation but I have come round to thinking it would be justified in making the issue of non-voting shares illegal. So many such shares have been issued in recent years that retrospective legislation seems called for. It is, I think, quite useless to appeal on ethical grounds to companies which have issued non-voting shares to give these shares votes, for generally such shares have been issued with the cold and precise intent of securing control with a minimum of financial outlay.

I am well aware that a way might be found round legislation on the lines of that adopted in South Africa but I am anxious that we in this country should reach a position where we could say to the governing bodies of our Stock Exchanges: "We have wiped the slate clean. All equity shareholdings now have votes. It will be up to you to keep a vigilant watch on any attempt to re-introduce any such shares again and to withdraw permission to deal in the shares of the company making the issue."

As to the question of compensation to be paid to holders of voting shares for enfranchising non-voters, it seems to me to be ironical that the people who have themselves created a special value for the shares they hold should be compensated for doing away with that value. But I feel so strongly that we should get rid of non-voting shares that I would pay even that price to achieve my goal. There is also the difficulty of the "outside" shareholder who for one reason or another may have paid a substantial premium to buy voting shares, and there is a clear case for compensating him for taking away a special value for which he has paid.

(8) The Protection of Minorities

Important issues are raised by the unsatisfactory position in which minority shareholders have been placed as a result of take-over bids in recent years. Many examples could be quoted, generally involving what are known as "Shell Companies", with which the committee will be familiar.

Often the control of such a company has been acquired for the purpose of employing its surplus liquid assets in other directions. "Control" can be *de facto*, not *de jure*,

and sometimes the "stranded minority" can be as large as 50 per cent. or more of the equity capital. The minority is "stranded" because the objects, of the business in question having undergone a fundamental change, the Stock Exchange authorities will very properly withdraw permission to deal until such time as the company submits full details of its new activities, reconstituted assets, and so on.

But in practice the new controllers may not submit such details, and the minority shareholders are thus left with unquoted shares in a business the activities of which have undergone fundamental change and whose fortunes they are powerless to affect.

There is admittedly a provision under Section 165 (b) (iii) of the present Companies Act under which the Board of Trade may appoint "one or more competent inspectors to investigate the affairs of a company" if "it appears to the Board that there are circumstances suggesting" that the shareholders "have not been given all the information with respect to its affairs that they might reasonably expect".

But, again in practice, even when shareholders in such companies have not been given all the information they "might reasonably expect", the Board of Trade has not acted, and short of being requested to do so, it is probably unreasonable to expect that it will, of its own volition. Moreover, since in the nature of things it is generally speaking the small shareholders who get left out of and stranded by such take-over bids, it is not surprising if no action is taken, since such shareholders are probably unaware of the powers conferred on them by the 1948 Act.

It would seem to me to be useful if a body analogous to the Securities and Exchange Commission of the United States (S.E.C.) could be set up in this country to which such matters could be referred. Such a body, being specifically and exclusively concerned with the protection of investors, would almost certainly come to be associated in the public mind with investment matters to a much greater extent than the Board of Trade is. It could work in close conjunction with the Stock Exchange authorities, which could draw attention to the plight of the "stranded minorities" under discussion, and to other matters which they considered needed investigation.

Probably too a close and useful co-operation would develop between the financial Press and a body similar to the S.E.C. The financial Press, it is safe to say, is in a unique position in that its readers will keep it informed of matters and trends where they may hesitate to get involved with "officialdom". To my mind it seems certain that certain financial scandals of recent years could have been avoided, or would not have "mushroomed" as they did, if those involved had been approached with a request for reasonable information concerning their activities by officials of such a body as the S.E.C., whose field of activities would cover all facets of investment.

This, I would emphasize, is not a case of being wise after the event. The financial Press did draw attention to the dangers inherent in the cases I have in mind but nothing was done until the crashes—which I personally had always thought were inevitable—did in fact happen.

The financial Press does often co-operate with both the Board of Trade and "the Fraud Squad", but on our experiences of the last few years it would seem that a body analogous with the U.S. Securities and Exchange Commission would be a useful watchdog which could act where the Board of Trade does not and where "the Fraud Squad" is too drastic a weapon to employ.

(9) Protection of Special Classes of Shares

In general, I think opinion in industry and in the City has moved far enough in recent years to ensure in most cases that companies do not "get rid" of their Preference shares on terms which are grossly unfair to holders (i.e. repay at par a high coupon Preference share which would otherwise command a premium in the market). Generally speaking, the protective organisations of the institutional investors can be relied upon to prevent unfair treatment of this kind. It remains to be considered, however, whether there may be a case for statutory protection of Preference shareholders by requiring that they shall be given the option of being repaid either at par or at an average of market values before the proposal for repayment arose.

(10) Board of Trade Powers to Appoint Inspectors

I have dealt with one aspect of these powers under (8) The Protection of Minorities. I have no other comments to offer on these powers.

(11) Disclosure of Ownership and Control

As a matter of general principle, I am strongly in favour of full disclosure of ownership and control. In practice, however, I do not think there is any effective means of preventing a person from disguising where beneficial ownership or control lies, although it is my understanding that in America such ownership or control must be disclosed. As I point out under (16) Take-over Bids, however, it seems to me to be reasonable that a bidder for shares in a take-over bid should be required by law to disclose his identity when communicating his offer to shareholders. I have also suggested under (6) Directors' Duties (c) *Directors' and Officers' dealings in their own companies shares* that directors should be required to disclose where they are beneficially but not directly interested in shares.

(14) Practice of Carrying on Business through Associated and Subsidiary Companies

My comment here is concerned with associated companies. I do not believe anyone knows precisely what an associated company is. But in practice it is something between a subsidiary company and a trade investment. (I have, in fact, known cases where a shareholding in an associated company has appeared in the balance sheet as a trade investment.)

This question of associated companies has come right to the fore in several recent instances of take-over bids and also arises because of the modern trend towards diversification. The investment in question can appear in the holding company's balance sheet at a purely nominal figure and since there is at present no requirement that the associated company's profits and asset values shall be consolidated (proportionately) in the holding company's accounts shareholders in the latter company can be completely ignorant of the existence of a valuable hidden asset. In such a situation, the small shareholder is almost invariably at a disadvantage compared with the person making the bid.

I would suggest (a) that wherever a trade investment or a holding in an associated company has a Stock Exchange value this value must be stated by way of footnote; and (b) that where a company holds more than 10 per cent. of the equity capital of another company, that company not being a subsidiary, then the holding company shall be required to state by way of notes to its accounts the amount of the dividends paid by the associated company or companies and received by the holding company in respect of the year being reported on and also the amount of the earnings from which these dividends have been paid attributable to the holding company by reason of its investments in such associated companies.

(16) Take-over bids

As I have said under (5) (a) *Fundamental Changes in Company's Activities*, I would do nothing to stop take-over bids which may have had their undesirable aspects but have on the whole done much to secure the fuller and more efficient utilisation of companies' assets.

However, I think there is a case for slowing the process of a take-over bid down; for bringing shareholders of the company making the bid into the picture by requiring their consent if and when the bid involves the issue of more than, say, 10 per cent. of their company's equity capital; and for fuller disclosure of certain particulars, including the identity of the bidder.

Various professional bodies have attempted to evolve a "code of conduct" for take-over bids. The codes, so far as I have understood them have been admirable but of course have no power of law behind them and have I think been ignored on more than one occasion.

For that reason I was the more delighted when the Board of Trade in May, 1960, drew up a new official set of rules governing the conduct of licensed dealers' business which among other things lay down the manner in which take-over bids must be made. These new rules seem to me to meet most if not all of the needs of the case.

(21) Accounts

Although I have paid tribute in the opening passages of this memorandum to the great improvement in company accounting standards as a result of the reforms embodied in the Companies Acts of 1929 and 1948 it will be evident from other passages that I do not think there is as yet sufficient disclosure of information about the financial position of a company, including its subsidiaries and associated companies.

Although the primary objective of the Companies Acts as I understand things is the protection of the investing public—and in that respect the existing Act still leaves something to be desired—it seems to me to be important to remember that the disclosure of further information in company accounts may well also protect the public in its capacity as consumer and increase the nation's overall economic efficiency.

It is in this connection that I would urge the desirability of all public companies in this country following the general practice of such companies in the United States, and the example of a handful of our leading companies here, in publishing details of their turnover, or sales figures.

It has been contended by experts that turnover figures by themselves are of but limited value as a means of judging the efficiency of a business or for the purpose of comparing one business with another. (Such comparisons do in my opinion bring the pressure of shareholders' and public opinion in general to bear on managements which emerge unfavourably from such comparisons and thus tend to increase efficiency.) Some of these experts, however, do not conclude from this that turnover figures should not be published. They argue that the profit and loss account should disclose, in addition to turnover, the outgoings, distinguishing between purchased materials, variable overheads and other direct costs on the one hand, and fixed overheads on the other. With these views I concur.

(a) Revaluation of fixed assets and use of any resulting surplus

I am strongly in favour of up-to-date valuations of fixed assets. The case for revaluation of "old" assets was of course much stronger in the early post-war years than it is now when the assets of most companies include a high proportion of "new" post-war assets valued in their accounts at reasonably realistic levels. Even so, there seems to me to be everything to be said for valuation of fixed assets at a realistic level—which I would define as replacement costs depreciated to make allowance for the age of the asset.

Without such a realistic valuation, a company's pricing policy may be quite erroneous; its profits may be insufficient to provide adequate depreciation; its dividends may be too high. In fact, customers, employees and shareholders of such a company may be quite unwittingly consuming the substance of the business.

In addition to this, the expression of annual profits as a percentage of the true capital employed in the business is a useful check on a company's efficiency, both relatively and absolutely. Where the true capital employed in a business cannot be known because fixed assets are taken in at historic and unrealistic levels, the value of such a test is naturally reduced.

Incidentally, the understatement of the real worth of fixed assets has in my opinion been one of the most potent factors behind the growth of take-over bids in the last seven or eight years. Understatement of fixed asset values does not deceive the sophisticated expert who has his own means of establishing true values. It merely misleads the general public, as shareholders, into accepting what seems to be a very generous bid which, in fact, is very far from being generous, or into selling shares on the market at an unduly low price.

Any surplus resulting from a revaluation should in the absence of very good reasons to the contrary be transferred to capital reserve and either capitalised by way of scrip issue or held inviolate there.

(b) *Share Premium Account*

I have no comment to make on this, except to say that if no par value shares become permissive companies with no par value shares will no longer have share premium accounts in their balance sheets.

(d) *Description of reserves*

I have little to say on this, except that as a matter of general philosophy I regard reserves as falling into two classes—those relating to the owners of the business and those representing liabilities to people outside the business. So far as the first category is concerned, my own feeling is that the fewer different kinds of reserve funds maintained the better. I would prefer to see the two headings

Capital and Surplus
Undivided Profits

set out in the balance sheet and aggregated under the heading of "Shareholders' Funds".

So far as the second type of reserve is concerned, these should be clearly and specifically stated under appropriate headings—"Future Tax Reserve", "Staff Pension Reserve", etc.

(e) *Definition of Profits*

I have little to say here, except that I would like to see the use of the word "profit" in company accounts restricted to the item which is as near as one can get to what the economist would define as profit. (In my opinion, true "profit" is only that residue of the benefit from a year's trading which can if required be distributed fully to shareholders without in any way whittling down the real substance of the business.) In other cases ("trading profit", etc.) I would prefer to see the word "surplus" or "earnings" used.

(f) *Exemption of banks, assurance and shipping companies from some of the accounting provisions of the Companies Act, 1948*

In general, I have no sympathy with these exemptions. Sometimes, where they are intended as a protection against foreign competition, I think they are ineffective, for I think most businessmen know a great deal more about their competitors than they care to admit.

But if they are ineffective so far as competitors are concerned, they are certainly effective in preventing shareholders in such companies from assessing the true value of their shares. Recently we had the extraordinary spectacle of one bank suddenly revising its profits upwards by 50 per cent. because it no longer needed to put so much to hidden reserves.

This action preceded a take-over bid, which was successful, by the Hong Kong and Shanghai Banking Corporation for the capital of the British Bank of the Middle East. In this take-over bid, shareholders of the bank taken over had no means of judging for themselves whether the bid was adequate, for it was a proviso of the bid that the real position of the British Bank of the Middle East should not be disclosed.

I think we should always keep in mind in such cases the position of the shareholder who sells his shares in front of such developments because on all the known facts they seem fully valued. It has always been regarded as undesirable, indeed criminal, in this country to mislead a shareholder by overstating the position into paying too much for his shares. I see no logic in company law which permits companies to understate their position and thus to mislead their shareholders into receiving too little for their shareholdings.

There is, of course, also an economic point involved here. The efficient bank, insurance company or shipping line may be prevented from reaping the benefits of their efficiency because of these exemption provisions. On the other hand, the inefficient concern can shelter under the provisions of these exemptions and not suffer as the result of its inefficiency or lack of enterprise: at least, it won't suffer as much as it would from full disclosure. (In this connection, it may be argued that no

company is bound to take advantage of the exemption provisions—and indeed at least one major shipping company does not do so—but I suspect that some insurance companies which would not be at all averse to disclosing the market value of their investments hesitate to do so for fear of upsetting other companies.)

It seems to me that if the board of directors of one bank make correct investment decisions, as a result of which they can show the market value of their portfolio to exceed the balance sheet figure, while the board of the second bank make wrong investment decisions and would show the balance sheet value of investments not to be fully represented by market values, then, if the second bank lost deposits to the first, or if its shares were quoted on the Stock Exchange to yield 1 per cent. more than the shares of the first bank, this is as things should be. I can think of no better way of encouraging the board of the second bank to make correct decisions next time.

It will, I am sure, be within the knowledge of the committee that similar companies in other countries seem to manage very well without comparable exemptions from full disclosure.

I would like in conclusion to make one general comment on accounts which ties in with much of what I have said earlier.

I have always felt that the major step forward in the 1948 Companies Act was the provision for consolidation of subsidiary companies' balance sheet and profit and loss accounts with those of the parent company. It is a long time now since consolidation became compulsory and I think we have forgotten what a revolution it represented and what astonishing differences pre- and post-consolidation accounts of the same group often threw up. There again, in passing, there must have been considerable resentment among shareholders who sold their shares on the market valuation based on pre-consolidation accounts only to find that the shares appreciated considerably so soon as consolidation showed the true facts of the case.

Because of what has happened between 1948 and today, however—largely, the trend towards diversification—it now seems to me that consolidated accounts can often conceal more than they reveal. We may well have reached the stage where we need both consolidated accounts *and* enough detail of how each of the subsidiary and associated companies has fared if directors of companies which diversify are to be accountable to their shareholders and the community for the success or otherwise of their diversification policy.

Even such a provision—for consolidated accounts *and* separate details of the experience of subsidiary and associated companies—could, of course, be circumvented easily enough by liquidating subsidiary (and perhaps associated) companies and running their businesses as "divisions" of the parent company. In that event, in my opinion, we should then need to consider a requirement in the Companies Act stipulating that where a company's turnover could be apportioned into clearly distinguishable activities then directors would be obliged to present the results of each "division" as if they had continued to operate through subsidiaries.

APPENDIX II

Memorandum by Courtaulds Limited

(1) Incorporation of Companies—Memoranda of Association

- (a) *Requirements as to minimum number of members and other conditions as to incorporation, and*
- (b) *The company as a legal entity distinct from its members—"one-man" companies*
- (c) *Limitation of objects to those stated in the Memorandum: obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects.*

The company offers no comments on these matters.

This matter was fully considered by the Cohen Committee, but the conclusions and recommendations of that Committee set out in paragraphs 11 and 12 of their Report were not in fact implemented in the Companies Act, 1948. It is submitted that effect should now be given to the views of the Committee, with the result that as far as third parties are concerned every company would have the same powers of contracting as an individual, and that objects clauses would operate only as a contract between the company and its shareholders as to the powers exercisable by the directors.

(d) *Shares of no par value*

The Company has no objections to the recommendations of the Committee on shares of no par value.

(2) Prohibition of partnerships with more than 20 Members

This is not a matter which concerns the Company.

(3) Classification of companies

Again this is not a matter of direct concern to this Company, and the Company offers no comments on it.

(4) Donations by companies for charitable and political purposes

The Company does not make donations for any purpose of a political nature. The Company does contribute to a number of charities, the policy being that contributions should be governed by the extent to which the objects of charities may be of some direct or indirect benefit to the Company or its employees.

(5) Exercise of powers of companies by directors and degree of control retained by shareholders

These are not matters on which the Company wishes in general to offer any comments. It is felt, however, that fundamental changes in a company's activities should not be brought about without reference to the shareholders; if the recommendations of the Cohen Committee referred to at (1) above are implemented, it is to be hoped that objects clauses in Memoranda of Association will be more narrowly and realistically drawn, so that a fundamental change of object would require an amendment of the clause.

(6) Directors' duties

It is suggested that the provisions of section 195 of the Companies Act, 1948 should be simplified in relation to the holdings of directors of a company in subsidiary or holding companies. This section resulted from a recommendation of the Cohen Committee (page 50, Recommendation 1).

The proviso to sub-section (1) takes outside the section shares in a wholly-owned subsidiary company. It is submitted that this exception might be extended to cover companies which are almost wholly-owned subsidiaries, and that in relation to other subsidiary companies which are left within the section the entries which must be made in the register could be greatly simplified.

Paragraphs 86 and 87 of the Cohen Committee's Report show that section 195 was intended as a safeguard against improper transactions by directors. Although it is, of course, possible for such transactions to be carried out in some circumstances in the shares of subsidiary companies, it is submitted that a simplification of the requirements of the section in relation to subsidiaries could be made which would save considerable administrative trouble and would not weaken the operation of the section in safeguarding shareholders against real abuses.

(7) Shares with restricted or no voting rights

Holders of the non-participating Preference Stock in this Company have their voting rights restricted in the usual way. No restrictions of any kind are or ever have been placed on the voting rights of holders of Ordinary stock, and it is the view of this Company that such restrictions are unnecessary and undesirable.

(8) The protection of minorities

(9) Protection of special classes of shares

(10) Board of Trade powers to appoint inspectors

(11) Disclosure of ownership and control

} The Company offers
no comments on these
matters.

(12) Share transfer and registration procedure

The Company has a number of suggestions to make in this connection.

Section 52: It is difficult to see what useful purpose is served by the return of allotments. The necessity for making a return causes a certain amount of work for officers of companies and must also cause work for the Registrar. It is suggested that the return of allotments might well be dispensed with altogether. If it is felt that a return is desirable, it is suggested that a simple return showing the number of shares allotted would be sufficient. If neither of these suggestions is accepted, there are two minor reforms which the Company would welcome, the first being the elimination of the requirement that a return should show the description of the allottees, and the second an extension of the period within which a return must be made from one to two months.

Sections 61(I)(c) and 62: It is submitted that the distinction between stocks and shares is now irrelevant, and the conversion from shares into stock should be unnecessary. All the shares in this Company have in fact been converted into stock. In theory conversion into stock used to have two advantages—

- (i) it enabled the holder to divide his holding for the purposes of transfer into fractions of any amount without restricting him to units as in the case of shares;
- (ii) it simplified the company's work in keeping the register and issuing certificates, since the register need only show the amount of stock held by each member, whereas shares had each to be identified by a separate number.

In practice neither of these advantages any longer exists. The Articles of most companies in fact prohibit the transfer of stock in units of less than a fixed amount. Under section 74 of the Companies Act, 1948, if all the issued shares of a class are fully paid and certain other conditions are fulfilled, none of those shares need have a distinguishing number.

The distinction between stock and shares is sometimes a nuisance. If an existing company with stock wishes to make a bonus issue it cannot issue stock direct, but must go through the motions of making the issue in the form of shares and then converting them; there appears to be no practical advantage in this.

It is suggested that the power to convert shares into stock should cease to be exercisable in future, and that companies at present having stock should be free to make bonus issues of stock to their stockholders. It may be that the distinction between shares and stock could be entirely abolished.

Section 113(2): The charge of sixpence for every 100 words of a copy of the register is now too little. The charge should be at least one shilling and possibly more; and it is suggested that power might be taken to vary the amount of the charge specified in any new Act by order. The period of ten days in which a copy of the register must be supplied is now far too short for a large company. The sub-section was no doubt intended to be used by members of a company and other persons with a direct interest in it, and it seems doubtful whether it was ever envisaged that outside persons such as advertising agents would use it to obtain complete copies of the whole register of a large company. This, however, does now happen.

Section 117: It has been suggested that this section prohibits the entry on the register of any reference to a designated account, such as "Mr. A. B.—No. 2 account". As a matter of law this construction is probably incorrect, but it is suggested that the matter needs clarification.

(13) Multiplicity of directorships held by one individual

It is the policy of this Company that its directors should, except in exceptional cases, devote the whole of their time to the business of the Company and its subsidiaries. It is a term of the contract with each executive director that he should do so, and that he should not accept any directorship of a company outside the Group without referring the matter to the Board of this Company and getting its written consent. There are only four members of the Board who are not executive directors, and in practice none of them holds any large number of outside directorships.

(14) Practice of carrying on business through associated and subsidiary companies

The Company has no suggestions to make for changes in the law on this subject. The original business of the Group is still carried on by the parent company through a number of functional divisions, but there are in addition a number of subsidiary and associated companies which fall broadly into four categories:—

- (i) subsidiaries originally established to handle overseas sales, e.g. Samuel Courtauld & Co. Ltd. (fabrics); Lustre Fibres Ltd. (yarns); Prinex Ltd. (machinery);
- (ii) subsidiaries which were originally independent concerns but have been acquired by the Company, e.g., British Celanese Ltd; Gossard (Holdings) Ltd.; Pinchin Johnson & Associates Ltd.; in addition a number of companies have been acquired by Group Developments Ltd., which is in itself a subsidiary set up to handle the Group's diversification activities;
- (iii) subsidiaries established overseas, principally those established in North America; and
- (iv) subsidiaries in which other companies have an interest (e.g., British Cellophane Ltd. and South African Industrial Cellulose Corporation (Pty.) Ltd.) and associated companies (e.g., British Nylon Spinners Ltd., S.N.I.A. Viscosa and Courtaulds (Australia) Ltd.).

(15) Loan Capital

The Company has no loan capital and has no suggestions to make in this connection.

(16) Take-over bids

The Company has used the procedure laid down in the 1948 Act on a number of occasions, notably in the acquisition of British Celanese and more recently of Pinchin Johnson & Associates. On every occasion the Company has disclosed its identity when making its offer. The offers have always been supported by the Board of the companies concerned, and in no case has any rival offer been made. The Company has experienced no difficulties, and has no suggestions to make for changes in the law except in relation to the minor point mentioned below.

(g) *Section 209(3) and (4)* at present provides that in the case of a take-over the consideration for the compulsory acquisition of the shares of the residual dissenting

shareholders shall be paid to and held in trust by the company which has been taken over. It is submitted that some independent person (such as a bank or the Public Trustee) would be a more appropriate trustee. From the point of view of the companies concerned, the holding of money or shares in trust for certain former shareholders, possibly over a prolonged period, is often inconvenient. The subsidiary company which has to act as trustee has generally no experience of doing so, so that a disproportionate amount of administrative time is often involved; in addition, difficulties arise on the winding-up or reconstruction of that company. From the point of view of the person for whom the money or shares are held in trust, it seems surprising that he should have to accept as trustee the wholly-owned subsidiary of a company with which he has declined to deal, and it is suggested that he would generally prefer to deal with a wholly independent trustee.

(17) Prospectuses

The Company has no comments to offer on this matter.

(18) Control over business of dealing in securities

(19) Unit Trusts

These matters are not of direct concern to the Company.

(20) Reduction of capital and purchase by a company of its own shares

The Company has no comments to offer on these matters.

(21) Accounts

There are a number of detailed points on which the Company would welcome amendment of the 1948 Act:

Section 149(5)(b)(ii). The effect of this provision is that a consolidated profit and loss account must show how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the company. The achievement of this end in practice is obtained in one of the following ways:—

							£
<i>Either</i>							
Group Profit before tax	..	..	..	..	..	..	100,000
Deduct: Charge for taxation	..	..	..	..	..	..	50,000
							50,000
Deduct: Minority shareholders' proportion of profit less tax	..						10,000
							40,000
Deduct: Amount of profit retained by subsidiaries	..	..					12,000
Balance of profit dealt with in the holding company's accounts	..						£28,000
<i>Or</i>							
Group Profit before tax	..	..	..	..	..	..	100,000
Deduct: Charge for taxation	..	..	..	..	..	..	50,000
							50,000
Deduct: Minority shareholders' proportion of profit less tax	..						10,000
Balance of profit for the year attributable to the members of the holding company (of which £28,000 is dealt with in the accounts of the holding company)	..	..	..	..	..	..	£40,000
<i>Appropriated as follows:</i>							
Retained by subsidiaries	..	..	..	..	..	..	12,000
Retained by holding company	..	..	..	..	..	..	20,000
Dividends paid, less tax	..	..	..	..	..	..	8,000
							£40,000

It is considered that the second method of presentation makes it clear that the retentions by the subsidiaries and by the holding company are of the same nature. They are given the same emphasis, and by being brought together it is believed that lay readers of accounts will be assisted in their understanding of the profit and loss account. By showing the results for the year in this way it is submitted that the words in brackets "of which £28,000 . . ." are superfluous, but the section at present appears to require their insertion.

It is suggested that section 149(5)(b)(ii) should be amended by inserting after the word "is" the words "or is not".

Section 153(I) reads:

"A holding company's directors shall secure that except where in their opinion there are good reasons against it, the financial year of each of its subsidiaries shall coincide with the company's own financial year."

In practice it happens that more often than not there are good reasons why the accounting years of subsidiaries should not coincide with those of the holding company, so that the sub-section probably has effect in a comparatively limited number of cases. It is submitted that it serves no useful purpose and should be repealed.

8th Schedule, paragraph 5(I)

This sub-paragraph deals with the method of arriving at the amount of any fixed assets. Like the rest of the Act, it appears to envisage only a "going concern" valuation and it does not fit the less common method in fact adopted by this Company of valuing assets "as new".

It is suggested that paragraph (b) of the sub-paragraph should leave the choice between the date of acquisition and the date of valuation open in all cases, whether the assets concerned have in fact been revalued or not. In addition a provision should be added to the effect that the amounts shown in the accounts of a subsidiary company under paragraphs (a) and (b) may, if the directors of the holding company consider it necessary, be merged with similar items in the holding company's accounts for the purposes of the consolidated balance sheet.

8th Schedule, paragraph 6

This paragraph provides that "the aggregate amounts respectively of capital reserves, revenue reserves and provisions (other than provisions for depreciation, renewals or diminution in value of assets) shall be stated under separate headings". It is suggested that the distinction between capital and revenue reserves is artificial. In practice, capital reserves in published accounts represent amounts regarded at the time in question as not available for distribution, whereas the lay reader of accounts generally believes that such reserves represent profits which can never in any circumstances be so available. It is submitted that it would be more realistic to distinguish between—

- (i) the share premium account (since under the Act the application of share premiums is restricted);
- (ii) unrealised capital profits (that is to say profits arising out of the revaluation of fixed assets or of any other assets in the accounts; this item would be maintained for so long as the corresponding element involved in the writing-up of assets remained and had not been written off against undistributed profits); and
- (iii) undistributed profits (which should be a single item including all realised profits on disposal of assets and any other exceptional items not regarded by the directors as profits for the year, as well as the balance of profits year by year from trading and investment income).

There should be no specific reserves, because in time either such reserves become general, and therefore become part of the undistributed profits, or, on some contingency materialising, they take the form of provisions.

It is therefore suggested that in paragraph 6 of the 8th Schedule for the words "capital reserves, revenue reserves" there should be substituted "the share premium

account, unrealised capital profits, undistributed profits". Consequential amendments would be needed in paragraphs 12(1)(e) and 27(1)(b) and (c) of the Schedule.

Schedule 8, paragraph 11

Schedule 8, Part I provides for a statement in the balance sheet of reserves, provisions, liabilities, and contingent liabilities, but does not provide for a separate statement of deferred liabilities, that is to say those which will not become due for settlement for a period of one year after the date of the balance sheet.

It would be helpful to shareholders to know how much of the amount stated as liabilities is due for early settlement and how much for settlement at some later date. Amongst such deferred liabilities an important item is the liability for taxation arising from accelerated depreciation allowances, that is to say allowances made for purposes of the computation of taxation on profits which exceed those made in the company's profit and loss account and which will be offset in later years by allowances for taxation purposes which will be less than those made in the company's profit and loss account in later years. This liability not being precisely determinable is frequently stated by way of provision.

It is suggested that paragraph 11 of Part I of the 8th Schedule should be extended to cover the amount of any liabilities not due for settlement within one year of the date of the balance sheet, including provisions for the estimated amount of taxation deferred by reason of accelerated depreciation allowances or for any other reason.

Schedule 8, paragraph 12(1)(c)

The present provisions of this paragraph, which provide for the amount of relief from U.K. taxation arising from taxation imposed elsewhere to be included with U.K. taxation in the profit and loss account, are productive of unnecessary and complex calculations which do not add information of value to the shareholders or even to those of their number who are technically qualified to appreciate the point in issue. It is suggested that the disclosure in the profit and loss account of the amount of taxation which has been, as a matter of fact, levied in the U.K. and, on the other hand, the amount levied overseas would probably be of greater value to the shareholders.

It is therefore suggested that the sub-paragraph be amended to read as follows:—

"(c) the amount of the charge for United Kingdom income tax and other United Kingdom taxation on profits, distinguishing where practicable between income tax and other taxation, and separately where practicable the amount, if any, of taxation on profits imposed elsewhere."

8th Schedule, paragraph 15(2)

The Act is not specific about the method of showing amounts of indebtedness on current account between the holding company and its subsidiaries. It would be better to require that such indebtedness between the holding company and subsidiaries should be dealt with under the appropriate headings of the balance sheet and not dealt with under the composite heading of investments in subsidiaries. This method would have the advantage of showing in the statutory balance sheet the affairs of the holding company on a going-concern basis.

(22) Audit

This appears to be a matter for the auditors themselves and is not one on which the Company wishes to offer any comments.

(23) Provisions as to returns

It is suggested that the requirement proposed by paragraph 5(b) of the 6th Schedule, that the annual return should give details of movements in the shareholding of the company, is unnecessary and that, since it involves the company in a considerable amount of work, it should be abolished. Any person who is interested in these movements can always get more up to date information from the company's register and it is difficult to see what purpose is served by including the information in the annual return.

(24) Company and business names

(25) Foreign companies

The Company does not wish to submit any evidence on these points.

(26) Internal management and administration

(b) Mode of passing extraordinary and special resolutions

It is suggested that there is no reason why there should be any difference between the method of passing these two types of resolution, and that all resolutions should be either ordinary or special.

(27) Winding-up

The Company has no evidence to submit on this matter.

(28) Problems of administration

Section 54(I)

This section, as worded at present, does not permit a holding company to provide the trustees of a Co-Partnership Scheme with money to be applied by the trustees in purchasing or subscribing for shares in the holding company to be held by or for the benefit of employees of a subsidiary company. This causes considerable difficulty since usually the employees of a subsidiary cannot in practice be given shares in the subsidiary itself.

It is therefore suggested that section 54(I) provision (b) should be amended to read—

“(b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for fully paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company or of any subsidiary company of the company, including any director holding a salaried employment or office in the company or in any such subsidiary company.”

(The words in bold type are those which it is proposed should be inserted in the existing paragraph.)

Section 185

This section deals with the appointment of directors who have attained the age of 70 and provides that a director shall vacate his office at the conclusion of the annual general meeting next after he attains the age of 70, that he shall not thereupon be automatically reappointed, and that special notice must be given of any resolution relating to the appointment of a director who has attained the age of 70. It is a common practice to appoint and reappoint directors who have attained the age of 70 and the required special notice has come to be regarded as a normal practice. Section 185 appears to serve no useful purpose and merely to cause a certain amount of administrative inconvenience. It is therefore submitted that, while the requirement of sub-section (5) of the section, that in the case of a resolution for the appointment or reappointment of a director who has attained the age of 70 his age must be stated in the notice and the resolution should be retained, the provisions as to special notice and vacation of office should be deleted.

Definition of “officer”

There are a great many places in the Companies Act, 1948, in which officers of a company are referred to (e.g. ss. 124, 125, 126, 127, 167, 197, 201, 328), but “officer” is nowhere exhaustively defined. There are provisions (ss. 124(4), 125(4), 126(2), 201(4)(a), 328(3)) to the effect that for certain purposes “officer” is to include any person in accordance with whose directions or instructions the directors are accustomed to act; and there is a general provision in s.455(1) that “officer” is to include a director, manager or secretary. It is often important to decide whether a particular person is to be regarded as an officer, but at present it is frequently difficult to do so; in particular it is difficult to say whether an employee who exercises certain administrative functions

which may in a sense be said to be managerial is a "manager". It is suggested that any new Act should include a precise definition of "officer" and, if necessary, of "manager".

Supplementary Note submitted by Mr. Mathys in response to questions in oral evidence

Questions were put to me (*see question 240, et seq.*) about a proposal that a parent company should be made legally responsible for the debts of its subsidiaries. The suggestion was made that it was hardly fair to allow a company to form a number of wholly owned subsidiaries to carry on distinct businesses and, if one of these subsidiaries fails, to allow the parent company to do nothing to save it and to let the creditors suffer.

It is obviously bad business ethics for a company to form a subsidiary to take over what may be a speculative part of its business and then, through not giving the subsidiary proper backing, to allow it to get into a position in which it cannot pay its debts. An extreme case of this sort may even be getting close to fraud, but at the other extreme it is possible to imagine cases of quite a different nature.

If, for example, a company takes over an existing company which is already in difficulties and heavily in debt and, despite the utmost effort, fails to put that company back on its feet, can it be said that the parent company is under any moral obligation to pay off all the creditors in full?

A case which is probably more likely to occur, and therefore is of greater practical importance, is one in which the subsidiary, though wholly owned, has a substantial degree of autonomy. For example, a large subsidiary operating a substantial business of its own in an overseas country may have on its board, in addition to representatives of the parent company, local business men who may have other important interests in the country in question and have been largely responsible for the building up of the subsidiary's business. In such a case the control exercised by the parent company must be of a general, rather than a close and detailed, nature. Furthermore, even with the fullest support from the parent company, it would be possible for a subsidiary of this sort to get into difficulties due solely to changes in local political or economic conditions which could not reasonably be foreseen, let alone controlled, by the parent company. To make the parent company legally liable for all debts of its subsidiary in such circumstances as these would, we suggest, be to cut right across the principle of limited liability which has been firmly established for many years, not only in the United Kingdom but in nearly all other countries.

APPENDIX III

Memorandum by Mr. Gordon Newton

(1) (a) Shares of no par value

No case appears to have been made for continuing to ban the issue of NPV shares. Subject to the introduction of safeguards against abuse, therefore, the law should be changed.

(3) (a) and (b) Public and private companies

Easy incorporation is a privilege. There seems to be no obvious reason why *all* private companies should not be required to file accounts at Bush House.

(5) Directors and shareholders

(a) Changes in a company's activities, however fundamental, are matters which must be left to the discretion of directors. They should be required, however, to notify shareholders of any such change immediately and to justify their action more fully than is usual at present.

(b) The disposal of a company's assets, again, must usually be a matter for the directors, subject to immediate notification and justification. If, however, the directors decide to dispose of a large part of the company's assets, they should make prior reference to shareholders and should either return the proceeds or show good reason for retaining them; a proposal to retain more than a certain proportion of the proceeds in such a case might well be made to call for a special resolution.

(c) Three problems arise out of the issue of shares otherwise than to existing holders of the same class. The first, the rate at which a company should expand by means of share issues to raise cash or finance acquisitions, is essentially one for the directors to solve; again, however, they should be expected to give immediate notice and full details of each such issue.

The second problem is the effect of such issues on the position of existing shareholders. The security of a prior charge holder can be weakened by the issue of new capital ranking *pari passu*, the position of Ordinary holders can be radically altered by the issue of Participating Preferred stock, and the equity of existing Ordinary holders is watered if new shares are issued at a price below that of the old or in exchange for assets less valuable than existing assets. So far as prior charge capital is concerned, the law should adopt a more realistic attitude towards the effect of new issues of capital carrying the same or prior rights to capital already in existence and make obligatory the consent of holders of existing prior charge capital. When shares in another company are acquired, either for shares or for cash, the directors should be obliged to produce a statement from their auditors confirming that the price paid is reasonable. When shares are issued other than to existing holders at a price more than 10 per cent. below the current market price, the directors should be required to explain the reason for the form of the transaction and to produce a statement from the company's auditor or banker agreeing that the transaction, in this form, is to the advantage of existing holders.

The third problem, that of altering the balance of voting power by issuing new shares to the same person or group of persons, is the most difficult. One solution might be to require that:

- (i) Directors should not issue new capital if the issue is likely significantly to affect the balance of voting strength without first seeking the specific approval of every class of shareholder whose proportional voting strength stands to be reduced.

- (ii) If directors without the approval of shareholders issue new capital and thereby significantly alter the balance of voting power, acting either in bad faith or without having made adequate inquiries, the transaction should be voidable within a period of not more than six months at the instance of shareholders whose proportional voting strength has been reduced.

(e) Directors should not lend company funds to a borrower in which any director or principal shareholder is substantially interested without making immediate disclosure in writing to shareholders and detailing the interest.

(6) (c) and (d) Directors' interests

If directors and senior executives of a company are not to be forbidden to deal in the shares of the company or those of its subsidiaries and associates—and there may be a case for that—they should certainly be required to disclose a good deal more about such dealings than is usual at present. Ideally, at any rate, a register of dealings should be kept at the company's office, kept regularly up to date and available for inspection by any member at any time: it should list the holdings of directors, senior executives, and partners in the company's brokers, accountants, solicitors and bankers, detailing any changes made during the year, the prices at which dealings took place, and any option dealings undertaken. There should be a much heavier fine than at present for non-disclosure, and the onus should be put on those concerned to interpret the requirement broadly—including with their own holdings those of near relatives, whether or not held in nominee names. A similar requirement should apply in the case of companies for which another company makes a take-over bid.

In the United States, we understand, companies are able, in certain circumstances, to reclaim short-term dealing profits made by directors in the company's shares.

(7) Shares with restricted voting rights

There is no doubt that the issue of equity shares with restricted voting rights should be forbidden for the future and that hybrid equity shares, such as participating preferred, should carry votes proportionate to their participating rights. Whether existing shares with restricted voting rights should be allowed to remain as they are indefinitely or should be compulsorily enfranchised at some future date will depend on the government's views about retrospective legislation.

(10) Appointment of inspectors

The Board of Trade has made relatively little use of its powers to appoint inspectors and these have often been slow in reporting. The position might improve if the Board were to take more account of practical financial considerations in deciding whether to investigate and were more willing to appoint qualified inspectors of its own. On the evidence of the past twelve years, however, it may be doubted whether the Board of Trade is fitted to act as the public's financial watch-dog without assistance. The point is elaborated in paragraph 29.

(11) Disclosure of ownership

Even though it is undesirable, on grounds of convenience alone, to ban nominee holdings, there is a strong case for disclosure when more than a certain proportion of any class of vote-carrying shares has been beneficially acquired by a single investor or group of investors. Any shareholder who, alone or in conjunction with others, holds, say, 5 per cent. or more of any class of vote-carrying capital should be obliged to notify the company of the size of his beneficial holding and of any changes in it, and the company should transmit the information to shareholders through the press; the fine for non-disclosure should be substantial.

(14) Subsidiary and associated companies

By holding 50 per cent. or less of the capital of another company, a company escapes the obligation to group accounts and can conceal important information about its

earnings and assets. It should be obligatory to disclose in the accounts the name and business of every company in which an investment of any kind is held; the size of the investment should be given and—in the case of investment in a non-quoted company—the last audited figures of trading profit and net assets and the dividend paid.

(16) Take-over bids

- (a) The bidder should be obliged to disclose his identity at the outset.
- (b) He or his agent should produce a banker's guarantee of his ability to meet full acceptance of the bid.
- (c) He should provide full details of the number and average price of voting shares in the company for which he is bidding acquired before the announcement of the bid and after it.
- (d) No bid should be open for less than a month, and directors should be required to provide holders with all relevant information within a month of learning about the bid.
- (e) All bids should be notified to the press.
- (f) The precise result of every successful bid should be published.
- (g) The time during which a bidder can compulsorily acquire the minority and the minority can demand to be acquired should be brought into line, and bid circulars in such circumstances should clearly state the legal position.
- (h) Details of all compensation and other payments accruing to directors as the result of a bid, whether or not they are to remain in office, should be published and made subject, as far as possible, to the approval of members before the bid can go through.
- (i) A bidder should be obliged to state whether or not he intends, if successful, to retain the Stock Exchange quotation.

(17) Prospectuses

The result of a prospectus issue—amount subscribed and details of allotment—should be published in the morning press before Stock Exchange dealings are allowed to begin.

(19) Unit trusts

Managers should publish full information about the composition of a trust's portfolio at least twice a year.

(21) Company accounts

- (a) Fixed assets should be revalued at least once a decade unless the directors can produce a professional opinion that revaluation would produce a figure not significantly different from that shown after depreciation in the accounts.
- (b) The value of stocks and work-in-progress for tax purposes should be noted if different from that shown in the accounts and an explanation given of the discrepancy.
- (c) Companies which have acquired interests of more than, say, 30 per cent. in other companies during the year should include with the group accounts a statement of their interests and the accounts of each company in which such an interest has been acquired for its most recent financial year. Companies with a diversity of interests should state each year the proportion of assets and profits attributable to each.
- (d) There may be a case for having only two kinds of reserve—distributable and non-distributable—supported by a note about any tax liability involved in distribution.
- (e) Before striking the net trading profit, full details should be given of directors' expenses allowed for tax, agency fees, pension fund contributions, and depreciation. The accounts should indicate the amounts actually allowed by the tax authorities for depreciation and provide an explanation of any significant variation from the amount shown, while the auditor should be expected to indicate whether he thinks the amount shown either excessive or insufficient.
- (f) There is no longer any reason to allow exemption from the usual accounting requirement to shipping companies, banks or insurance companies.

(g) Turnover figures should be provided, and ideally some figures of manufacturing costs.

(h) All changes in amounts liable under directors' service contracts should be shown in the accounts and made subject to ratification in general meeting.

(22) Auditors

A full explanation should be provided for any change of auditor both by the company and by the auditor. The explanation should be given both to shareholders and to some such watch-dog body as the Board of Trade.

(26) Internal Management etc.

Present voting procedure is inadequate. We suggest that:

- (a) Members should be supplied with a separate two-way proxy on each resolution.
- (b) Full information should be supplied well in advance about each resolution and the case for it.
- (c) All special and extraordinary resolutions should be decided by postal ballot on not less than three weeks' notice.
- (d) All circulars issued by directors or others soliciting proxies should be cleared with some such body as the Board of Trade for accuracy and adequacy.
- (e) Any member other than a director who obtains proxies representing 10 per cent. or more of the class of shares voting on any resolution should be entitled to demand from the directors all information relevant to the matter at issue; if he still wishes to oppose it, the matter should be decided by postal ballot held not less than three weeks later, and all reasonable expenses should be met by the company.
- (f) Pension funds to which a company contributes should either be prohibited from holding shares in the company or its associates or should not be allowed to exercise their votes: all such pension funds should publish details of their investments with the company accounts.
- (g) Sizeable cross-holdings, direct and indirect, should be prohibited. No company should be allowed to hold more than so much of the voting capital—unless acquired through a bid which brings its holding to over 50 per cent.—of any company which already holds that much of its own voting capital or has an interest, at however many removes, in a company which holds that much of its voting capital.

(29) Other matters

The Stock Exchange has not the resources to act as a full-time financial watch-dog and is reluctant to make use of its only sanction, suspension of quotation; the Board of Trade seems reluctant at present to make adequate use of the powers it possesses. There may well be a case for setting up a body charged with supervising the financial scene as a whole, which would maintain liaison with all other official and unofficial bodies working in the same field and which would make recommendations for more formal action when necessary. Such a body would have to be adequately staffed with professionals who had experience of the City but there might be no need to equip it with special powers.

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*).

MR. FREDERICK RUDOLPH ALTHAUS.

MR. ERIC ALBERT BINGEN.

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR.

MR. GORDON WILLIAM HUMPHREYS RICHARDSON.

MR. CHARLES HILARY SCOTT.

MR. RON SMITH.

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
SECOND DAY

Friday, 30th September, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS.

MR. E. A. BINGEN.

MR. L. BROWN.

SIR GEORGE ERSKINE, C.B.E. (*Questions
418 to 539 and 641 to 721 only*)

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.
(*Questions 641 to 721 only*)

MR. K. W. MACKINNON, Q.C.

MR. R. SMITH.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. I. M. GLUCKSTEIN and MR. H. E. LOFTHOUSE *called and examined.*

418. *Chairman:* Mr. Gluckstein, you are the Chairman of J. Lyons & Co. Ltd. and you, Mr. Lofthouse, are the Secretary?—*Mr. Gluckstein:* Yes, Sir.

419. We are very much obliged to you for your interesting memorandum and for coming to help us with your oral evidence today. As to your memorandum we have read it and I have no doubt will read it again, so we do not propose to trouble you with detailed references to all the provisions you have dealt with, but we will confine ourselves to those which develop the main points which you seem to us to make. You begin with the incorporation of companies, and about that you say that no useful purpose is now served by limiting a company's objects. This is paragraph 1 on page 1 of your memorandum. Could you develop that?—*Mr. Lofthouse:* I would say on that, Sir, actually it is not from our company's point of view a very important point. We have not been concerned in incorporation of a public company for 40 or 50 years, and we just put the point that we thought it did seem that that is the position today. If the memorandum is well drawn today you can do very nearly anything you like. I make the point but, speaking for the

Lyons Company, it is not of great importance to us.

420. Of course the formal memorandum now in common use has been criticised in several quarters, I think, as a prolix document which really goes beyond anything that was contemplated in the Companies Acts in the way of object clauses.—Yes.

421. You are no doubt familiar with the old form in the schedule to the Act which confines the objects severely to running a line of steamships or something of that sort, and simply adds matters incidental to that main object. If you compare that with the memorandum of association of J. Lyons and Co. Ltd., you will find that in that document power is taken to do very many things so that it would be difficult to find any activity that could not be covered by your object clauses. That is how it stands, is it?—Yes.

422. And from what you have said I understand your company is content to let matters rest at that?—Yes.

423. And as a matter concerning all companies, what is your view? Do you think it is best that the long form should

persist—I gather that is your view?—My personal view is that I think the time has gone when you should need all these objects. It does seem to me that a company should be allowed today to do anything it wants. And, as I say, at the present time you put in such a long list that you get there anyway.

424. If you were a dictator and you were setting about revising the Companies Act in what you thought the best way so as to make it the best kind of Act in every respect, would you do anything about the memoranda of association or would you leave the existing law as in your view satisfactory?—So far as the objects are concerned I think I would change the law so as to allow a company either to do almost anything or to put in things that it is not to do—that is to say by way of exceptions. I am suggesting, Sir, that there should not be a greater restriction than there is today, and that the objects clauses should be shortened by making it lawful to engage in various activities without specifically saying so.

425. You think the memorandum should enable the company to do in effect everything that a natural person could do?—Yes, Sir.

426. And would you make that subject to any qualification or control?—I do not think I would, Sir.

427. And would you allow the memorandum, widened as you suggest, to stand as the document defining and limiting the powers of the company?—Yes, I think so.

428. And you would be content with that?—Yes.

429. Then I think we can pass from that . . . —If I may just add I am suggesting—I think this is being suggested from many quarters—that in any case incidental powers, like the right to borrow money and so forth, do not really belong as objects. You have usually got in that you can mortgage the company's property, you can borrow money and all sorts of things like that. Whatever is decided about the objects, I think those things should certainly be covered without the necessity for having them appear in the memorandum itself.

430. That is to say you would adopt the plan which I believe has been adopted in various other countries which have broadened on our company law, that plan being to schedule to the Act the various ancillary powers which any company ought to have, and to enact that the company shall have these powers without the necessity for mentioning them in the memorandum?—That is right, Sir.

431. But subject to that you are content with the existing law but would like to see the memorandum made if anything still more comprehensive than it is?—Yes.

432. What you are really aiming at is conciseness in the document?—That is right, Sir.

433. You want its effect to be as general as possible?—That is right, Sir.

434. Unless you have anything further to say on that topic I think we can pass from it.—No, Sir.

435. The next heading concerns donations by companies for charitable and political purposes, and about that you say in your memorandum that you consider that donations for these purposes should be entirely at the discretion of the directors and that there should be no limitation or restriction. Then in regard to donations for political purposes you point out that most companies are directly concerned with political issues, your company, for example, being concerned with the law relating to food, and presumably you might from time to time wish to support or oppose particular legislation affecting your business, and in such a case you very reasonably say that your company or the directors ought to have an absolute discretion as to their expenditure?—*Mr. Gluckstein:* Yes, Sir.

436. Then turning to the wider matter of donations for charitable—and I think one should add benevolent—purposes you say there should be an unfettered discretion. But would you qualify that by saying that the object to which the company contributes must be one which can reasonably be supposed to benefit the company in some way or other?—Without any doubt, Sir. We are dealing now, Sir, with charitable donations?

437. Yes, charitable and benevolent. I add benevolent to make a wide field.—We, Sir, in our company look upon these donations generally as conducting to good trade or public relations. I think I can say we are conscious of the fact that any money we give away is the shareholders' money, therefore unless we think it is in the ultimate interest of the company, that is the shareholders, we will not give it. That may sound cold-blooded, but we think you cannot deal with other people's money in the way you can your own, but we do feel we should have unlimited discretion to do that where we really think it is in the company's or the shareholders' interest.

438. Of course one can take many examples. There might be some benevolent fund outside your organisation—a benevolent fund standing by itself—which provided benefits for people retiring from trades of the kind with which your company is concerned.—I think we would want to subscribe to that—in fact we do so. Our own staff on occasions have had benefits from trade benevolent associations. It might be the benevolent association of somebody who is very important to us in the business and whom perhaps we thought it would be unwise to refuse.

439. That kind of example would be a case of a donation which pretty clearly would be likely to benefit the company?—Yes.

440. But then one may spread it wider than that. Supposing there is some disaster at the other end of England, or indeed somewhere in a country overseas, and a fund is launched by the Lord Mayor—or whoever it may be. Would you think it right to contribute to that kind of fund?—May I put it this way? If there is a Lord Mayor's appeal we usually think it is unwise not to. In other words if you do not it may be bad for the company. If there is an appeal from the Lord Mayor, it is usually in the form of a national appeal which appears in the press, and the leading companies appear. We do not think it is good for the prestige—and therefore the good—of the company to stay out.

441. You mean somebody would run his finger down the list and say "Where

is Lyons? They are doing very well, I would have expected them to contribute"?—Yes, it sounds cold-blooded, but it is the only way to look at it.

442. As regards expenditure of this particular description, do you think it ought to be shown in the annual accounts by way of a note or otherwise so that the shareholders may know how much of their money is going on that?—I do not see any reason why it should be.

443. Why it should?—No. I do not think it is all that vast. It is not likely to be very serious if we did show it, but it could have the effect of making us look mean—or it could have the effect of making us look extravagant. I do not have any strong feeling about it. I would have thought better not.

444. On the whole not?—On the whole not, but I do not feel very strongly about it.

445. The next matter you deal with is under heading 7, which is the matter of voteless shares—shares carrying no voting rights or restricted voting rights. And I gather that from your own experience and on principle you are strongly against the view that such shares should be prohibited?—We are, Sir.

446. I am speaking of voteless shares in the sense of shares which have no votes at all, if you follow me.—Yes.

447. And you deal in detail, very interestingly if I may say so, with a case in your own experience—that was your amalgamation with Horniman and Company, was it not?—Yes.

448. In which voteless shares were used, you say, to the great advantage of all.—That was the first time that we had thought about voteless shares—it may have been the first time anybody had thought about them. The point about it was this: we were buying the business from the Horniman family and it was suddenly realised fairly late in the proceedings—and I am speaking really from hearsay, I was otherwise engaged at the time, but I think I know what happened—that if the Horniman family were given this large number of shares they could be of some importance in the company's

affairs. Therefore the idea was thought up of letting them have shares without a vote, and they were quite satisfied. But as I think we said in our memorandum in thinking you are buying company B you may in fact find that company B has gained control of your company; and it could happen because you have given them too many votes. The Horniman shares were over 74,000 which would have been at that time a considerable block of shares in what was then a comparatively small company. That was the history of it.

449. And it did work satisfactorily in practice, did it not?—It did not in fact matter because the Horniman family sold most of their shares very shortly afterwards. But that we did not know was going to happen.

450. But it is right to say—passing from your particular case to general principles—it is right to say, is it not, that you support the continuance of voteless shares?—Very strongly, Sir.

451. And you say you see no reason for doing away with them?—That is so.

452. What would you say of the proposition that it would be reasonable to give the holders of voteless shares the right to receive notices of and attend at meetings, and possibly to speak at meetings albeit they were not allowed to vote?—I would see little or no objection to it.

453. No objection to that?—In fact—Mr. Lofthouse will correct me—but I think at this moment if anybody was a holder of voteless shares and wrote and said he wanted to come to the meeting, we would tell him he could although he was not entitled to. I do not expect we would allow him to speak, but we should see no objection to it as long as one could take the proper precautions to see that he did not vote.

454. Yes, I see. But you probably would not allow them to speak?—

Mr. Lofthouse: At the present time if anybody writes and says "I would like to attend the meeting"—that is any shareholder who is not entitled to come—I write and say, "Yes, you can come on the understanding you take no part in the

proceedings". In other words he cannot speak or do anything there but he can attend.

Mr. Gluckstein: But I would see no objection even, if it were allowed, to making a speech. One would have, as I have said just now, to be able to take proper precautions to see that he did not vote.

455. That might be a difficulty in a largely attended meeting?—*Mr. Lofthouse:* It is a bit difficult.

Mr. Gluckstein: I think we could get over it.

456. Give them a pink card or something?—Something like that.

457. Then there is this point put against you on voteless shares. Supposing you have a capital consisting of £100 divided into 500 A ordinary shares and 500 B ordinary shares, and the articles provide that the powers of voting attached to the share capital should belong to the A shares exclusively. What about this possibility? Conceivably the A shareholders might use their votes, being the only votes attached to any shares, for the purpose of altering the rights of the B shares and saying that they were not to be entitled to any more than ten per cent. dividend, or were not to be entitled to have their capital returned in a winding up until after the A shares had had theirs.—I am not a lawyer, Sir, but I should have thought that was against the law.

Mr. Lofthouse: I would not have thought they could do that without a class meeting—not change their rights.

458. Might it not depend on whether in the particular case under consideration the A shares and the B shares could be regarded as separate classes for all purposes? Your answer there might be that in any ordinary form of articles conferring rights of voting on one part of the shareholders only, it would be a wrongful discrimination against those who had no votes to make their rights different from those who had?—*Mr. Gluckstein:* I would have thought that could not be done to-day. But if it could I think that would be wrong and the law should be altered so that the B shares could not be treated like that.

459. Speaking for myself it is not a proposition which I would have supported with any great gusto in the Chancery Division. I would not have expected my submissions to be very well received. But there it is, that point has been put forward so I thought I would mention it to you and your answer is that you cannot think that such a transaction could be regarded as legal?—*Mr. Lofthouse*: That is right, Sir.

Mr. Gluckstein: Adding to it, that if it is legal it should be changed.

460. Yes, that is important. Then there is this proposition put. Granting the existence of voteless shareholders who in general have no voting rights at all, would it be right to allow voteless shareholders a right of voting on certain particular matters of importance comparable to that one finds attached sometimes to preference shares? For instance would it be right or reasonable, do you think, to give the voteless shares a right of voting on the question of winding up the company?—I think I read this in one of the memoranda submitted to you, and it did seem to have much merit. I do not mean that impertinently. I can conceive of certain circumstances where there should be a right of recourse to the court who would decide whether they should have a vote. I would see no harm in it if there were special circumstances in which you could go to the court. Winding up, I would have thought, was a very reasonable one.

461. And you might have a case where no dividends at all had been paid for some considerable time which would have to be specified. The answer you suggest is that when a situation has arisen where it seems that in fairness it might be right for the voteless shares to be given a vote, then provision should be made under which the voteless shareholders could apply to the court for an order that on this particular occasion they were to be allowed to vote?—Yes, Sir.

462. That fairly states your view on that question?—I think the word used in another connection is where the shareholders are "oppressed". That would not be quite correct, but I think if the shareholders were in a way oppressed they should have a right to go to the courts.

463. Of course there are various provisions dealing with oppression both by statute and the common law.—This is not strictly oppression—this is suffering.

464. It is difficult to generalise, but a situation of the kind might well arise where there was no question of oppression.—Yes, Sir—rather suffering than oppression, perhaps. Yes, I would see no objection.

465. Then this question, also on voteless shares: it has been pointed out as one would expect that on take-overs, mergers and so on the voting shares are found to command a larger price than the voteless shares. And I think you say in your memorandum that that obviously is because the voting shares carry control of the company?—Yes, Sir.

466. That would account for the difference in price. Then this rather philosophical question is put—ought the voting shares to profit by the right of control, seeing that the assets to which the control relates—that is to say the assets of the company—have in part been provided by the voteless shareholders.—If I could give you this example—it can easily happen, I suppose, in a company that a group of people between them hold 51 per cent. of the votes, all the shares being voting shares. That 51 per cent. would presumably command a very much higher price than the remaining 49, so that even if they all had votes someone who has the last two shares, so to speak, is able to command a very much higher price because he is the man who has the ultimate control. I think I am right that there was a much talked about case a year or two ago where somebody sold some controlling shares—and voting shares—regardless of the interests of the minority of voting shareholders.

467. You see the point is put—and as I say it is rather philosophical or metaphysical, which is a convenient expression to describe something one does not quite understand—that the control belongs to the general body of shareholders or should do.—Yes, but as I say if they are all voting shares and a group of people have 51 per cent., they still have control. I do not see how you stop them selling their 51 per cent. by law. I do not say I

agree with anybody doing it—that is a different matter—but I do not see how you can say you cannot go and sell your 51 per cent. unless all the other shareholders are going to get the same price.

468. Without dividing up amongst your fellow shareholders, voting and voteless, the proportion of the value of shares attributable to control? You look rather horrified—I do not say it is a very good point, but it is one point that has been put on this topic.—I do not understand. If you are to have a free market and assume there are no voteless shares, I do not see how you prevent the man who happens to have the majority of the shares selling them for any price he likes.

469. One might add this—the Estate Duty Office has no doubt as to the persons to whom the control belongs when it comes to assessing duty on his death.—I believe that is so.

470. And in my experience it is always a matter to which they attach prime importance. This block of shares on the Stock Exchange may be worth so much, but it carries control, and they duly tax the deceased shareholder on those shares which do carry control. Perhaps that is a matter which we cannot really pursue very much further.—I do not see how anything can be done if you are going to have a free market in shares. There are people here who are much more qualified than I am to answer that.

471. Very well. Then we can pass from that one. You say in sub-paragraph (f) of your evidence under heading 7 which is still on voteless shares:

“To provide that shares should confer votes proportionate to their interests in the ‘equity’, unless only one class of ordinary share with equal equity right is permitted, would produce a great crop of anomalies.”

And the question arises out of that, what kind of anomalies have you in mind? —You have a class of share known as a preferred ordinary or participating preference. There are so many kinds of shares which may under certain circumstances have votes and not under other circumstances. Are you going to give

them votes or is it suggested you should give them votes in all cases?

472. The point is taken, I suppose—or the way you meet this point is in this sort of way, is it not—that obviously you cannot deal with this matter of voting rights by saying that each share should carry one vote. One starts from that because you can have sub-divisions of shares and so on. You can have some of a pound and some of a shilling, and if they each carry one vote then of course the shilling shareholders would swamp the others, so that will not do. As an alternative to that you can say one vote for every £1 nominal of share capital held. That is a possible way of doing it?

—*Mr. Lofthouse*: In our case, Sir, we have got an ordinary share of £1 and we have got a proportional profit share of £1. The price of one on the market is about £4, the other is about 15s. 6d.—and the latter gets a fifth of the dividend. So that is just one other instance—I believe there are quite a lot of these difficulties.

473. I was trying to test this. Obviously one vote per share is no protection. Then if you give one vote for every pound of share capital held you run into the kind of difficulties—if you are working out what some people call a fair scheme of voting—which you mention; that is to say you may have preference shares, you may have participating preference shares, you may have deferred shares, and each of these would give a different interest in the equity.—*Mr. Gluckstein*: Yes, Sir.

474. And you say it would really be impossible to disentangle or define the voting rights to be attached to all these various classes of share so as to make them commensurate with the shareholder's interest in the equity. That is really what it comes to?—To do so equitably.

475. Yes. And when you refer to anomalies in your memorandum you mean difficulties of that sort, do you?—

Mr. Lofthouse: Yes, Sir.

476. Then you submit in your memorandum that if voteless shares had not been permitted many family businesses would have been inhibited as to getting

further finance because they might well not have wanted the control to pass into the hands of strangers?—*Mr. Gluckstein*: Yes, Sir.

477. It is put that quite apart from issuing voteless shares, various expedients could be adopted to provide such a family company with capital without giving up any voting power, and it is said that might be done by means of loans of various kinds—income notes, that kind of thing—securities whose interest in the profits and assets was made *pari passu* with that of the ordinary shareholder but whose holders were nevertheless creditors and not shareholders, and had no vote. What would you say of an arrangement of that kind?—I think recently there was an issue by a very well known firm of preference shares in a business where the family still retained all the ordinary shares—I think I am right about that. I see no objection to it, but I do not see why you should be limited to that sort of issue and be unable to give the public a chance of buying a share which has an equity interest, as well as preference shares.

478. You include preference shares which I think on all hands it is agreed can be made voteless or only voting in certain circumstances. So that is a possibility. Would the type of loan I have described be a possibility?—No, Sir, I do not think it would.

479. And anyway you say there is no reason for the law to dictate how a company shall carry on its business. There is no reason for doing that unless some clear abuse is shown?—Unless a clear reason is shown that it is bad for the country.

480. The next matter is heading 11 which is disclosure of ownership and control—paragraph 11 on page 6 of your memorandum.—Yes, Sir?

481. You come out strongly against any legislation requiring disclosure of nominee holdings. Do you admit any qualification of that general view? If I might explain what I mean. Would you think it reasonable that either the directors or the other shareholders should be entitled to be informed where some individual had become entitled to, say,

10 per cent. or more of the issued capital? If it appeared probable that one individual held through nominees, say, 10 per cent. of the capital of the company, do you think it would be reasonable to legislate so that the directors or the general body of shareholders could demand disclosure of the beneficial owner of the shares in question?—I do not think it would be reasonable to change the law, Sir. A certain amount of business has to be done, I think, always through nominees. If I may give a somewhat different example. One sometimes wants to buy property in the name of a nominee. The method of acquiring that property may be by buying shares. I do not really see why you should be made to disclose it and what good it would do to anybody when you have done it. But perhaps I have not quite understood it. I am not trying to ask you questions, but I am not quite clear who would benefit by the change in the law.

482. Put it this way. Someone through a number of nominees is quietly buying up the share capital of the company and he hopes to do that up to a point where he has got control, then he will turn the company to his own advantage in some way. If his fellow shareholders knew that that was what he was after, might they not hold out for a higher price than if they knew nothing—that there were a number of isolated dealings apparently unconnected? You know much more about this kind of thing than I do; I should have thought it was a device for getting the shares cheap.—I should have thought—again with deference to those members of the committee who know much more about it than I do—I should have thought the price of shares would have risen so quickly and high that everyone would have known.

483. One remembers reading as a child books about the Turf when an enormous sum was put on a horse in small proportions by bookies all over England and by that means they were able to get very good odds—that kind of thing.—But the bookmakers, I believe, were able to change their rules accordingly without any change in the law.

484. Yes. As to the merits of purchasing through nominees your view

really is, is it not, a share is a piece of property like any other and if you choose to hold that in the name of a nominee there is no reason why you should not. Is that your view?—Certainly.

485. Supposing someone sets about buying most of the housing property in a given neighbourhood where house property is much in demand. Supposing he buys each of 20 houses in the name of a separate nominee and having by that means secured all the housing, proceeds to put up the rents. And then he unmasks himself and says that "Brown, Jones and Robinson are merely my nominees, here I am the sole owner of all these houses". Would you say ethically there was anything wrong with that?—I do not think I would like to do it but I would not like to change the law just to meet my feelings. I do not think it would be right to change the law. I have known a case in my own company where we were intending to develop a property where, if it had been known that we were buying the property round about, we would have been—if I may use the ugly word—blackmailed. In fact the information leaked and we nearly were blackmailed. I do not think it is a bad thing that you can buy through nominees—you can only buy at the price the person wants to sell. They do not have to sell. They can keep it if they like. If they are willing to sell at a price they think is fair, I do not know why we should put them in a position that they can hold us up to ransom.

486. And the point is put that it is bad for the morale of a company and its employees and so forth if share dealings go on the details of which are not forthcoming.—I cannot express a view on that, but I cannot really see why it is. I do not think violent fluctuations in the shares of a company are good for its business, but I do not think I can say more than that.

Mr. Lofthouse: It is just as bad for morale when it is announced who is taking over. I should think a lot of the recent acquisitions have created a lot of feeling—at least at the time when the proposals were out—amongst the staff. I should have thought it applied in any case.

487. You say that what would affect morale would be doubts about the new management which seemed to be coming in, so to speak?—Yes. I do not think it is any worse when the staff do not know the identity of the take-over bidder than when they do.

Mr. Gluckstein: If it is suggested that someone is going to acquire control of a company surreptitiously and is going to ruin the morale of the people that are working for that company, he is going to suffer as much as anybody because he is going to take it over with a staff which is demoralised. He would not be very clever.

488. Perhaps there is not a great deal in that point, but it has been suggested that shareholders are entitled to know who the other shareholders are with whom they are engaged in the joint venture which the company was set up to carry out.—I do not think I can comment on it. I see nothing in it.

489. I think my only other question on this aspect of the matter is whether you can illustrate your statement that disclosure of your ownership could prove a handicap in some cases to business development.—I gave you one just now—the acquiring of property. If we were going to build a big hotel and in order to do so we had to acquire some houses or some business premises, there can always be somebody who says "I know they want this very badly, I am not going to move unless they pay me three or four times what the property is worth", bearing in mind that he has not got to sell except at a fair price anyway.

490. Yes, I think I follow that. Then the next one I want to ask you about is the carrying on of business through subsidiary and associated companies. That is heading 14—you will find it on page 6 of your memorandum. You say that, in your view, there should be no restriction and that "any restriction might well prove a serious handicap to the marketing of goods and to business development; for example, a company with an established trade serving a particular class of customer and wishing to expand into a higher or lower price range would be handicapped if it was not

able to preserve its anonymity by trading through a subsidiary". Can you give an example of that sort of handicap?—I can give two, I think. If I am engaged in the business of selling very high class goods and I want to try a venture in selling cheaper and less high class goods, and if I am trading under the name of Lyons in the first place and now put on an article and sell it as a Lyons cake which is equally good value but a very inferior article at an inferior price, it is likely to damage the better class cake. People not knowing about things will say "This is not as good as Lyons used to make". And the same thing in reverse—from selling cheap things if you go into the dear market people will say "Lyons are charging more for their cakes than they used to". If you do it under different names you do obviate that muddle. I think that would be one example. The other one is this. When you are engaged in the wholesale or manufacturing trade and you want to branch into the retail trade. There may be very strong opposition, particularly if you do it in your own name. If you own a subsidiary company and you do it through that, you are certain to arouse less opposition. I think the former argument is a much more important one than the second.

491. I suppose some people might say that that was ethically open to some objection—I am not saying it is, but it might be criticised.—On the contrary, Sir. I would say it is more ethical to do it this way. If I have been selling a person a cake at a high price and I now want to go into the market and sell a cake at a cheap price in the same name am I not more likely to deceive him? It is more ethical to sell it under a different name otherwise he may be deceived.

492. He says "This is a typical Lyons bun", and really it is not a Lyons bun at all.—I think he is more likely to be deceived if you are not allowed to sell them under a different name than if you are. I hope I have made my point clear?

493. Yes, you have made it clear. Still on this heading 14, on the footing that companies trade through subsidiaries, suggestions have been made to increase the information available as to the identity and so on of these associated and

subsidiary companies. It is clear from what you have said that you would be against any disclosure showing the subsidiaries of J. Lyons & Co. Ltd.?—I am afraid I would, Sir. I am not a person who particularly wants secrecy, but the difficulty is when you do not have secrecy but disclosure you get a fair amount of publicity—sometimes unwelcome—and it may be the very thing you have been seeking to avoid; it may put you in a very difficult position.

494. The first proposition is that every company should state, for example in its annual report, the names of all its associated and subsidiary companies and the nature of their business. That clearly would cut across your view of this matter, and then the second proposition was that similar disclosure should be made of the percentage of capital held in such companies and the percentage of profits paid by them. Clearly that would come under the same objection because you object to the whole idea of stating the names and so forth of your subsidiaries. Then finally there is the revolutionary suggestion, which has been discussed, that the parent company should be legally responsible for the debts of its subsidiaries either entirely or in proportion to its interest. Have you ever heard of such a thing as that?—Not till this moment, Sir.

495. What do you say about it?—I think I would have liked notice of it, but it seems to me if you have two different legal entities then they should remain different legal entities. I am bound to say I think it would be recognised amongst all the reputable companies in this country that they would not allow one of their subsidiaries to default. I do not claim we would be the only people—I think it would be the feeling of all.

496. I quite appreciate that practical aspect of the matter.—I do not see if you are allowed to have a different person in law or a different body in law how you are going to say that somebody who owns control of that should be responsible for its debts, because it then ceases to be a separate person.

497. That of course is the conventional criticism, but consider this case. I

decide to set up in the retail boot trade and I buy a dozen good corner sites up and down the country. I form a separate company with the same members for each boot shop and I constitute a holding company which holds all twelve. Of these shops six do well and six do badly. I get out of the ones that have done badly as cheaply as I can—which may be very cheap owing to limited liability—and I retain the ones that have done well, and the creditors of the ones that have done badly are left in the cold. Legally that may be all right, but while I appreciate it is rather a crude example of the matter we are talking about, would it be in accordance with your ideas of fair play?—Not having had notice of this, Sir, I would say this about it. I am assuming to start with that you had bought your premises, therefore the people who are going to suffer are the people who sold boots to you. It is perfectly within their power before they sell you boots to go to Bush House to make proper trade enquiries about the particular company who is going to buy the boots and satisfy themselves. I have had a case myself something like this recently where a company which had a large number of shops wanted to become the tenants, I think it was, of our pension fund. Every shop was a different company which we ascertained from—I should think—Bush House. We were not willing to accept them as tenants. Anybody else can go to Bush House and make enquiries. I do not know if that answers the question?

498. You say that the type of transaction of which I put a very imperfect example is legal, and that people dealing with limited companies can easily find out how they stand by going to Bush House and making enquiries?—And there are plenty of enquiry agents who do not charge a lot for getting the necessary information as to a company's stability. Without having given it any previous thought, I just do not see any point in the suggestion.

499. Your first reaction is there is not sufficient ground for changing this aspect of the law, which of course turns on the conception of limited liability which has been accepted for very many years.

That is really what you would say?—Yes, Sir.

500. The contributions which we have had have included a large number of suggestions concerning company accounts. I do not think I need trouble you with these as you do not include this heading in your memorandum of the subjects you wish to discuss. I think it would be hardly fair to you in the circumstances to start asking you questions, accountancy questions, of which you have had no notice. You did say at the beginning of your memorandum that you were confining your observations to the particular headings which you listed at the beginning?—Yes, Sir.

Mr. Gluckstein, those are all the questions I personally have in mind to ask you, but members of the committee may have some further questions to put.

501. *Sir George Erskine:* Perhaps I might ask Mr. Gluckstein one question. I was very interested to hear your views about voting and non-voting shares, and in illustrating it you gave us two different cases—one where you had control in the hands of voting shares with perhaps a large number of non-voting shares, and the other case where you had control in the hands of the holders of a majority—you say 51 per cent. of the shares—in the case where all the shares had votes.—Yes.

502. In either of these two cases one might assume that the other shareholders—either the non-voting shareholders or the minority shareholders—had confidence in the people who were running the business and had control, and were quite happy to remain in that situation because they thought the people who controlled the business and were developing it were doing a good job. Now the people who are in control get an attractive offer to buy their holdings—and of course the other shareholders may not know anything about the offer or have anything like the same confidence in the offerors—do you think it would be reasonable for the offeree to stipulate that in any offer under which he sold the control that an offer should also be made for the other shares, so that the offeror was in effect acquiring the whole of the company and

not as it were—to use a common expression—leaving the other people in the lurch?—May I answer it this way? Dealing first with our own case which is always easier. Over a very long number of years my family—if I may so describe it—have offered shares to the public in our companies, and they have built up a faith in them and the public have faith in us. I would think if we were to sell our controlling shares to anybody without looking after the other people we should be both wrong and foolish. Nevertheless I do not think that the law should be changed, because it seems to me that if you are once going to impede the free buying and selling of shares then they will eventually not serve their proper purpose. I do not uphold the sort of thing you are saying—I hope you do not think I do. I think it would be a naughty thing to do and nobody who was an intelligent person, I would have thought, would have done it, but that is a different thing from changing the law. If you change that you are eventually going to do away with what I call free bargaining and free trading. But again this is not a subject on which I am very well informed.

503. *Mr. Brown:* Keeping on the same subject—the case you put for non-voting shares—I have very great sympathy with the point made, but is it not possible—is it not a fact—that the practice is developing to an extent where perhaps it might be considered unreasonable? We have cases where the holder of the voting shares has a minute proportion of the capital of the company—two or three per cent. only of the capital in voting shares. The time may come—it happens in companies—when the management becomes inefficient, but that management or family may be much more concerned with keeping the management than with the efficiency of the business. Is that not a possible abuse for the other 90 odd per cent. of the capital?—You are liable to the same abuse if it is 51 per cent. or 49 per cent.

504. But the degree is so different. If it is 51 per cent. the interested parties have 51 per cent. financial interest. If it is only two or three per cent. they have only two or three per cent.—I do not see how that protects the shareholders if the

directors are inefficient; they will still lose their money. It may be a consolation to know other people will lose money with them but they will still lose the money.

505. The thought is that where the family interest is so large they are much more likely to ensure efficiency even amongst their family, and where the family interest is so small they make more out of it as a management.—We will not speak personally because our family interest in fact is a very big one. Apart from voting shares or salaries it is a very big one in the way of non-voting shares, but that does not help this argument, I think. But it seems to me that in this imperfect world perhaps it is better that people should have freedom. And nobody can be made to buy the shares. I, Sir, do not like smoking; I do not want to pass a law to stop you smoking. If you do not want to smoke you do not smoke. If you do not want to buy shares that have not got votes you do not have to buy those shares. As long as you know they have not got a vote why buy them? Perhaps I can put it this way. I am told this is a question of democracy. Correct me on my history—I think many years ago I was told that the Magna Carta was the beginning of the freedom of this country. I think I have subsequently been told that in point of fact what it did was to transfer the power from the king to the barons, and that is really what I think you are going to do here only they will not be barons. They might be very big corporations, insurance companies or investment companies, but the public still will not have control.

506. The alternative case is somewhere along the lines Sir George Erskine mentioned—the case of a very small percentage being sold and thus giving control to an entirely different third party whose interest in the business may not be to run it successfully but to use its factories to manufacture for their other interests. Could that not create an abuse that would make it worth considering whether something should be done to prevent it?—I am not aware that there have been such abuses.

507. There is a big case—I do not say of abuse—where the new owner of the property is more interested in running it

as part of his group to manufacture rather than to sell.—Yes, Sir, but if they had all been voting shares and he had bought 51 per cent. he could still have reached the same result.

508. There is a very big difference in achieving this position by buying 51 per cent. of the capital and buying 3 per cent.—The principle is the same.

509. The practice is different.—I think I may even know the case you are thinking of. I did not know there had been abuse.

510. I am not suggesting there has been abuse; it is a case in which it can arise? —Yes, I think it could.

511. *Mr. Bingen:* This is really rather the same point as Sir George Erskine and Mr. Brown have put, but in a slightly different way. Your first comment on voting and non-voting shares was that you saw no reason to distinguish between the case where a small majority holding the voting shares sold out compared with the case where all the shares were voting shares and 51 per cent. were sold out. You say in either instance people were paying for control and therefore that control had more value than scattered and lesser percentage holdings did if they were placed on the market. But is there not really theoretically this difference that Mr. Brown has mentioned. In the one case people holding a very small proportion in a voting form can sell out regardless of the interests of the balance of the people who put the majority of the money in the business. That is surely different and might merit different treatment from the case where people have put up 51 per cent. and therefore hold control.—I see no difference in principle, I see a difference in degree. But I would still say to you, Sir, they did not have to buy the shares. You did not have to buy the house or the shares; you bought them presumably in the knowledge that they were non-voting shares—that was a risk you ran, and you probably paid a little less for your shares for that reason.

512. Those are the circumstances as they exist today, but do you think in the future that sort of position should be allowed to arise—two classes of shares,

one voting and the other non-voting which has these disadvantages. We are looking at the future rather than the past.—I have assumed you were not dealing retrospectively but only with the future. As long as you do not pass a law to make people buy non-voting shares, I do not know why you have to do anything with the ones that choose to do so.

513. May I pass on. It is quite clear, Mr. Gluckstein, you see no objection to the idea of nominee shareholders—in fact you are against any change in the law. One knows there are great practical difficulties in changing the law in any event—change in ownership and so on. You, as chairman of a big public company, are you not interested in knowing who your shareholders are whom you are working for in the position of *quasi* manager, *quasi* trustee? Does it not interest you to know for whom you are working and if perhaps a group is secretly trying to buy control of your company? It is really two questions wrapped into one.—I do not think I am. My job—the job of all of us—is to look after our staff and shareholders. I do not think I have to take more care of one sort of a shareholder rather than another sort. I have the same duty to you as a shareholder if you happen to be the head of a big boot business or the owner of a small boot shop, or big insurance company or anything else. I still have the same duty to look after your interest regardless of who you are.

514. Supposing through nominee shareholders a competitive group were slowly trying to acquire your interest, would that interest you?—I do not think they could, Sir. But if I put myself in the position of somebody else, who was in that position, I do not see anything in it.

515. Perhaps I could ask you two or three questions on one other section of your evidence. You said you were against any compulsory disclosure in your balance sheet or accounts of holdings in subsidiary and associated companies. You pointed out that if you were selling higher grade products you would not want to sell lower grade products under the same name. That would be detrimental in the first place to the higher grade product. Does that mean that in the ordinary course of

business you find a company does not sell different grades of products under one brand name? That really it is necessary to have different companies some of whom are not known to the public, to sell the lower priced products?—I would think on the whole yes. It is better as it is; I would not like to say everything we sell is exactly one grade of quality, that would be an exaggeration. We do form companies quite often in order to market something at a higher class or a lower class and which would damage our other trade. I think there must be a number of cases—not always—where other companies would want to do the same thing.

516. It would follow you must have a number of companies which I, as an ordinary consumer, do not know belong to J. Lyons?—Very likely.

517. If I were to go to Bush House to look at Alpha Products, I would not find J. Lyons and Co. as the owners?—Very likely, Sir.

518. I would have to find the nominee?—Yes, but this is to some extent a question of protecting the public, and to some extent a question of protecting our good name. I am not entirely in favour of secrecy, but the trouble is the moment you appear at Bush House the papers blaze it abroad, it gets published all over town. I do not know really how you draw the line between secrecy and excess publicity.

519. Do you think this is a particular phenomenon of the food, catering and hotel business, or would that general principle broadly be applicable to other companies? I had not appreciated until you said this there was that practice of trading through subsidiaries.—I should have thought it was common to other trades. I do not see why it should be but I should have thought it was very general.

520. *Mr. Althaus:* Mr. Gluckstein, I would like to go back to your point about non-voting shares. You very rightly take the attitude, I think, that people can buy them or not, as they like. I dare say you would agree that that argument can be developed further. There are remedial actions which can be taken. A man can sell the shares if he does not like what is

going on. In the event of something deplorable happening, such as an assault by the A shareholders on the B shareholders, he may find that action is taken by parties controlling quotations and so on. Your argument is really, all these things do in fact adjust themselves by the operation of free choice and free decisions?—I certainly think that.

521. *Professor Gower:* In view of that, I wonder if I might put the other point of view. I quite see your point that shareholders, as long as they know they are buying non-voting shares, have only themselves to blame if these work out badly; but you fairly said that clearly it should be banned if it was against the public interest. The case, as I understand it, put by the opponents of non-voting shares is really that people who are managing other people's property, as directors of companies are, ought to be subject to some sort of control by someone; for, that the basis of our Companies Acts is that they should be subject to the control of the majority of the shareholders. The principle is enshrined in the Act now by saying all directors can be dismissed at any time by an ordinary resolution.

The argument as I see it is this, that if you allow non-voting shares it does enable the directors, by retaining a minute proportion of the equity shares and issuing to the public non-voting shares, to entrench themselves so that they are irremovable; so they can be as incompetent as they like and as long as they are not actually fraudulent nothing can be done to put them out. They are free from any threat of a take-over bid and that, it is said, is contrary to the public interest.—I think the words you used at the beginning were that everybody had a vote—I cannot remember exactly how you worded it. The law is not that everybody has a vote but that every voting share has a vote. The preference shareholder does not have a vote generally.

522. But it is surely true to say our law is based on the assumption that the directors, the management, will be subject to some sort of control by the shareholder. If you allow non-voting shares you can get a situation in which they are subject to no control by the shareholders. If the

directors themselves hold fifty-one per cent. of the equity then it is surely fair enough that they are free from any outside control—they are the majority—but there is a difference in the case where they are in a minute minority. There are a number of cases now where companies are controlled by directors who hold less than two per cent. of the equity and nobody can do anything about it.—Except not to buy shares in that company.

523. But the shares are already issued.—Or sell them.

524. But this surely is not the best way of ensuring efficient management of these companies, some of which are important public companies. I agree the individual shareholder can get out if he does not like it, but is this the best way of promoting efficiency?—I think, with respect, Sir, you are on a different argument. I thought this was to improve the Company Law and not the efficiency of the company.

525. But the suggestion is that there is something contrary to public interest, and that this is what is contrary to the public interest.—It seems to me, if you are going to have inefficient directors, they will be there anyway, unless you are going to make the point that every business in the country shall be a public company or nationalised, and every business must have public shareholders and in every case the directors must be subject to the votes of other people. You are always going to be up against that difficulty. It may be a private company: are you going to say the public must be allowed to have a share of that private company so that it shall be efficient?

526. I am acting as devil's advocate in this, but the argument is based on the assumption that the management is based on the control of the majority. Now you have a good point and you say, not necessarily the majority of shareholders; but, the majority of equity shareholders was, I think, the original conception. This has been defeated by this device of non-voting shares, and the suggestion, as I understand it, is that this is bad for business because it means directors can have absolute power and that absolute power corrupts absolutely, and that unless you are going to subject directors to some control by the shareholders they will have

to be subjected to some form of State control, which most businessmen would regard as something worse. Is there not something in this argument, or would you rather we increased, say, the powers of the Board of Trade so that they can exercise some supervision?—I think there could be arguments probably for increasing the powers of the Board of Trade in cases of "oppression"—which is the word I used before. It would have to be something serious.

527. It would be very difficult to get the Board of Trade to supervise efficiency.—I do not know how you could do that by law.

528. Only surely by having the threat that if directors are so inefficient someone will make a take-over bid and put them out. Is that not the case for take-overs?—I am against it. I have never been a take-over bidder, I have never been a victim; but I do not think I want to stop people taking over. I do not really want to do anything to stop freedom of contract and freedom of doing something which is reasonable. If you are asking me whether I prefer nationalisation to the abolition of non-voting shares, I think I must ask for notice.

529. *Mr. Smith:* I would like to turn to the subject of charitable and political contributions. I rather gathered the impression that it was a question of charity beginning at home rather than charity in the sense I have understood the term. The point is made that the contribution is made when it benefits the company and is in the ultimate interest of the shareholders; but at the same time your memorandum makes it clear you want to maintain the existing position which, other than recourse to law, denies the shareholder the right to comment whether in fact it is in his interest. Are those two things reconcilable?—I believe directors are always doing things they *bona fide* believe to be in the interests of their shareholders. You cannot publish all you do. I would like to make it clear that the money we give to charities or benevolent associations will be for the benefit either of our shareholders or our staff; and in fact in giving it to the staff we are still doing it

eventually for the benefit of the shareholders. A contented and happy, well cared-for staff must be to the advantage of the shareholders. But I do not think it should be necessary to publish the details. To put it in another way—I say this without having given thought beforehand—if we had to publish a list of our donations it might in some cases cause us to give more money to certain things.

530. I am not disputing that your directors make these payments either in the interests of their staff or shareholders; but in your memorandum you are saying you see no reason for any change in the law, and in fact you seek that there should be no limitation whatsoever on the directors in making this decision. It comes back very much to this, that benevolence is going to be determined by the directors and on the basis of the present law the shareholder automatically has no right to comment on the contributions being made allegedly in his benefit.—If I could put it this way, I cannot see the motive—I put myself as a director—why I would want to give the company's money away unless I thought it was for that reason; unless it was going to benefit me, which I have no right to do.

I might equally, if I started having political opinions, say that we ought to sell below cost because it would be good for the country, and we would very soon become bankrupt. That would reflect in the company's affairs. I think, if you do not trust people to run the business to the best of their ability, I just do not see where you are going to get to.

531. I think that clears the point. You are saying it is to the benefit of the shareholder and that that is determined by the director and that the shareholder himself has no right to say whether or not he considers it to be to his benefit.—If I may put it another way, I do not disclose to shareholders what I pay the local manager. I pay him what I think is the best thing in the end for the shareholders.

532. Can I turn to the other side of it? I can accept naturally enough that your company would be interested in the laws that are going to relate to its affairs, but I do not see that you can draw from that the conclusion that it should thereby

have the power to contribute as a commercial concern to political campaigns and political parties.—When we deal with political points, they are not party political points. A Bill may be brought in by any party which we think is detrimental in some respects to us. In fact it has happened. We are not interested in party politics, but it is still politics whether brought in by one party or another. I mean by politics something that comes before Parliament and is debatable. I can tell you of cases where some party has brought in Bills and Acts which have affected our business and where we thought we should be represented and put forward our arguments for amendments to the Bill. By political I do not mean party political.

533. *Professor Gower*: Does that mean you think companies should be forbidden from making contributions to party funds directly?—I do not think I should like to do that. I do not think I want to stop anybody contributing to party funds.

534. *Chairman*: The kind of political argument you had in mind, Mr. Gluckstein, as I understand, was some new Act on conditions of work and so on which your company thought was definitely impracticable to carry out, one of those Acts which put an absolutely unqualified and inescapable obligation on suppliers of certain types of goods to conform to certain precautions, or whatever it may be?—That would be the general purpose of it. But in answer to Professor Gower, Sir, I do not think you should prohibit a company from contributing to a party, any more than anybody else is prohibited from contributing; if the directors think it is for the good of the company, not if it is for the good of themselves. I think you must trust the directors to do what they think right.

535. *Mr. Smith*: Even there the shareholder is not entitled to express a point of view as to whether it is in his interest?—If we are going to ask the shareholder to express his view on everything affecting the company we shall spend most of our time at shareholders' meetings and very little time running the business. I think you must trust people to run these things.

536. *Mr. Bingen*: I think, if you are talking about political donations, you have to bear in mind that these must be such a small proportion of their sales or profits that you would not expect to consult the shareholders. They must be negligible. Unilevers have shown their figures this year—I do not think we would object to showing ours—but they all bear a very reasonable relation to the size of the business. We must not assume, in answer to Mr. Smith, that any board of directors would be throwing large sums away for improper objects, or objects which were not directly related to the company.—If we err on it, we err on being on the mean side, but I would claim that is a good fault.

Mr. Smith: I would have thought Mr. Bingen's comment would lead straight to the fact—why do you not advertise it and stop people from drawing conclusions that it goes the other way?

Mr. Bingen: I am merely amplifying what Mr. Gluckstein said.

537. *Mr. Mackinnon*: Am I right in thinking that what you have in mind is this, that some legislation is introduced which is going to put some restriction on an activity of Lyons, for example, and there happens to be a society in existence,

a sort of quite dispassionate body that has taken up the cudgels on behalf of this cause and is fighting it through political channels in Parliament, and what you have in mind is a donation to that body? Is that the sort of donation for political purposes?—If I could give you an example which just occurs to me—if I were engaged in the tobacco business and there is an association which I think is anti-smoking; supposing somebody starts an association which is pro-smoking to fight the association which is anti-smoking, I think I would be reasonably entitled to support the new society because they are going to help my business.

538. When you refer to donations for political purposes you have not in mind actually giving out to party funds a sum of money at all?—I have not got it in mind but I would not like to say I never would have, or other people would not have.

539. *Chairman*: Gentlemen, I think those are all the questions anybody wants to ask you, and we are very much obliged to you for your help. Thank you very much.—Thank you, Sir. I hope we have not wasted too much of your time.

Chairman: I thought it was a very interesting discussion, if I may say so.

(The witnesses withdrew)

(Adjourned until 2.00 p.m.)

THE LORD PIERCY called and examined

540. *Chairman*: Lord Piercy, we are all very grateful to you for your memorandum and for coming to help us to-day. Now, you are Chairman of the Industrial and Commercial Finance Corporation Limited?—Yes.

541. And your company has shareholdings or long-term loan investments in about 700 companies, and has examined a large number of Memoranda and Articles of companies. Could you give us an idea as to the type of companies mainly represented in that 700? Is it a mixed

bag?—Very much a mixed bag, ranging from the very small ones—it is part of our policy to provide facilities to as many small companies as we can—to quite large ones: companies with resources of a million or more.

542. So your knowledge extends to a representative cross-section of the companies in this country, if you can put it that way?—It is a bit ambitious to put it in that way, but perhaps we are, to a small extent, except that we do not do anything with the really large public

companies, which are a different sort of animal from the smaller public companies or the private companies.

543. Yes. As to the *ultra vires* rule, you will probably remember that the Cohen Committee thought that in view of the enormous width of the modern memoranda, the *ultra vires* rule had become an illusory protection to shareholders and yet might be a pitfall to third parties. I understand that in your view the *ultra vires* rule should be retained. Could you develop that?—Yes, that was rather the feeling among our technical people. I think it is a bit starry-eyed to do much about objects at this time of day, but certainly there is a strong feeling among us that the objects should be realistically stated, and we are adverse to this wide range of miscellaneous objects all standing independently, a large number of which really are not intended to be operated.

544. Do you think it would really be practicable to abolish the wide form of memoranda, to restrict the form of memoranda by legislation?—What you could hardly hope to do would be to rectify it as regards existing companies. That is the difficulty, is it not? I suppose you could, as regards new companies. I am not at all sure myself that you can do much more about this than try to bring it about to be a practice for companies to state in their annual reports what activities they are actually engaged in. It does not go very far, but that would be something.

545. It might be possible to do something about new companies, but it would be difficult to clip the wings of existing ones?—That is precisely what I think.

546. But by a restriction on the width of memoranda in conjunction with the power for altering memoranda, as it now stands, you would at a blow give some degree of protection to the shareholders?—I believe you would, definitely. One would have to run a little risk of hard cases under the *ultra vires* rule, but I would rather do that if one could get as far as you have indicated.

547. Of course, to put the argument the other way, by restricting the memoranda one would be putting the clock back to,

say, 1862, and the people professionally concerned would find themselves confronted—or they might find themselves confronted—with the situation where it was open to doubt whether a particular quite legitimate proposal was within the power of the company?—Yes, and it is a professional opinion, I think, that this present practice of universal objects has arisen from the too strict interpretation of what can be done under these simpler objects of earlier times.

548. Would you say that perhaps the Chancery Court was a little strait-laced in the way it regarded this matter—I am sure, quite unwarrantably?—Yes, I have heard that. In that context the suggestion sometimes crops up of making a standard list of operative powers a company might use, including such things as holding land or investments—that sort of thing. These operative powers would be strictly related to the specified objects. That, I think, is a suggestion intended to ensure that there would be a bit more latitude of interpretation, and that the company might do something which at first sight seemed to a Chancery lawyer not to follow quite strictly as a means of carrying out a particular object. Do I make myself clear on that?

549. Yes, very clear.—I have no doubt you have already seen suggestions of that kind in some of the submissions.

550. Yes: what I had in mind was rather the other way—that if we restrict the Memoranda and Articles now, we will be putting company lawyers in the same position as they were in during 1862, when the original Companies Act came in. They would fly to multiplication of Objects in the Memoranda, so far as they were allowed to, in order to remove all possible doubt.—If I understand you correctly, that is a suggestion as to how I think the present multiplicity of Objects in the Memoranda and Articles has arisen?

551. Yes.—What I was suggesting was—supposing for the sake of argument, in the case of new companies, objects were few and simple and genuine—whether there might be ways and means of enabling a Court to give a more liberal and helpful interpretation under the Objects

than perhaps was done in earlier times: I should have thought that would not be impossible. There is a lot of experience, legal and general, behind us now that we had not got in 1862, and if a company wants new Objects or fresh powers, the procedure for getting them is not really difficult or protracted provided it has willing and sympathetic shareholders.

552. So that really the upshot of your view on this question is that you think consideration should be given to the possibility of introducing a more concise form of Objects?—Yes, I would not put it higher than that, because I appreciate it is a very difficult question at this time of day.

553. Then perhaps it would be putting it too low to call it a pious hope. You think that the laws regarding the *ultra vires* principle, whereby a company is tied to the Objects stated in the Memorandum, should be continued?—Yes, I believe the principle is sound.

554. To pass to another topic, I do not think you are particularly interested in shares of no par value?—No.

555. Then we will not trouble you with questions about that. Under the heading "Classification of Companies", you give us an interesting picture of the broad distinction between a public and a private company, I think one may say from the economic point of view?—Yes.

556. You are not seeking to make a new division in the legal sense to alter the law as regards what companies are private companies, in relation to the Act?—I think that if you ask an exempt private company to file accounts and to use a qualified auditor, you practically annihilate the exempt private company. My remarks would be to simplify the division between private companies and public companies.

557. Yes, as was done in 1908, or whenever it was?—In other words, I am rather suggesting that, owing partly to the effluxion of time and the general development of education and so on, it is no longer very sensible to retain the exempt private company.

558. Then your inclination would be to retain the public company and the private

company which is not an exempt private company—that is to say the exempt private company would disappear?—Yes, it comes to that.

559. And then the distinction remaining is of very little effect really, is it not?—It is not much of a distinction, but it is convenient.

560. The ordinary, the non-exempt private company, is absolved from filing a statement in lieu of prospectus?—Yes.

561. But apart from that and its ability to trade with only two members.—Yes, I am not awfully attached to the two members.

562. And other things such as a company being liable to be wound up because its members are less than two as compared with seven in a public company—apart from minor privileges, the distinction would virtually disappear between public and private, if you did away with the exempt private company?—I think there is a certain value—not much perhaps—in limiting the members of a private company to fifty. It makes a ring fence, which is of some practical convenience; and of course there is some virtue in the restriction of transfer. So there are the two things which would remain, and I think those are important.

563. Yes, I see. Could you tell us rather more about your views as to the privileges of exempt private companies, because these have been much discussed by the various contributors to the evidence to this Committee?—I think they are clinging to a notion of privacy chiefly as a defence against their competitors, which is quite out of date. As I have said in the memorandum, I think it is not so very difficult nowadays to find out what the resources and the personnel of a small private company are. From the merely competitive point of view, I think there is not much in this exemption; but from the point of view of creditors, I think it is important that proper accounts should be compiled and audited and filed. That is my main point.

564. Yes, proper accounts should be filed; and what do you say as regards the special privileges in regard to the auditor?—I think that should be done away

with, and that it would be to the good of a private company—after all, even a small private company is liable to be attacked in regard to surtax. It may have some intricate little problem of Profits Tax, or this and that, and there is a great advantage in its employing a qualified auditor, and it would not be doing an exempt private company any injury, I think, if it were to be prescribed that it should do so.

565. You think it is in the public interest and that in the long run it might well be in the interests of the exempt company itself?—Precisely.

566. Yes, then the next item is that of charitable contributions by companies—for benevolent objects and political objects. As to that, you say such donations are objectionable in principle?—Yes. I am conscious that I have put forward a rather uncharitable view, but on the whole I think companies are pressed too much to make donations of one kind or another. I also think some of them are too prone to do this; and of course where donations or subscriptions are made by the company and allowed by the Revenue, part of the burden of the subscription falls on the Revenue, so that a contribution of, say, 9d. is made at a net cost of 4d. That is a principle that could be abused. At the present time certain donations and subscriptions are allowed by the Revenue. On the whole they are not illiberal about that. I should be quite prepared to swallow anything that could pass that test, but anything over and above that, and of course particularly anything of a political complexion, I should think was wrong. Then there is the other point—this is perhaps an idiosyncrasy—but I think at present large corporations are pressed too much to assist in the financing of university buildings and chairs and large public objects of the same kind. Of course, I know the medieval merchant was very liberal in that respect, but I cannot help feeling there is so much public provision of this sort of thing now that it savours of excess to expect business corporations to find these large sums. Those are my views, and I am quite aware they are perhaps rather illiberal.

567. Of course, there might be some objects, I suppose, which could fairly be

described as beneficial, or likely to be beneficial, to the company which would not pass the scrutiny of the income tax authorities as a necessary expense of the trade?—Yes, I agree. I have your meaning. Pharmaceutical companies are in the habit of making large subscriptions to scientific objects and research organisations and conferences on this and that, connected with medicine and surgery; and I think that may be a border line case.

568. They allow that?—They do, yes. I do not know what sort of margin that represents, but that may be the instance you are thinking of.

569. On the whole you think a good general guide would be not to exceed what the Revenue would allow as a necessary expense?—Yes, that would be my suggestion.

570. And then there is the case of Tate and Lyle?—Yes, I think that is objectionable, not because my views are left: it is a border line case. There was also the "square deal" of the L.M.S.

571. There have been a number of cases of that sort.—Yes, I think one has to be careful about those.

572. It was explained by the Chairman of J. Lyons and Co. Ltd., who was giving us evidence this morning, that by political objects he would mean not so much party political objects as objects directed to legislation which might affect the company's business.—Yes, take the extreme case of that—nationalisation. I think the effort to protect one's company's interests goes a bit far when it comes to propaganda against broad political policies such as nationalisation; or, to take another example, the activities of the Monopolies Commission.

573. On the other hand, to subscribe to a fund got up to oppose some legislation which companies carrying on a certain kind of business considered oppressive to them might not be so bad?—Yes, I think there is something in that: all these things are questions of degree. They shade off, and it is difficult to draw a line.

574. Then I think we can pass from that topic. Under heading 5, which

relates to the exercise of the powers of the company by directors and the degree of control retained by shareholders, you give, I think, three examples in which you express the view that the authority of the company in general meeting should be obtained. Those were items (a), (b) and (c) under heading 5, which relate to fundamental changes in the company's activities, the disposal of the undertaking and assets, and the issue of new shares?—Yes.

575. As to 5(a), you described the situation of a company whose existing business had ceased or been reduced to a low ebb, while on the other hand it had something in the way of capital funds, and so forth. You say about that, "... the approval of the shareholders, based on a proper explanation of the facts and the purposes in view, will generally be essential and should be ensured." That is one instance where, in your view, the directors ought to go to the company and say, "Do you approve of what we propose to do?"—Yes: of course in that particular field what commonly happens is that somebody buys the company and gets complete control of it; but it would be my view that the consent of the shareholders should be obtained.

576. And then under (b), disposal of the undertaking and assets, you say: "Such measures should require approval by special resolution decided perhaps by voting papers to be deposited at the offices of the company. It is for consideration whether on such an issue, shareholders with limited or no voting rights should not have a statutory right to vote." Those are three examples of cases in which you think the authority of the company, either by ordinary or special resolution—probably the latter—should be obtained?—Yes.

577. Have you any other examples to suggest?—Not off hand. In (b) I have thrown out a suggestion put up by one of our people dealing with the case of disposal of the undertaking and assets and where it is a method that is within the discretion of directors: the suggestion is that shareholders with limited voting rights, perhaps preference shareholders, even more A shareholders, might have a

right to vote—because it cuts at the whole basis of their interest in the company. Whether it is a feasible suggestion, I cannot say.

578. The same point was being discussed in the Committee this morning; on the assumption that voteless shares should be allowed to continue, whether it would not be reasonable to give the holders of those shares a right to vote in certain cases?—In certain connections, and this would be one of them, I think—certainly (a) and (b) under heading 5.

579. Then as to (c), that is the issue of shares, your remarks under that sub-heading were directed to the issue of a block of shares for cash, I understand, to non-members?—Yes. Reading over that paragraph, I thought it a little confused. Perhaps the issue for cash to non-members and the issue of shares for acquiring another company or property should come under the same group.

580. Cash issues to non-members have been discussed so far on these lines, that the Board should, unless there is some very good reason to the contrary, offer any block of shares they are issuing in the first instance to the shareholders, in accordance with their rights or present holdings, before it is offered to an outsider. The suggestion is that if the company proposes to allot these shares other than to existing members, the existing members ought to be consulted and they ought to have the power to agree or disagree to giving the necessary authority by resolution at a company general meeting.—I would subscribe to that, with the rider that if it is a case of acquiring new assets or making some new issue which is of importance to the company, it is a consideration which might be satisfied by shares, if it is desired to do it that way, but the shareholders should be consulted.

581. I am sorry, I left out the second branch. I was dealing with the cash issue because other considerations apply in other cases, such as the acquisition of a business; but one ought to consider whether the shareholders should not have a voice in that as well.—Yes, but only if it is an important fraction of the outstanding issued share capital.

582. Yes. You would agree, would you not, in all these cases it is very largely a case of degree?—Yes.

583. If the directors have to go to the shareholders on all these matters, important and unimportant, they would be very much handicapped in carrying on a business?—I am not sure this sort of thing happens as frequently as that, but certainly there is a question of degree. There is a transaction of a certain size where it would be almost frivolous to bother the shareholders with it, but I do not believe that a rule of this sort would be inordinately burdensome to any company.

584. If it happened any day, it could hardly be classified as exceptional or fundamental?—I agree. Of course, the case of the so-called holding company is a separate one because there the technique is commonly to acquire new property, new assets, or whatever they may be, and give shares in exchange. That is a special case.

585. Here is a question on the point about the issue of shares otherwise than to existing members, and it is a question which was going to be put by Mr. Lumsden, one of the members of the Committee who is unable to be present today. He wondered if you had any comment to make on the suggestion that the specific approval of shareholders should require to be obtained by resolution in general meeting before any issue, or possibly any substantial issue, of equity shares in the company is made by directors other than to existing equity shareholders. Pausing there, that is what we have already been discussing, and you have expressed the view that in the case of a substantial issue you think it would probably be right that the shares should be offered to the shareholders unless they agree otherwise in general meeting?—Yes, precisely so.

586. Mr. Lumsden's question adds this, would that be your view, even though the resolution which sanctioned the creation of the authorised share capital specifically stated that the shares created should be available for issue by the directors in such a manner as the directors should decide?—I think the shareholder should be

on the look-out for any such resolution as that, and get the final words struck out.

587. But as the law now stands, if the shareholders agreed to such a resolution on the creation of the new shares, *prima facie* they are giving that discretion.—If the resolution is passed in that form, the directors have that discretion and there is nothing more to be done about it, but I think it is a bad form of resolution. I do not think they should be given that discretion.

588. It is a bad form, and if it is a bad form then it would be open to an amending Act to say that such a provision must not be put in?—That is very much a question for lawyers, with respect; but I would be pleased to see that.

589. Now passing to a new topic, I understand that in the United States companies may claim short-term dealing profits made by the directors in the company's shares. Do you think a similar provision is needed in this country? That falls under heading 6, the director's duties.—I do not know anything about practice or experience in America. One hopes that they manage to collect these dealing profits. My general feeling is that it would be much healthier if there were no dealings by the directors in the company's shares, and therefore no profits to be claimed by the company.

590. That would be a Draconian rule?—I think it would be very difficult to regulate legislatively directors' transactions in their own companies' shares. I have only in the last day or two seen a letter which suggests some rules which would make it reasonable and moral, but on the whole the position should be that directors, if they acquire shares in their own company, should acquire them to hold and should not in any circumstances do anything which could be called dealing. I am afraid you have to leave that to rest on the moral principles of the individual; I am afraid it would not be difficult to devise ways in which they could do these dealings and conceal them.

591. Yes, you think it should be left to the honesty and good taste of the

directors?—Yes, plus disclosure annually of the director's dealings. That, I think, is an important safeguard. As to setting limits within which directors might operate, one suggestion is that within the six weeks after publication of the annual accounts a director might be free to deal in the market if he wished, because during a period of that sort the ordinary investor and his advisers would know as much as the director, because it would all be in the profit and loss account and the directors' report. I do not think a lot of that particular suggestion; suggestions of that sort do not really get to the root of the matter: evasion is so easy. After all, every one has cousins or friends or nominees, and so I am afraid it has to be left to the sense of principle of the directors.

592. Yes, I follow. Then coming back to the matter of voteless shares, which we touched upon earlier, I think it follows from what you have said just now that, on the assumption that voteless shares should be allowed, it would be reasonable to give the holders a right to vote on certain specially important matters?—Yes, the one or two fundamental matters—those are matters which I have rather suggested seem to me to be as much of interest to the preference shareholders as to the holders of A shares.

593. There is a common form, is there not, in cases where there are preference shares, providing for circumstances in which preference shareholders are to be allowed a vote, and denying them a vote in all other circumstances?—Yes.

594. Then going now to heading 8, the protection of minorities, you are putting the view that statutory provisions giving protection to minorities appear to be reasonably adequate, and that ignorance of the statutory provisions is the main trouble?—Yes, on that particular point I notice the Institute of Chartered Accountants make a very interesting suggestion; that it should not be necessary to satisfy the court that to wind up a company would unfairly prejudice the members, but otherwise that it was just and equitable for the company to be wound up—I think that may be one obstacle to the better utilisation of Section 210. I think it is.

595. Yes, that submission has been made to us by more than one contributor.—I certainly agree with that.

596. Now under heading 11, which relates to the disclosing of beneficial interests in shares or nominee holdings, you suggest that a company shall be enabled always to ascertain the beneficial ownership of any holding which appears to be in the name of a nominee and that where several holdings appear to have a single beneficial owner this fact should be indicated in the annual return of the members of the company. You say quite correctly "the company", but in fact it would be the directors who would administer this provision, would it not?—Yes, the directors and the secretary.

597. Have you considered the Board of Trade powers of investigation, and in particular their power to investigate the true ownership of shares under section 172?—Yes, but that is a power which is called into exercise only in special circumstances. I was proposing this as a normal power by directors.

598. Just a domestic power of the company itself?—Yes.

599. It would put the directors, would it not, in a rather invidious position if they had to challenge the shareholders and say, "You must disclose your beneficial interests", and so on?—It could naturally be used in an invidious way, and also in a ridiculous way; and this suggestion would hardly cover the ground. Take the case of investment for a fund where the holdings are put in the names of two personal nominees. For a time nobody would think there was anything special about this; but if a stockbroker or jobber saw those names a number of times he might put the thing together and build up a picture and say "These are really nominees". Perhaps that is not a very good illustration, but it is an illustration: where there are personal names I am not sure that this power would be of much use because its exercise might easily be invidious. But in every list of members of a large company you find large blocks of shares in the name of bank nominees and various nominee companies, and those are the ones most apt to be used, I think, for administrative purposes. To unravel

the beneficial ownerships behind those blocks might be useful and helpful, and that would be the main use of this power, I think.

600. What would be the sanction of it? Supposing somebody says, "That is my affair: I am not going to tell you"—Is not that a legal point?

601. I do not know, but you might get an awkward situation; and if the directors were empowered to say, "If you won't tell who the true owner of these shares is we won't let you vote", the door would be opened to all sorts of manoeuvres.—But in the case of bank nominees, if you gave directors the right to call for the names of the beneficial owners and it empowered banks to release that information, would that help?

602. I do not know: obviously the subject is extraordinarily difficult.—Yes, it is difficult, but I am inclined to think it is necessary to do something about it because one cannot deny there is a certain amount of, shall I say, strategic attack on some companies, and these things can be mounted under the names of nominees. Though there may be no real harm, and one cannot object too much to people accumulating large shareholdings, at the same time it seems to me that it is fair to uncloak these devices, if there is some regular mode prescribed by which it can be done.

603. There have been a number of suggestions made. For example, it has been suggested that the beneficial owner of more than x per cent. of the issued share capital of the company should himself be under an obligation to make a disclosure.—Yes, I would not rely on that. In certain banks in the 1930's, the owner was not supposed to hold more than x per cent. of the share capital, but people who owned far more than that, probably through nominees, did not go along and disclose it; and I doubt if they would if they thought they were safe behind a nominee's name. I hope that is not a low view of human nature.

604. Of course, one is considering in these matters the type of person who, for ulterior motives, means to keep his dealings secret. That is the type of man

you are up against, and he is the type of man of course who will go to all lengths to defeat any plan.—Yes. On the whole, I would not be opposed to any means which would enable his manoeuvres to be unmasked. You cannot stop his manoeuvres, but let him conduct them in the open.

605. In cases of transfer the disclosure of beneficial interest would be extremely difficult, owing to the labour it would involve in a company of any size.—Yes, I really think so.

606. One thinks of something like the note about the scheduled territories on the back of the transfer form?—Yes, I know; but it is worth considering, of course.

607. I do not know that we can carry that much further. But the suggestion has been made that all investments made by a company on its own account should be kept by it in its own name. The suggestion is that most nominee holdings derive from companies, or a large proportion do.—I would not know whether that is the fact or not. Of course, this brings the question home to one's own bosom. I think it logically follows from what I have said.

608. In India it was decided that a refinement of this sort should be introduced. There they have prohibited companies from holding shares beneficially owned by them, otherwise than in their own names.—Of course, if something like the suggestion I have put forward was adopted then it would be easy to ascertain the beneficial ownership if it was thought to be a sufficiently large holding—or if, for instance, a large increase occurred in the holdings of a nominee company, or something like that. I would rather suspend opinion on that one. I do not like to express antagonism to it, but I am just wondering whether it does deprive a company of some of the conveniences which do arise from using a nominee.

609. One would have to face it, and the question is whether the result which would be achieved would be worth the inconvenience possibly caused to companies.—I am inclined to doubt it

myself, and I think there would be really no significance, in a very large number of cases, in having the shares in the name of the beneficial owner rather than in the name of the nominee company. Of course there might be other cases where it would be rather important. I would prefer not to express an opinion on that *ad hoc*.

610. Yes, I see. Thank you. Then we can go to heading 14, which concerns the practice of carrying on business through associated and subsidiary companies. You say in your memorandum that this may be capable of lending itself to abuse, and you suggest that provisions should be made for the disclosure of the names of, and the extent of the interest in, subsidiary and associated companies in the holding company's annual accounts. That is your suggestion?—Yes.

611. Perhaps you could give your views on these two further points. The first is that reciprocal shareholdings beyond a certain percentage should be prohibited. It is said that what may happen in such a case is that where each of two companies has a substantial block of votes, falling short of legal control in the other, a common board of directors can use the votes of each company to perpetuate their own control, although in fact the directors are minority shareholders in each company. I do not know whether you agree that might be the result?—Yes, I suppose it could. I do not know how you would cope with that or prevent some other device being substituted for that particular one. The ingenuity of lawyers and accountants is like Stevenson's abhorred dexterity of surgeons.

612. I suppose the answer is that if such a thing could happen that is rather reprehensible?—It is rather unsavoury.

613. But if that method of achieving such a result is stopped, it is not unlikely that others would be invented?—You cannot devise water-tight measures to preclude that sort of thing entirely, and I do not think that is an important enough case to single out to find a specific remedy for it.

614. Then the second suggestion is that the parent company should be legally responsible for the debts of its subsidiaries, or at least a part of them.—It would be an excellent provision, if it could be brought about.

615. But there again I suppose people would find means of getting out of it—the sort of people who wanted to get out of their burden?—Yes, there is scarcely any limit to that sort of ingenuity; but obviously it is completely fair in principle that if a company chooses to carry on its operations, in whole or in part, through subsidiaries that the parent company should take responsibility for the whole. In business it does in fact often happen that you lend to the subsidiary and get a guarantee by the parent company; or various arrangements in that form. It is a point that is always arising. If you could establish a legal liability on the part of the parent company for the solvency of the subsidiaries, it would be probably a good thing. I am not sure it is not a little starry-eyed.

616. Possibly. There might be changes in the shareholdings, possibly before the trouble arose?—Yes, it could be.

617. Very well. I think there is only one other question I had in mind to ask you, and that is about prospectuses, which I know is a matter upon which you have made no comment, but the point on which I thought you might perhaps help us is this. As you know, the investor in quoted stocks has the protection of the scrutiny carried out and the regulations insisted on by the Stock Exchange, in addition to the safeguards in the Companies Act itself. Have you ever considered the position of investors in unquoted stocks, with which the Stock Exchange is not concerned? Do you see what I mean?—Yes, I do. I suppose there is a good deal of informality in some of these cases about taking up share subscriptions. I thought the practice was that any statement should be certified in some way by reputable auditors, and then one is reasonably safe.

618. Perhaps I might put it another way. One of the things this Committee has to consider is the protection afforded to investors in respect of prospectuses,

and so on. As matters stand at present the great protection consists of the statutory regulations, coupled with the Stock Exchange regulations, which in some respects go a good deal further than the statutory ones. The investor is amply protected, because he gets the benefit of the legal requirements and the Stock Exchange requirements.—Yes, and I would add to that that the present-day regulations of the Stock Exchange and the manner in which they are operated is an immense protection to investors, but then, you see, they apply to public companies whose shares are going to be quoted, where there is going to be a free market and where the investor is not really, in a sense, much interested in managing the company; he is buying a marketable security. The case of the private company is different: the number of shareholders is limited to 50, and its opportunities for raising outside capital are rather more limited. It is largely dealing with its own shareholders, or people known to it, or institutions. I do not believe you could apply anything comparable to the Stock Exchange regulations to the raising of capital of private companies, nor do I think it is in any way necessary.

619. You said private companies. You mean rather unquoted companies—that is what I have in mind?—Yes, the unquoted company.

620. Suppose that an unquoted company, through some operator in the provinces, puts out a prospectus which complies, on the face of it, with the legal prospectus requirements but does not say there is going to be an application for a Stock Exchange quotation, so that it is outside the Stock Exchange regulations altogether. The subscriber, on the face of such a prospectus, has much less protection, because the Stock Exchange regulations do not apply?—Yes, I do not know that there is a very important point there. Who would be handling these unquoted issues? They would probably be placings, would they not? I should think it would be right, if subscriptions are invited in a case like that, where there is going to be no application to the Stock Exchange, that there should be some rules about the information that should be given and the certifications that

should be required, but I am sure it would not need to be on the elaborate scale of the Stock Exchange rules for quotation. I do not think what you are indicating—I speak with respect—I should not have thought that particular sector of the field was very large or very important.

Chairman: We had before us the other day a prospectus which raised this point. It was Professor Gower who brought this to our notice. Perhaps I might ask Professor Gower if he would expand this subject?

621. *Professor Gower:* Apparently at least two hire purchase finance companies are publishing prospectuses inviting subscriptions for their shares without their being quoted on any Stock Exchange. They circulate these prospectuses quite widely, and as they also advertise for deposits they have already got a good list of likely recipients.—May I ask you, as an authority, does the Prevention of Fraud Act not get them?

622. No, because they publish a prospectus which complies with the Companies Act.—Yes, I think there is something there that can be dealt with. I am not sure of the precise method, but it should be dealt with and no doubt they can do that sort of thing through the old-fashioned outside broker.

623. There are no brokers, you see. When I got a copy of this I wrote to them and said that I observed there was going to be no Stock Exchange quotation and asked what would happen if I wanted to sell my shares? They wrote back and said something to the effect that "if you write to the secretary, he is generally in touch with people and is able to arrange things". Of course they constantly keep shares on tap the whole time.—Yes, this is nonsense. It is a further hint that hire purchase finance companies could be the rogue elephants of our time. In spite of what I said before, I entirely concede that it ought to be attended to.

624. Would it be reasonable to suggest that nobody should make a public issue unless the shares were quoted on the Stock Exchange?—I would entirely agree with that. I think it would be an important and salutary piece of legislation, and that would not preclude the

private company and the small public company with unquoted shares from raising a limited amount of capital from regular sources. That is an interesting point.

625. *Mr. Mackinnon*: Just one point, Lord Piercy: you say you would like to see companies with subsidiaries giving full information of the subsidiaries—what proportion they hold in the balance sheet, and the nature of their business?—Yes.

626. It has been suggested to us that might have some disadvantages for a holding company which wishes to operate and keep certain of its activities undisclosed to the market. A particular sort of example was given of a company which makes a high-grade product on the one hand and, at the other end, a low-grade product, and it wishes to market the low-grade product, but not to do it so as to impair its own high-grade name—would you think there was anything in that argument to set against the advantages of disclosing this information?—I would have thought not, and as regards that particular case of course, that can be dealt with by having associated companies rather than parent and subsidiary, with common elements on the board. There is a legitimate case for that up to a point, and certainly it does not invalidate the general proposition that particulars about subsidiaries should be disclosed.

627. Of course, if your argument is sound, you could defeat the disclosure of information by arranging things through associated companies.—I know, but there is no limit to this, and you have to bear in mind there are all these loose strings and vague margins in the company world.

628. *Professor Gower*: Could I clarify a point in connection with charitable donations? Lord Piercy, I understand your view to be that companies should be allowed to make them, provided they are allowed for tax purposes. The test of whether charitable donations should be allowed would then depend on whether it was a legitimate tax deduction for Revenue purposes?—Yes.

629. You could put the directors in an impossible position, because they would never know until they had made the contribution that they would get away with it—what would happen if the Revenue did not allow it? Would they have to repay it out of the profits of the company?—No, I think it would come out of the net profit after tax. But I do not think that is a real difficulty because in the first place the directors in an established company have a certain run of experience on which they can rely, and in the ordinary way the accountant or financial director or auditor is moderately on visiting terms with the Inspector of Taxes. He can always go round and put the case to him. I have known the Special Commissioners to be accessible to the extent of giving an informal view without commitment on some special case. Provided you make an appointment with them, it does not take long.

630. *Mr. Althaus*: I was going to ask the same question about charitable contributions. About the issue of new shares in quoted companies, you say it may be that the Stock Exchange covers the point. Therefore I take it your main point is that any special legislation or compulsion should only apply to unquoted companies in view of what I understand is your belief that the Stock Exchange does in fact protect the interests of the shareholders very largely in these matters?—Yes, I would agree with that. As a matter of fact, at one end or the other, the Stock Exchange with their rules for quotation and general dealing and financial principles—they are the great safeguard to the investor.

631. There was another point, not in your memorandum, but the Chairman asked you about companies holding accumulations of shares in their own names. I suppose it would be possible for some interested party to accumulate them on their behalf and only at the psychological moment to transfer them to the company? There is really no protection in asking a company to declare its interest in this matter?—I quite agree.

632. *Mr. Brown*: Just one question on the objects and powers of companies, which we started discussing. I gather,

Lord Piercy, your desires are that companies' operating powers should be limited closely, and shareholders should be consulted if they did wish to expand the powers?—Yes.

633. There are many cases where they have wide powers now, and if they wished to build up wide powers would it be practicable or reasonable to say that a provision might be made to the effect that object powers would lapse if not used?—I think it is an excellent suggestion: it is quite first-rate, and would go far to clear up the present situation. I was going to make a suggestion about the protection of shareholders, but yours is a much neater idea, if I may say so.

634. I was intrigued and mystified, looking at page 9 of your memorandum. You use the words, "where several holdings appear to have a single beneficial holder". I wondered how several holdings could so appear?—As a result of discovery: you might find out about it. Perhaps it is an impracticable suggestion, but you could perhaps put them together, or something like that.

635. As regards investments by companies held in their own names, the suggestion is made that it is only a company which is likely to acquire control surreptitiously by means of nominee holdings—is that a fair comment, or are there not a number of individuals today concerned with takeover bids who could very likely do this on their own account, even if they intended to put it into their company later?—I would not say it is altogether a fair comment. There must be other companies, of course, like us; we quite commonly put holdings of one kind or another in companies into nominees' names.

636. My question was put, about the assertion that it is only a company which is likely to acquire control surreptitiously—in other words, not an individual—but are there not a good many individuals who are likely to do this surreptitiously?—Yes, I think that is the weakness of that suggestion, for what it is worth.

637. And non-voting shares—you express yourself very clearly as having no objection to non-voting shares in an

ordinary case. It is not unknown for the management to become inefficient, and when that occurs would you agree there should be a right probably for the shareholders to take action and change their management?—I think in principle it would be a very good thing.

638. Does it happen on occasion?—Mostly when the mischief is done: at a position of crisis it is done, and even then it is not a very flexible or rational instrument for doing this. The people who are voted in on somebody's suggestion may be as bad as the ones voted out.

639. You do not think it right or wise that shareholders should possibly change management when not satisfied?—No, I would not say that. I would rather say that the right does not avail them much. I think it is largely a paper right, but a sort of latent sanction which may weigh with directors. I am not so much positively in favour of A shares as dead against any legislation on the subject. I think that would be going too far and that we could leave it to opinion, *viz.*, the Stock Exchange, investors themselves, opinions expressed in the Financial Press, and so on. I would be inclined to think, on that footing, A shares may prove a permanent feature, although I know that powerful interests at the moment seem adverse to them.

640. *Mr. Althaus*: May I revert for a moment to a point Mr. Brown raised about nominee shareholdings. I am quite prepared to think it is established from a legal point of view, but I think Lord Piercy would agree there is a pattern of ingenuous shareholdings in cases in which one examines them which is quite unmistakable. The question really is whether that could in fact be brought into any sort of statutory provision at all. I have myself on many occasions had to examine lists of shareholders in a somewhat hostile manner, and have never had the slightest doubt in my own mind where the rather artless associations began and continued.—I would think there is a good deal in that: I do not know whether Mr. Brown thinks so too. What always causes some admiration in me is when they are looking

at the applications for an issue experienced fellows can work out the major part of duplicate applications. I do not know how it is done; it is the result of experience I suppose. I quite agree with Mr. Althaus.

There is one point I might make. I have mentioned the unit trust. I thought on reading the memorandum of the Association of Unit Trusts that possibly I could make some useful

observations on that memorandum, and if the committee would like it I would gladly do that.*

Chairman: We would indeed welcome that very much. I think that is all the questions we want to trouble you with, and we are extremely grateful to you for coming here and helping us.—Thank you very much indeed.

* This memorandum by Lord Piercy appears on pp. 121 *et seq.*

(The witness withdrew)

MR. W. A. NICOL, MR. W. W. FEA AND MR. G. T. HUGHES called and examined

641. *Chairman:* We have Mr. Nicol, Mr. Fea and Mr. Hughes, Administrative Director, Financial Director and a member of the secretarial staff of Guest, Keen and Nettlefolds, Ltd. I have stated it correctly have I?—*Mr. Nicol:* Yes, Sir.

642. We are most grateful to you for coming to help us this evening, and also for the extraordinarily well-prepared memorandum you have submitted. As to your position with regard to what may be described as a "one-man company", I gather you operate extensively through the wholly-owned subsidiary, and it would be a considerable convenience to you that it should be possible to do this with one member without the necessity of the number of members being two or more. That is to say, you would like the law to be altered so as to allow a company with only one member?—*Mr. Fea and Mr. Nicol:* Yes.

643. One has to face it that that would be an extremely revolutionary amendment of the law, would it not?—*Mr. Fea:* I am not a lawyer and I do not know if they would say that for a certainty. But so far as the application to this group of companies is concerned—we have a large number of subsidiaries—and it would be of great convenience to us if only the parent company was the shareholder.

644. In your particular case you say that would be a great convenience and no harm could be done to anyone, but one

has to consider the general picture. You may not be able to answer this if you are not a lawyer, but do you not agree the whole basis of our company law heretofore has been that the company shall consist of an association of persons who collectively create a legal entity distinct from the members composing it?—*Mr. Nicol:* I think in substance you are absolutely right.

645. One gets it in Section 1 of the Act. That certainly postulates more than one person, and one gets that carried further in Section 13. That provides, in subsection 2, that:

"From the date of incorporation mentioned in the certificate of incorporation, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate . . ."

What was contemplated was that such subscribers of the memorandum should be a body corporate. How do you apply that where there is only one member?—Of course we regard the wholly-owned subsidiary much more like a branch, in the sense that its only difference from a branch is its independent existence at law, and consequently, the protection given to creditors. In all other respects it functions but as a branch of our organisation. We feel that the general summation of the case we have made is that it would be

helpful if we had only one shareholder, the holding company.

646. You would point out no doubt that, in order to observe the existing law, recourse has to be had to the use of nominee shareholders who really serve no useful purpose?—Exactly.

647. Are you not rather getting the best of both worlds here? You are running something which you term a branch but you are running it as a limited company of which the parent company is the sole member, so you have dispensed with all meetings and corporate activities and substitute the Common Seal of the parent company or the signature of an authorised director as sufficient to perform any of the functions of the company and exercise any of its powers?—Still observing its independent existence in law. There is no fundamental change implied in our memorandum of evidence.

648. But you have to go behind the company to find what is inside before you can deal with it in this rather summary manner?—*Mr. Hughes*: I think what we are really trying to do, what we are suggesting should be done, is to make the law accord with what is the fact. As I understand it, for the past sixty years it has been possible for one man, whether an individual or an artificial person, to create a company of which he is the only member.

649. Mr. Jones, who keeps a sweet and tobacco shop, simply signs a couple of documents and, with the aid of a nominee, comes out as a company, and he can duplicate that performance as often as he chooses.—Yes. That is the existing position of the law of course. I think all we are saying is that, in the case of a private company, it hardly seems necessary to have in addition a single nominee shareholder.

650. Of course Guest, Keen and Nettlefolds are a well-organised and competent concern. No doubt they can manage their affairs in this way without disadvantages to anyone and with proper advantages to themselves. Have you considered the case of the ordinary individual, the man who starts the sweet and tobacco shop?—*Mr. Fea*: On that I would draw

a distinction between the limited company, having its wholly-owned subsidiary, like Guest, Keen and Nettlefolds, and John Brown who wants to form himself into a limited company. In the last resort our group depends on its holding company, its author and source of everything, and which is accessible to the public and its members through published accounts, whereas the one-man company is not. We were talking in this matter about our particular circumstances and the ability to have a wholly-owned subsidiary treated as a separate equal class of company for the purposes of a holding company, which organised its business that way and not through branches.

651. You say so far as you yourselves are concerned the situation is met by confining this proposed arrangement to wholly-owned subsidiary companies?—We think it most important to restrict it to that category.

652. You say you are not concerned what may happen with other companies, but so far as the wholly-owned subsidiary is concerned you would like some amendment of the law so as to enable it to be constituted with one member—its holding company?—Yes.

653. I follow your position. The point has been taken by a number of other witnesses and it will have to be looked into from the legal point of view. Of course we need not be bound by the law as it is because we can recommend any amendments we like to see made, if it is practicable to make them. I do not think we can carry that aspect of the matter very much further. Passing from that I would like to ask you a question or two about *ultra vires*. You say on page 2 of your memorandum:

“We consider that the objects clauses of memoranda of association, as at present drafted, provide no appreciable safeguards for members or third parties, and we think that the memorandum could well become purely a document as between the company and its members. A third party would then be entitled to assume that a company has the same power as a natural person to do whatever it purports to do.” That is substantially what was recom-

mended in the Cohen Report.—*Mr. Nicol*: Of course we regard the memorandum of association as the charter of the company defining its powers. Our main recommendation under the heading of *ultra vires* is that the ancillary clauses of the memorandum should be codified, in other words detached from and put into a separate codified section, and that the objects clause should in essence be concerned in defining the real objects for which the company is trading. It is, at the present time, through having a large number of clauses dealing with generalities and other factors, confusing in the sense that it is difficult to decide what one is really concerned with in these particular clauses without a lot of interpretation. Our submission here was to try to make the objects clause operate only as between the company and its members, leaving the third party in the position that he should be treated as not being prejudiced in any way.

654. But then you are going to give the company *vis-à-vis* third parties the absolute powers a natural person would have?—Yes.

655. So that the third party is entitled to assume that the company has power to do whatever it does?—Yes.

656. And then behind that curtain is defined, as between the members of the company and the directors, the extent to which the absolute power of a natural person is to be exercised by the company. That is really what it comes to?—Yes.

657. Have you considered the possible difficulties in practice of this arrangement? What will take the place of the memorandum as the charter which the company shows to the world? Will it just be a naked certificate of incorporation?—No, I think it would be a simplified objects clause, covering in general terms the objects and purposes of the company, without all the clauses which are now set out in considerable detail but which, I think, are not really considered by many people in dealings with that company. I think there is at least a certain amount of confusion, and the position at present depends on the aspect of the clauses, on the interpretation put on them by the legal people.

658. According to your proposal this simplified memorandum as between the company and third parties will constitute a charter for the company to do anything a natural person can do. That is the position, is it?—Yes, that was our understanding in putting forward this as a simplification of the existing set-up.

659. There might be difficulties in practice. Have you considered the case of a third party dealing with the company, in the person of one of the directors, and these two people engaged in a transaction which they both know full well has been forbidden by the shareholders of the company. How does the matter then stand?—*Mr. Hughes*: The position we are advocating is, I believe, already the position with chartered companies. I do not know if this point you have brought out does apply or has been considered in relation to chartered companies. I would have said it is more a question of what powers the directors have and how the shareholders exercise control over them, that being a matter between the shareholders and directors of the company.

660. I do not follow that. Under the law as it stands at present when a company is incorporated by Royal Charter it operates under the charter itself; in the case of a company incorporated under the statute, it operates in accordance with the memorandum, and under the law as it now stands these documents do circumscribe and define the things the company has powers to do.—I am afraid I was certainly under the impression a chartered company could do anything even if not empowered to do so in its charter.

661. But there is not duality of powers?—In practice if a chartered company can do anything a natural person can, the position you mentioned earlier could occur, and the only remedy of the shareholders would be to sue the director in question.

662. That is what it would come down to. The person dealing with the company would be entitled to assume through thick and thin that the company could do that thing whatever it was.—I think in practice it is what happens to a large extent now. I very much doubt whether

it is a consistent habit to consult the memoranda or objects clauses of other companies.

663. Of course that has grown up through the exigencies of the case really, has it not?—*Mr. Nicol*: I think the tendency is to give a fairly generous construction of the objects clause.

Mr. Fea: We have found there is more and more ingenuity put into making an objects clause as wide as possible.

664. The result is that in practice except in a rare number of cases it is assumed the company has power and everything is all right. In the odd case the transaction is something outside the memorandum and then trouble arises—*ultra vires* trouble arises. I want to understand how your scheme is going to work. I do not want to take up time. You must take it, must you not, that the third party is absolved completely as regards exercise of power and the company has absolute power. The thing would not work short of that.—*Mr. Hughes*: I think that is what we had in mind.

Mr. Fea: And that the shareholder's remedy is against the individual or the director who transgresses against the direct authority the company may have had from the shareholders at an extraordinary meeting rather than through a memorandum which remains on the record.

665. Might this not lend itself to abuse? Might not an unscrupulous director get together with a third party equally unscrupulous and make away with the company's assets? Then the shareholders would be left without a remedy against the director who might be a man of straw?—If the objects had been drawn as widely as they are now he might still be purporting to act within those objects but in fact defrauding under them.

666. I am trying to understand it. Am I right in thinking you are going to suggest in place of the existing memorandum a basic *carte blanche* to the company to do whatever it pleases?—*Mr. Nicol*: In effect that is so. The usual thing is to err on the generous side and our purpose was to try and simplify that so as to give the company absolute power *vis-à-vis* a third party.

667. You say there is sufficient protection to the company from the shareholder's point of view by the fact that they can intervene by special resolution and curtail the power; and you say there is sufficient protection from the point of view of the third party because he is entitled to assume the company has power to do what it is purporting to do. That is the arrangement you suggest in substitution for the arrangement under which one relies on the verbiage of the memorandum of association?—Yes.

668. The committee will have to consider that proposal in due course and see what there is in the possible objections made to it. It would be helpful if you would tell us a little more of your view that the present classification of companies limited by shares does not bear a proper relation to economic realities. I think you make a broad distinction between public and private companies, on the footing that the public company is the company with shares quoted on the Stock Exchange and the private company is the company with shares not so quoted. Is that right? I found it rather difficult to follow.—*Mr. Hughes*: I think our point here is under the existing Act it depends on the wording of the Articles. Whatever the difference should be, this we think is the wrong way of doing it.

669. What advantage is there going to be in changing the Act in this respect?—I cannot say I think any specific advantages would follow. I think however we feel that the Companies Act should correspond with economic circumstances as much as possible, and we think that in the public mind when people talk about a public company they mean one like Guest, Keen and Nettlefolds, and not one which happens to have 51 members by accident.

670. I agree that the present drafting of the Act is not as elegant as it might be, and I think I am right in saying there is no definition of a public company except when once or twice it is referred to as a company which is not a private company. Then I gather you do not advance any specific advantage in regard to this classification of companies, but you say it would be a more artistic arrangement than the present one?—*Mr. Nicol*: It is really clarification of definition.

671. Passing to another topic, have you any views on what is called in the Act the exempt private company, which has certain advantages?—Of course we have not got any exempt private companies. The only view one might advance is that it is a desirable thing to maintain for the small private businesses.

672. You think the small private businesses should enjoy the privileges accorded to the exempt private companies?—I think so.

673. Of which the chief is not filing annual balance sheets and accounts?—In the main it relates to the small business man working in private and doing a good job in the economy of the country.

674. As far as you are concerned you see no reason why he should not be allowed to keep these privileges?—Yes.

Mr. Fea: I think the fact that he converts himself into an exempt private company for other reasons should not thereby make him responsible for having to disclose his position.

675. Is there not this way of looking at it—a man and his wife start by carrying on a small business in partnership. So long as they carry on the partnership they are personally liable for all the debts. They take advantage of limited liability under the Act and they absolve themselves from that liability providing they pay up the amount of their shares so as to make them fully paid up shareholders. That is the sum total of their present personal liability, and creditors have to look to the assets of the company. In those circumstances is there really any reason for excluding the exempt private company from the obligation to file accounts? They get the benefit of limited liability and their creditors look to their assets.—I must attempt to be consistent. We are not asking that a wholly-owned subsidiary should be exempted from filing its accounts.

676. You actually have not been very much concerned with this particular aspect?—No.

Mr. Nicol: We are not concerned at all.

677. Then there is heading 5 which concerns the exercise of powers of companies by directors and the degree of

control retained by the shareholders. On that heading you have made certain recommendations and say that in your view the company should obtain the approval of its shareholders to (1) a change in the activities of the company or its subsidiaries which is fundamental to the undertaking as a whole; and (2) the disposal of all of its undertaking or assets or a material and substantial part thereof. The definition of assets in this context should include interests in subsidiaries.

There is much to be said for these two recommendations, but can you perform the impossible task—I should not call it impossible but very difficult task—of defining what is fundamental to the undertaking as a whole or what is a material and substantial part of the undertaking?—*Mr. Hughes:* I think the point is that the directors must have a certain amount of latitude—they should not have 100 per cent. latitude so to speak—and although the word “fundamental” or “material and substantial” does not indicate a specific percentage I think it is the best we can do. We must leave it to the draftsman.

678. If you specify a percentage somebody will evade the provision by going to one percentage point less than the statutory percentage?—*Mr. Fea:* May I add to that the difficulty of defining the percentage of what? Are you talking about a percentage of the capital employed, or the turnover, or profits? We think it must be left to the directors of the company to make up their minds with their full knowledge of the business what it is their duty to report to the shareholders. In one case it might be as low as 10 per cent. or 15 per cent., and in another it might be 30 per cent. or 35 per cent.

679. So your conclusion is that these measures which you recommend appear to you to be a reasonable recommendation subject to the difficulties of definition?—*Mr. Nicol:* I think it comes down to definition. This is broad policy to be settled by a board of directors.

680. That is a poor foundation for legislation. That is the trouble, is it not?—Yes.

Mr. Hughes: We gave particular thought to "a material and substantial part thereof" because we considered it might be thought a substantial part of the business was not material and *vice versa*.

681. The suggestion has been made to us that these matters might be left to be guided by a sort of code of practice rather than making them the subject of actual legislation. What do you think of that?

—*Mr. Fea:* I think legislation has tended to follow the evolution of the best practice. I do not think it can precede it. If it is not now entirely established as the best practice to have this then probably the legislation should wait until that has evolved.

682. (1) I do not think we can carry that very much further. Then there is the question of the issue of shares to persons other than existing holders. It is suggested such issues ought to receive the sanction of the company in general meeting unless the shares are offered to the existing shareholders *pro rata*. On that I take it you would think it right to put some limit on the number of shares concerned so as to avoid what would really be unnecessary meetings to approve small transactions such as the provision of shares to a pension fund or shares required to qualify a director or something of that sort. Would you agree any such provision might require a reference to a minimum percentage of shares: 15 per cent. or 20 per cent. of the issued or nominal capital, whatever it might be?—I am not quite sure I have your point. We have put in the evidence to say we thought the board should be allowed to make an issue within a limit without having to report those to the shareholders for prior permission.

683. I have in mind the case where the directors have some shares which they are minded to issue in order to raise cash for some purpose or other. The proposition is in those cases, at all events where a substantial amount of shares is concerned, the shares should be offered in the first instance to the existing members *pro rata*

(1) A supplementary note, submitted by Guest, Keen and Nettlefolds Ltd. in response to this question, is printed in Appendix VI, page 143.

unless they pass a resolution dispensing with that.—*Mr. Nicol:* That I think is absolutely right.

684. I was only adding as a qualification that some provision would have to be made to exclude from that obligation small issues of shares such as the issue of shares to a director to make up his qualification or something like that.—That might from a practical point of view be very desirable.

685. I think this applies to the issue of relatively large shares, blocks of shares.—Do you draw a distinction between issues for cash and issues in consideration for the purchase of a business?

686. I distinguish cash from the case of shares issued otherwise because in the first place it would be impossible to offer these latter shares to the members because the transaction postulates they should go out to somebody else. In those cases it would be a matter for the shareholders to approve or disapprove of the transaction, whereas in the case of shares issued for cash they would *prima facie* have a claim on those shares *pro rata*, so there would be a difference.—*Mr. Fea:* I was just wondering where you say they will have a claim *prima facie* whether that is a point. You feel they must have a claim *prima facie*. It was rather suggesting that every issue for cash has to be made *pro rata* to the existing shareholders.

687. That is the suggestion unless the company meeting votes otherwise.—That was my point.

688. I do not think we can carry that much further. I do not want to take up too much time on this, but what is your experience as to the interest taken by shareholders in your affairs? Do they come crowding into your meetings?—*Mr. Nicol:* You always get a certain number who come out of interest, I think. Some of it, I think, is by long tradition. Of course, I think the success of the company has a bearing upon it. I should imagine, if a company was not doing well, you would have crowds coming to shout the odds and get rid of the board, but a successful company, provided it sends out a full statement of accounts and a full Chairman's statement with full particulars of the company . . .

689. And a suitable dividend warrant?
—And a suitable dividend warrant to follow. I think that in itself is an acceptable *quid pro quo*, and therefore I think they think there is no purpose in attending the meetings. We try as far as possible to encourage shareholders to come, especially those who write in and enquire about the accounts and any other matters pertaining to the company meeting, but in practice I think, if you have got a good dividend policy and a good set of accounts, they do not show very much interest.

690. Supposing a notice was sent out about one of the transactions of the kind we have been discussing—a notice of a general meeting to consider and approve a proposed sale by the directors of a substantial part of the assets described. Would that bring the shareholders in, or would they just leave it to the directors?
—I think in general they would leave it to the directors. I think my experience in sending out circulars has been that it is the man with probably 50 shares who makes the biggest noise.

691. I suppose he has paid his footing by becoming a shareholder, and he is entitled to have his turn at making a speech. There are various other suggestions I would just like you to notice. There is a suggestion that provision might be made for voting by means of postal ballot. Have you considered that sort of possibility, assuming it could be provided for in an Act?—We have not resorted to that in any way.

692. I would assume that where some substantial transaction which does require the approval of the shareholders is proposed, that your notice of the meeting to pass any necessary resolution would be accompanied by a reasonably full explanation of the nature of the transaction?—Yes, every time. We fully support that.

693. And probably shareholders, if that were satisfactory to them, would leave it at that and let the directors get on with it?—I think that is the general consensus of opinion, that if a full explanation is given, and it looks a proper proposition, the shareholders would leave it to the directors to carry out the transaction.

694. You raised a point under Section 199, which concerns directors' interests. On page 9 of your memorandum you say: "Disclosure of Directors' interests. We submit that holdings and dealings in securities *bona fide* for investment purposes only in a public limited company quoted on a recognised Stock Exchange should not be required to be disclosed under section 199". Should not that exemption, if allowed, be subject to some limit as to the amount of the investment in any one concern?—I think it is a question of the relevant amount.

695. The proportion?—The proportion. We do not wish to abolish the rule altogether, but we feel that the present rule probably goes a bit too far and is inconvenient without any corresponding benefit.

696. I follow. What do you mean by *bona fide* investment?—*Mr. Hughes*: I think we put that in with the implication that if an investment was made by a director with the intention of making a profit out of his office, there should be some means for the shareholders to impeach that. I do not think we considered it in detail.

697. The next point is under heading 7, and it concerns voteless shares. You have expressed the view that the regulation of shares with restricted or no voting rights is a matter for the Stock Exchange and not for legislation. That appears from page 10 of your memorandum. It appears in a notice to the Press dated 19th August, 1957, that the Council of the Stock Exchange have said that they did not look with favour on the voteless equity share, but they did not consider it justifiable to use the high-powered sanction of refusing a quotation to non-voting shares, which would have the effect of taking away from companies powers which they legally possessed. They added that the proper remedy against the issue of non-voting shares was an amendment of the Companies Act. Would you care to comment? You said it was a matter for the Stock Exchange and not for legislation, and the Stock Exchange said it was a matter for legislation and not for them.—*Mr. Nicol*: I think we thought it was difficult to legislate on a matter like

this. It was much better that public opinion should be expressed.

698. All one can say is that there are those two views.—I must say that the Australian Stock Exchanges deal with the matter. We know that the Birmingham Stock Exchange has prohibited non-voting shares in certain instances.

699. Have you any strong views one way or the other about voteless shares? —We have no experience of non-voting shares. I think we rather agree with the criticism of non-voting shares. In course of time I should imagine it would be desirable that there should be prohibition on the issue of shares without voting rights. But that must, of course, be a gradual process.

700. You have no experience of that yourselves?—No.

701. And you have not availed yourselves of any foreign legislation to introduce them by any subsidiary company overseas?—No.

702. I do not think there is very much more that I want to ask you. I do not think I need to ask you about heading 14, which concerns wholly-owned subsidiaries. I think we have sufficiently dealt with the position there, because this question is again directed to the concept of a company with a single member, and the various advantages you say you expect to derive from that alteration of the law. However, I might perhaps mention this. It has been suggested that a holding company should be liable for the debts of its subsidiaries, in proportion to its beneficial holding of their shares. Have you got any views on that? Theoretically, a rascally company might have an unsuccessful subsidiary and let it sink and maintain the rest of its undertaking; and it is suggested that the fair thing there would be, if practicable, that the parent company should be liable for the debts of the subsidiary or an appropriate proportion thereof, according to its shareholding. What is your general view on that?—*Mr. Fea*: I think our general view is that a reputable company would wish to stand behind its wholly-owned subsidiary. The suggestion that I would

formulate is possibly that if that was the law or the general practice, a subsidiary, where a holding company had expressly taken itself out of that provision, would be compelled by statute to state on the balance sheet or accounts that it was a subsidiary of XYZ Ltd. and that XYZ Ltd. did not guarantee its debts; unless that statement appeared, it would be assumed that any wholly-owned subsidiary was guaranteed by its holding company. As far as my own company is concerned, I think we would feel that we must stand behind wholly-owned subsidiaries in the United Kingdom. We might in certain circumstances have different views about subsidiaries overseas, say in places like the Congo.

Chairman: Yes, I can understand that. Those are all the questions I had in mind to ask, but Mr. Lawson is going to ask some questions on accountancy.

703. *Mr. Lawson*: We have had a very large number of suggestions as regards the contents of annual accounts. It would be helpful to have your views on a few of them. One suggestion is that a company should show the trading results derived from its main activities. I do not know quite how far that suggestion would go, but I imagine that in a group such as yours the suggestion would be that you should show separately the profits from your steelworks and engineering works, and so on. Do you think that is a practicable suggestion, and, if it is practicable, is it desirable?—I think the answer, as to practicability, depends very much on how your company or group of companies is organised. In our own case, the companies do not fall into neat patterns. We have, as a broad line of demarcation, the steel companies on the one side in the United Kingdom; we also have certain activities abroad that are very nearly steel—they are fabricating, although they are not actually making, steel. We have certain rolling mills which fall into the half-and-half category. We have a large number of engineering companies, and we have a few merchanting companies. If one was confined to those three principal activities—if this could be accepted as a reasonable division—apart from the political overtone I think it would be practicable to segregate. In my

company's last accounts we published a list of the products we make, and it ranged from A to Z, and we could not possibly attempt to group those conveniently. We operate purely through subsidiary companies, and the holding company, itself, has no trading activities. Therefore, it is open to anyone going to Bush House to scan the accounts of our subsidiaries in the United Kingdom, which are found there. That has been done by certain brokers who have then added up those figures and circulated to their clients what they estimate are the Guest, Keen and Nettlefolds profits from steel, from a certain named number of our larger U.K. companies, and from miscellaneous activities. It does not and could not do more than that. I can envisage other circumstances of a company that would be organised into divisions, which divisions confined themselves to certain products and groups of products, where a real breakdown of the activities of the company could be given. If you meant just profits, I wonder whether that has much validity unless it can be related also to the capital employed in those activities, as the shareholders are concerned essentially with the return that they get on their money. They would also want to know the capital employed and the respective return from the different activities, so that they could say to the directors "On the one side you make 25 or 30 per cent., on something else you make 10 per cent., and on something else you make a loss", which are all relative figures in regard to the capital employed. If they made a loss on one activity where the capital employed was £10,000, and the total capital was £5 millions, it would not matter.

704. Really what you are saying is that, if there is a division of your assets and profits between wide sections of the business, if it were practicable to find a definition of that kind there would be no difficulty about figures, but there is clearly some difficulty about definition is there not?—Yes. I think in most companies it must be pretty difficult once they get to be at all large.

705. But in principle, if it were practicable to find a definition, do you see any advantage in that suggestion? Would

it be a useful thing for shareholders to know the results from your different activities, or do you think they merely look at your business as a whole and judge the results accordingly?—I personally think they look at the business as a whole. If it is not doing as well as they expect it to do, or as well as other companies which they believe to be competitive are doing, then they ginger up the directors. What you have suggested is one of the pieces of information which they might require in those circumstances, to come to a judgment about where the directors were falling down. It would only be one of the many questions they could ask. I doubt whether it ought to be made a statutory obligation to give the information. I think, if a company has not succeeded as well as the shareholders expect, it is a very legitimate question for a shareholder to put to a Chairman at an annual meeting, and the Chairman or Board of Directors should be compelled to give an answer.

706. In the course of your answer you touched on another point. You said that the shareholders would go to Bush House and look up the results of your subsidiary companies. I take it from that that you do, in fact, disclose to shareholders the names of your subsidiary companies or main subsidiary companies?—Yes.

707. Of course, there is not at present any statutory obligation for that to be done, and indeed it is another suggestion, which we have had, that it should be made a statutory obligation for holding companies to disclose the names of their subsidiaries. What would be your view on that? Should that be a statutory obligation?—The Chairman asked me whether we ought to underwrite or guarantee the debts of a wholly-owned subsidiary, and I think it is part and parcel of the answer to that that a wholly-owned subsidiary should have to disclose, on the face of its accounts, who its parent company was. Therefore, if you have it one way round, it is equally obligatory on a parent company to disclose the names of its wholly-owned subsidiaries. I have a slight doubt about partly owned, because that does bring in the other parties who own the minority shares.

708. There is another question of a similar kind, and that may be your answer to this. The suggestion has been made that it would be useful for shareholders to know the proportion of the assets held and the proportion of the profits earned in overseas countries, either by companies or groups of companies. Do you think that would be a desirable thing to do, or not?—I think I must take the same line as before, that I do not think it ought to be made compulsory. I think it should be left for shareholders to be entitled to ask the question and to get the answer to it if they are dissatisfied with the progress of the company. But I can see objections to having to disclose it compulsorily. Difficulties arise in local cases where a company is wholly owned by a U.K. company, and there might be reasons why they do not want to disclose the capital employed. We have had that arise with some of our overseas companies. They do not wish us to disclose their figures, because of local repercussions.

709. Could I turn from that to the question of associated companies; that is to say, companies in which the number of shares held does not exceed 50 per cent. so that they are not subsidiaries. We have had quite a number of suggestions to the effect that the information at present given about those companies is inadequate. The point is made that the dividends derived from those investments are, of course, included in the accounts but they may be only a very small part of the profits of the companies concerned, and that, therefore, there is something of a secret reserve being built up, and the value of the investment in the associated company may be very much larger than the figure at which it appears in the books of the parent company, about which the shareholders know nothing. Have you any views as to whether additional information should be given about that type of company and, if so, what information should be given?—This is a company in which you have a minority of up to 50 per cent., and it is not marketable because, otherwise, you would have to disclose it?

710. Yes.—I assume in the first place that one would have to disclose the invest-

ment income gross, so that that could be related by a shareholder to the book value at which that investment was stated in the balance sheet, so in the first place he would get some idea of the return from the whole of those trade investments, compared with the balance sheet value. As regards disclosing to him the further value that lies behind that book value, I find it a very difficult question to answer. There may be cases where there are very, very large reserves in relation to a company, where the directors, as I understand it, cannot in those cases get those reserves distributed to their own company without the consent of an equal or greater partner. It seems to me that they are radically different, therefore, from those which they can control and dispose of. They cannot secure distribution of those reserves of their own volition—only by getting equal or greater voting power to agree. I think that is a big distinction.

711. That is a distinction which would make it extremely difficult to put a value upon those investments in a balance sheet. On the other hand, it might still be argued, might it not, that it would be a good thing for shareholders to know what profits were being built up and maintained in those associated companies, and that there would be no real difficulty about providing that information. That is the type of suggestion we have had.—I would think that, as those companies cannot by definition be exempt private companies, their accounts can be found in Bush House, and I do not know that it would be necessary in those cases to require the accounts of those companies to be published with the accounts of the company holding the investment.

712. A summary of them?—A summary of them, yes.

713. You are aware, of course, that the Act now requires that a company shall give a note of the amount of any material contracts into which it has entered, and the emphasis is on the word "contracts". Now clearly there are many cases where quite a large capital expenditure programme may have been embarked upon, but contracts placed for only a small part of that programme. Do you think that, in addition to stating the amount of

contracts entered into, the Act should in some way require companies to disclose capital expenditure programmes of that kind?—Yes, Sir, I do. In my own company's case we do disclose the amount which has been sanctioned by the board of the parent company for expenditure on capital account by all companies in the group, which is outstanding at the date of making up the balance sheet, and I think that is a commitment which, though not legally binding until the contracts have been placed with the suppliers, ought to be known by the shareholders.

714. You link it in your case, do you, to a board resolution? That is how you would define it?—Yes. The wording we actually use is "Capital expenditure sanctioned by the board and outstanding at such-and-such a date amounts to so much". We then go on "Contracts placed against these sanctions and not provided for in the accounts"—which is the statutory requirement—"amount to so much". In addition, if I may refer to another document going with the accounts—we publish the Chairman's statement and the Directors' report and accounts altogether—considerable reference is always made to capital expenditure in the Chairman's statement. In other words, we consider this a most important part of the information to be provided to shareholders.

715. I do not want to take up much time about this, but I would like to ask you one or two questions about revaluation of fixed assets, because we have had quite an amount of evidence on that subject. Some suggestions have been made which go as far as recommending that the Act should make it obligatory on companies every five years to have a valuation made of fixed assets, and either to disclose that in a note or to incorporate it in the accounts. Do you think that is a sensible suggestion?—Your point was to have a revaluation and then to consider bringing it up to date?

716. Yes. The suggestion was that there should be periodical action every five years, to have a revaluation of assets and an explanation to shareholders. I wonder whether you feel that would be of value to shareholders, or not.—I think that it is the return from the assets,

of course, that is the principal concern of the shareholders and, as I have mentioned, it is that return expressed as a return on the capital employed that is the criterion. It is the profit and loss account aspect which is more important than the balance sheet, and that profit cannot be properly arrived at until depreciation has been charged. I am of the view that, where the depreciation which has been charged is restricted to the amortisation of historical cost, that is not a sufficient charge under present-day conditions. I find considerable difficulty in making up my mind whether we should not have revalorisation in the sense that the French undertook it when they compelled companies to restate their fixed assets, having regard to an index based on the age of the assets, which was an overall index expressing the fall in the purchasing power of the franc, and which I think they properly called revalorisation; or whether, as I think is more generally understood by revaluation of assets, we should have their current replacement value which, again, could be expressed as their current replacement cost reduced by some percentage either as an expression of past life or related to the probable future working life, but at any rate to give a figure which is an attempt to assess the replacement value as it is. I do not think that has anything to do with net realisable value, because you do not hold fixed assets to sell them; you hold them to make use of them and get a profit out of them. I feel that in theory I would agree that it ought to be done, but in practice it is an extremely difficult job in a very large group of companies. You have the problems of deciding whether it should be done by independent valuation from outside, which is a very lengthy and expensive business, or whether it should be an internal job done by engineers and accountants together; whether it is to be related to indices of replacement of those particular types of assets; or an expression of the fall in purchasing power of money itself. Of all those views I personally incline to the last as the simplest, the most practical, and the only one which is capable of universal application.

717. The difficulty about your last one is that as stated it does not take into account technical changes which may have

affected both the process of manufacture by the particular plant, and also the cost of building the capital assets. I was reading last night the report of the Central Electricity Authority, and it was interesting to note there that the cost of building a power station per kilowatt installed today is lower than it was in 1948, despite the change in the value of money. When you get into that type of situation, any formula can be quite misleading, can it not?—Yes, I quite agree, but there you are dealing with a very large unit which has a single objective, with the production of power at the end. It is very different from an engineering group of companies, where you have hundreds, thousands and tens of thousands of machines which produce an extraordinarily wide variety of products. How can you express it in terms of capacity to produce x units? I quite agree the productivity of machines may have doubled and trebled, they may have been automated, or you may be using different materials, but I find great difficulty in seeing how you can look at the replacement of a unit which was built 20 years ago. Obviously, you do not replace it unless you bring it up to date, and it is extremely difficult to relate it to replacement of capacity. You can do it with a power unit but not in general engineering.

Mr. Lawson: I think you have given me the answer. In theory, there is a lot to be said for it, but in practice it is very difficult to do it in many cases.

718. *Mr. Bingen:* I can understand the difficulty you have in revaluing assets, as to past life, future life, technical obsolescence and so on. If you come to the conclusion that it is not practicable to put them in your balance sheet at a revalued figure every five years, or whatever it is, would you think there was any merit in having a statutory provision that a statement should be made as to whether they have been revalued or not; in other words, so that if you do not do it attention is drawn to that fact?—Yes, Sir. The present statutory requirement is that they are shown at cost or, if you have a valuation—I have not checked it up—I think you should state the date of that valuation. Therefore, if there is no qualification, they are at cost. I accept

your point that, if there has been no valuation, that should be stated. If I may make a further point, because I do not think I made my own company's practice quite clear, we do accept the view that there should be some stepping-up of depreciation and, if I may come back to the profit and loss aspect—we do not think the balance sheet is quite as important—we do step up the charge for depreciation on profit and loss account by the method I mentioned. We use an index number which we apply to the cost of the assets year by year, and scale up the depreciation by the weighted average of those figures.

719. So you show your assets at a revalued figure?—No, Sir.

720. *Mr. Althaus:* With regard to the disclosure of the experiences of overseas subsidiaries, would it be right to say that, with the world as it is, the kind of local embarrassment you mentioned would be so widespread as to render it unreasonable or prejudicial to the interests of those concerned to require disclosure, in general?—I would say, yes. I think on balance, yes.

721. *Professor Gower:* Could I ask a question about the revaluation of fixed assets? As I understood your argument, you were saying that shareholders should be enabled to get some idea of what profits were being made on the capital employed and presumably, if that is so, while fixed assets are valued at cost less depreciation that is an extremely inaccurate way of getting any true idea of what the fixed assets are worth. On the other hand, it is very difficult to decide how you should realistically revalue. Also, could it not be argued that, if the directors were required to give some statement of current value, as long as they indicated on what basis they had made that assessment, that would at least be more meaningful to shareholders than the present cost less depreciation? In other words, does it matter very much that there are a variety of possible ways of doing it and that there are arguments about which is the best? As long as the directors state the current value and explain on what basis they have made their assessment,

would not that be more useful to shareholders than the present historical cost less depreciation?—I must confess I am not happy about the present basis. I have explained some of the practical difficulties of finding another basis. If in a particular company the directors were satisfied that they could find and apply a reasonable basis, then I would be in favour of so

stating, but I am not sure that that could be universally applied.

Chairman: Thank you very much, gentlemen, for your assistance. I think those are all the questions we have got to trouble you with, and we are grateful to you for coming and helping us.—Thank you.

(The witnesses withdrew)

APPENDIX IV

Memorandum by J. Lyons & Company Limited

We have confined our comments to the items numbered 1(b), 4, 7, 11, 14, 23, 26(b) and (c) and 29 in the list furnished to us by the Secretary to the Committee. Many of the remaining points are of a technical nature and will have been considered in detail by the various professional bodies who will be submitting evidence to the Committee. We feel sure that they will have been adequately covered by the panels set up by the professional bodies and that we could not make any useful additional contribution. Our comments are numbered to correspond with the numbers in the list submitted to us.

(1) Incorporation of Companies—Memoranda of Association

- (b) *Limitation of objects to those stated in the memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

It seems to us that no useful purpose is served to-day by limiting the objects. If, however, it is felt that some limitation must be preserved, then we suggest that companies should be allowed to alter the objects as easily as they can alter the Articles of Association.

We would also point out that many of the provisions usually included in what is commonly known as "the objects clause" are not objects at all but powers incidental to the achievements of the principal objects, and it seems to us that every company should be entrusted with these powers by statute so that it would no longer be necessary to include them in detail in the Memorandum.

(4) Donations by Companies for Charitable and Political Purposes

We see no reason for any change in the law; we consider that donations for these purposes should be entirely at the discretion of the Directors and that there should be no limitations or restrictions. In regard to donations for political purposes most companies are directly concerned with political issues—for example, we are much concerned with the laws relating to food, licensing, town planning and property.

(7) Shares with Restricted or No Voting Rights

(a) We believe that it is desirable to retain, upon business and economic grounds, an unrestricted power for companies to create shares or stock of different classes, not only divided into the main groups of preference, participating preference, ordinary and deferred, but also permitting sub-divisions within these main groups. Thus some preference shares may carry high preferential status and relatively low dividend rates, others may carry a lower degree of preference and a higher dividend; there may be in the same company two or more classes of participating preference share, with varying degrees of participation in the "equity" of the company; more than one class of ordinary or deferred share commonly exist with different rights designed to attract investors desiring different types of investment. It is against this background that the question should be examined.

(b) Any proposal to abolish shares with restricted or no voting rights of necessity involves giving voting rights either to all shares, or to all "equity shares" (however they may be defined). We consider that there are two fundamental objections to any such proposal.

(c) First, there is no case for interfering with freedom of choice or contract in this field, since (with one exception for which the existing law provides an excellent safeguard to the shareholder) there is no case in which any person acquires non-voting or restricted-voting shares against his will and without being fully aware of the

limitation of rights attaching to his shares save as donee or inheritor in which case he can renounce them if he so desires. If, as is said, non-voting shares are unpopular or the conception is not in line with modern thought, they will cease to attract investors and the problem, if there be one, will solve itself. There is, in our opinion, a strong case for retaining the facility for enabling an investor to acquire a share in the prosperity of a successful company, albeit with no vote or restricted voting rights, at what will normally be a lower cost. The criticism of this view as a *laissez-faire* attitude involves depriving the investor of an opportunity, if he desires it, of acquiring the share of his choice, and would create an interference with freedom of contract which is unnecessary and is an unjustified criticism of the intelligence of the investing public.

(d) The exception referred to in the last paragraph is the case where 90 per cent. or more of the shareholders in a company have accepted an offer to exchange their voting shares for non-voting or restricted-voting shares and the offeror seeks to avail himself of the power of compulsory acquisition of the balance under Section 209 of the Act. The safeguard is the Companies Court, which may "think fit to order otherwise" under the first sub-section; we are convinced that this is a satisfactory protection.

(e) We have two other comments under this head. First, if it is believed that the investor often does not know that the shares he is acquiring do not enjoy voting rights (though we do not think there is any substance in that belief) the solution is to insist upon plainer labelling of non-voting or restricted-voting shares to ensure that no person shall purchase such shares without clear warning of the limitation of rights attaching to the shares. Secondly, a good deal of public attention has been called to cases in which the holders of shares with full voting rights have succeeded in selling them at high prices compared with the market prices ruling for non-voting shares, notwithstanding that the voting shares, while conferring control, do not carry the right to a majority of the "equity". In our view, criticism based upon such cases, while understandable, is misconceived. First, the holders of the non-voting shares are in no way injured or affected. Secondly, the enhanced price is paid for the control, and is not affected in any way by the presence of non-voting shares. Thirdly, even if all shares carried votes, a block of shares which would confer on a purchaser absolute or virtual control would command a higher price than the remainder of the voting shares.

(f) Our second main ground of objection, subsidiary to the first, is the difficulty—if not impossibility—of legislating for true equality of voting for all shares of all classes. It would be useless to specify "one vote per share" and no more, since the creation of shares of different nominal values would wreck any scheme so simple as that. To provide that shares should confer votes proportionate to their interests in the "equity", unless only one class of ordinary share with equal equity rights is permitted, would produce a great crop of anomalies. For the reasons already advanced, it would be a retrograde and undesirable step to abolish all differential categories of share having some interest in the "equity", such as participating preference shares, ordinary shares, deferred shares and varying classes of these types of share. If, as we think, these should be retained, the calculation of their proportionate interests in the "equity" would of necessity be most complex, if not impracticable, and the computation of votes on a poll would be virtually impossible.

(g) The non-voting ordinary share has served a useful function in that it has enabled family businesses to expand by affording the public the opportunity to invest in them whilst still preserving the characteristics of the family business. Whilst we could not say that it would be true of this Company, it is not unlikely that if non-voting ordinary shares had not been permitted many family businesses would have limited their size to what the owner-managers could have afforded to finance. Not only have many such non-voting shareholders prospered exceedingly, but the industrial life of the country has also benefited thereby. The first issue by this Company of "A" ordinary shares which do not carry voting rights was made in 1918, when we acquired the business of W. H. & F. J. Horniman & Co. Ltd., the consideration being one Lyons "A" ordinary share for four Horniman's ordinary shares. The number of shares issued was 74,410 and at that time the issued ordinary capital of the Company was £400,000.

The issue of voting shares would have given the Horniman family an unduly large block of votes, and it was for that reason that it was decided to issue non-voting ordinary shares. It could well be that Company X wishing to complete a deal for the acquisition of Company Y by an exchange of shares might find itself unable to do so because an exchange of voting shares would result in effect in Company X becoming controlled by Company Y.

In case it is of interest to the Committee, we append some details of the Company's "A" Ordinary stock. The nominal value of the "A" ordinary stock which does not carry voting rights is £5,700,684. The stock is transferable in units of £1 and for convenience the stock is hereinafter referred to as "shares", each share being of the nominal value of £1. The following is a summary of the issues:

	<i>No. of shares</i>
Issued in connection with the acquisition of other businesses	84,910
Issued for cash	1,447,329
Issued as fully paid (capitalisation issues)	4,168,445
	<u>5,700,684</u>

The last two issues for cash were in February 1951 and November 1953. These issues, both of which were rights issues, were as follows:

1951	660,000	1 for 3 at £4 10s. 0d.
1953	629,069	1 for 4 at £4 2s. 6d.

The last Capitalisation Issue was in 1958, when 3,145,342 "A" ordinary shares were issued as fully paid on the basis of one for one.

(11) Disclosure of Ownership and Control

(a) Nominee shareholders and debenture holders (including nominee holding companies)

In our view it would be unreasonable to require disclosure of the actual owners of nominee holdings. We can see no reason why holdings of shares should be treated differently from any other business transaction. It is not an uncommon practice, for example, to purchase and to hold properties in the names of nominees and we are not aware of the practice having given rise to any abuse. Moreover, disclosure could prove a handicap in some cases to business development.

(b) Control through nominee directors

The present definition of "a director" seems to us to be wide enough to preclude the true control of a company being concealed by having nominee directors.

(14) Practice of Carrying on Business through Associated and Subsidiary Companies

In our view there should be no restriction. We are not aware of the practice having given rise to any abuse and any restriction might well prove a serious handicap to the marketing of goods and to business development; for example, a company with an established trade serving a particular class of customer and wishing to expand into a higher or lower price range would be handicapped if it was not able to preserve its anonymity by trading through a subsidiary.

(23) Provisions as to Returns

In the return of allotments "the description" of each allottee is still required to be given as well as the name and address, although this requirement is not applied to other returns and records.

Section 200 of the Companies Act, 1948, requires the company to send to the Registrar notification of any change among its directors or in any of the particulars contained in the Register. This notification is required to be made within fourteen

days of the change. It is suggested that immediate notification should only be required for changes in the membership of the Board and that the particulars in the Annual Return should suffice for minor changes.

(26) Internal Management and Administration

(b) *Mode of passing extraordinary and special resolutions*

Apart from the length of notice required there is virtually no difference between extraordinary and special resolutions and we see no reason for retaining both.

(c) *Securing proper disclosure of information in circulars seeking proxy votes*

We do not think any legislation is necessary or desirable in regard to the disclosure of information in circulars seeking proxy votes; it seems to us that this is a matter better left to the Stock Exchange. In the case of shares quoted on the London Stock Exchange, drafts of the circulars have to be submitted to the Stock Exchange for approval.

(29) Any Other Matters within the Terms of Reference

Directors' names on business letters, etc.

We doubt the necessity of continuing to require the disclosure of directors' names on business letters, etc. as provided in Section 201 of the Companies Act, 1948, but if it is decided that this provision should be retained we do suggest that it should not be required in trade catalogues and showcards.

Section 195 of the Companies Act, 1948

We suggest that a wholly-owned subsidiary should not be required to keep a register of directors' holdings which it has to do now by virtue of Section 195. This register is only open to the inspection of members and the effect of it is that we have to keep registers for our wholly-owned subsidiary companies and we ourselves are the only people with the right to inspect them. The Section provides that the parent company's register need not include shares in the wholly-owned subsidiary, but there is no corresponding provision in regard to the subsidiary company's register.

Cadby Hall,
London, W.14.
12th May, 1960.

APPENDIX V

Memorandum by Lord Piercy, Chairman, Industrial and Commercial Finance Corporation Limited

Industrial & Commercial Finance Corporation Limited (I.C.F.C.) has shareholdings or long-term loan investments in about 700 companies, and has examined a large number of Memoranda and Articles of companies. The experience of Estate Duties Investment Trust Limited, which is managed by I.C.F.C. is also relevant. The following represents, in the main, the consensus of the officers of the Corporation on the matters raised in the Committee's list of subjects:

(1) Incorporation of Companies—Memoranda of Association

- (a) *Requirements as to minimum number of members, and other conditions of incorporation*
No observations.
- (b) *Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

Our feeling, in general, is against the universality of modern objects clauses. Objects should be realistically limited so that the activities genuinely engaged in, or proposed to be engaged in, should be clear. They should contain no *carte blanche* for undertaking new and different activities, or for acquiring companies so engaged. A selected list of powers commonly taken by companies might be usefully set forth for inclusion in Memoranda. The present method of altering objects should be retained with the existing safeguards for objecting minorities provided by Section 5.

The *ultra vires* rule in principle is correct. It follows from what has already been said that the rule should be retained. Too much, in our view, can be made of hard cases.

- (c) *The company as a legal entity distinct from its members—"one-man" companies*

It is not thought that some straining of the protection afforded by incorporation with limited liability can be eliminated (which presumably is the point aimed at here). But the observations below on the privileges of exempt private companies may be relevant.

- (d) *Shares of no par value*

We are in favour of the Government's announced intention to implement the recommendations of Cmd. 9112, 1954.

(2) Prohibition of Partnerships with more than 20 Members

No objection is seen to the retention of the limit presented by Section 434.

(3) Classification of Companies

- (a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

The public company with quoted shares has tended in modern times to become, in the most characteristic examples, an autonomous entity controlled by a Board of Directors which is perpetuated by co-option, the members of which may hold not a share in the company. Its members are investors who regard their holdings not in any real sense as a participation in the enterprise but as marketable titles to income, and characteristically to equity income, for well understood reasons. As one of the

Corporation's officials remarks (apropos of objects) the investor cares little whether the profits are derived from the manufacture of kitchen sinks or of ocean liners. This is not to say that annual accounts, and the information given about company activities, is otiose: it is the happy hunting ground of investment experts and the staple of financial journalism. Nevertheless, the efforts of some large companies to interest members in the business as such are largely wasted for the reason given. The perfection of this model occurs in the cases where a large company's shares have a free market. Not all quoted companies fulfil this condition, yet there too, the investor is remote from any genuine participation (or interest) in the company's working. The point is not affected by the fact that many public companies are, in a sense, private companies in disguise. The British Capital Market is built on this peculiar institution.

In contrast to this, the private company essentially is a group of partners (often a family group) which has assumed company form because of the conveniences it affords and mainly the privilege of limited liability. No doubt the private company can, and does, evolve in numerous instances into the public company. As suggested above, many do so which cannot hope for, or do not put themselves in a position to obtain, a free market for their shares. But there is nothing to be done about this.

We regard the existence of the two categories of public and private companies as socially valuable, and economically desirable.

The question of the adequacy of restrictions imposed on private companies concerns chiefly we believe a doubt about the sub-category exempt private companies, on which see below. Oppressive treatment of shareholders by managements of private companies occur. The difficulty here is not the absence of legal remedy so much as ignorance of Company Law, and ignorance of where to seek effective counsel.

(b) Nature and merits of distinction between exempt and non-exempt private companies (Sections 127, 129 of Companies Act, 1948)

The case for the exempt private company, notionally resting on a social advantage in favourable treatment of the very small company, is doubtful. The exemption from liability to file a balance sheet annually, which is the chief privilege of these companies, is widely cherished, but it should be removed. The privilege of limited liability is extremely valuable; its counterpart should be the fullest possible protection for creditors. The circumstances of a small business can anyhow hardly be concealed nowadays from the inquisitive.

If the above recommendation were adopted the dispensation as to auditors' qualifications would naturally disappear. Having regard to present day intricacies of taxation it would anyhow be an advantage to all concerned.

(c) Unlimited companies and companies limited by guarantee

No observations.

(4) Donations by Companies for Charitable and Political Purposes

Such donations are objectionable in principle. There is a current tendency to expect large companies to contribute liberally to all sorts of public objects. It is doubtful if any distinction should be made in respect of such contributions. We suggest that the amount of all such donations (whether by parent companies or subsidiaries) should be stated in the annual accounts. Alternately, the accounts might state the total figure of donations which have been disallowed for income tax, taking in this way the practice of the Revenue as a canon.

(5) Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

As already suggested, the structure of company (more particularly public company) management and the facts of shareholder control make a curious picture; and the recent epidemic of bidding and the vogue of diversification have thrown some of these aspects into relief. But none of this, it may be suggested, constitute a *prima facie* case for legislative alteration. The market in the shares of quoted public limited liability companies, centring on the Stock Exchanges and the new issue market, is an

instrument of great power and efficiency for organising the direction of savings to industrial and commercial purposes. The notes above on objects, however, are relevant. Further to that:

(a) Fundamental changes in company's activities

The principal case is where a company's existing business has ceased or been reduced to a low ebb, while elements of the company structure, in the way of capital funds, or organisation, or merely a Stock Exchange quotation not withdrawn, remain. The motives for utilising such a company as a vehicle for new activities may obviously arise from any of these facts and are not necessarily objectionable. In any case formation expenses may be saved. But the approval of the shareholders, based on a proper explanation of the facts and the purposes in view, will generally be essential and should be ensured. A type of case which has occurred, notably the nationalised company left with large compensation funds and no business, which turns itself into an investment trust, or a holding company, without any alternate policy of repayment of capital or liquidation being propounded to the shareholders, raises a doubt whether the existing procedure by special resolution is a wholly sufficient protection to shareholders. It may be that provision for longer notice, or a poll by deposit of voting papers would be desirable if the circumstances in which this is desirable could be defined.

(b) Disposal of undertaking and assets

Such measures should require approval by special resolution decided perhaps by voting papers to be deposited at the offices of the company. It is for consideration whether on such an issue, shareholders with limited or no voting rights should not have a statutory right to vote. In the statement of the case presented to shareholders, the interest of directors individually should be declared, including any agreement or understanding with regard to employment with the purchaser.

(c) Issue of shares

While freedom to issue blocks of shares at discretion for one purpose or another, including the buying of other businesses, is dear to the hearts of some boards of directors, it is bound to be looked upon with misgiving by shareholders—leaving out, of course, the special case of "holding companies", where it is the technique. The problem of controlling undue freedom by rule however is difficult. It may be that in the case of quoted public companies, sufficient protection exists in the Stock Exchange conditions for quotation, and opinion expressed in the financial press. The case of the private company and the small, perhaps unquoted, public company, differs from that of the large quoted public company. In these cases, owing to the uncertain value of the shares, and lack of proper disclosure, the issue of additional shares of a class already in issue made by directors at their discretion, may easily water down the value of the shareholders' property and/or alter the control detrimentally. In the cases of public companies with no quotation, and private companies, it might be advantageous to require the sanction of the members by ordinary or special resolution.

(d) Borrowing money and charging property

No observations.

(e) Lending money otherwise than in the ordinary course of business

Disclosure would be a safeguard. The aggregate of such loans might be shown separately in the annual balance sheet, and along with this, to regulate window dressing, the maximum amount of such indebtedness during the year of record.

(6) Directors' Duties

(a) Should their duties be stricter and more clearly defined, and if so, in what respects?

The role of the director in various sizes and types of company varies so much in practice that little benefit could be expected from attempts at formulating duties or setting up standards of performance. There may be a case for prescribing a minimum annual number of board meetings, formally held and recorded, for all companies, public and private.

(b) Are Directors generally aware of the legal duties arising from their fiduciary position?

The answer probably is yes, but instances of directors with no precise knowledge of the Memorandum and Articles of their own company, and without legal knowledge as to a director's duties, are common. It is difficult to suggest a practicable remedy.

(c) *Directors' and officers' dealings in their own companies' shares*

No observations.

(d) *Disclosure of directors' interests*

No observations.

(e) *Should bodies corporate be allowed to be directors?*

The existing provisions appear to be adequate.

(7) Shares with Restricted or No Voting Rights

In the case of private companies any restriction on the freedom to issue such shares would be wholly undesirable. It is the constant care of a private company that a group (sometimes a family group) should retain control. If, however, all the shares had to be voting shares that would deprive such a company of the possibility of introducing risk capital willing to carry an equity risk in return for participation in the equity profits.

The case which is currently debated is that of the large public company with quoted shares. There is a natural repugnance to the engrossment of voting control in a company by a relatively small group, whatever the history; and important associations of investors have expressed disapproval of "A" shares.

I cannot profess to share these views. In a general way I would rather buy "A" shares in a good company at 50s. than the ordinary at 54s. or 55s. I believe it would be a mistake to legislate on this subject. It can well be left to the Stock Exchange and the financial press. I am prepared to argue the matter further if desired.

(8) The Protection of Minorities

The statutory provisions appear to be reasonably adequate. But here again the trouble is ignorance of these provisions and of a ready source of reliable counsel. It may be that the Committee will invent some relief for this situation.

(9) Protection of Special Classes of Shares

Section 72 appears to us to be satisfactory. It might be an improvement to increase the period for application in sub-section 2, from 21 days to 30 days.

(10) Board of Trade Powers to Appoint Inspectors

No observations.

(11) Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies)*

The holding of shares through nominees, and in particular the nominee companies of the banks, is a first class administrative convenience to many individuals and companies; and this aspect must not be overlooked. On the other hand it is a means for concealing ownership and can be used for mounting an operation for altering the balance of voting control of a company. Divers remedies will be propounded to the Committee. Would it be too drastic to suggest that a company shall be enabled always to ascertain the beneficial ownership of any holding which appears to be in the name of a nominee and that where several holdings appear to have a single beneficial owner this fact should, or may, be indicated in the annual return of the members of the company?

(b) *Control through nominee directors*

No observations.

(12) Share Transfer and Registration Procedure

No observations.

(13) Multiplicity of Directorships held by one Individual

Although 50 directorships held by one man (there is such a case) seems ridiculous, the evil does not necessarily reside in the numbers, but in the services needed or

supposed to be done, and the holding of 4 or 5 directorships may, in some cases, be as great an abuse as the holding of 50. It hardly seems possible to make a recommendation on this subject.

(14) Practice of Carrying on Business through Associated and Subsidiary Companies

This practice obviously may lead to abuse. A provision for disclosure of the names of, and the extent of the interest in, subsidiary and associated companies in the annual accounts would be useful.

(15) Loan Capital

No observations.

(16) Take-over Bids

No observations. The subject is well covered.

(17) Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

No observations.

(18) Control over Business of Dealing in Securities

No observations.

(19) Unit Trusts and "Open End Mutual Funds"

If I have any contribution to make on this subject I will submit a separate memorandum. My experience, though very substantial, is pre-war.

(20) Reduction of Capital and Purchase by a Company of its own Shares

On the whole we should prefer to see maintenance of the existing position.

(21) Accounts

It would be an advantage if accounts would state:

- (i) the business which is carried on by the company, and the same for all subsidiary companies;
- (ii) the total sales with a division into sub-totals where this would be interesting to shareholders;
- (iii) the division of the aggregate net profit between the different activities which produce it, but there would be great resistance to this proposal;
- (iv) some indication of the value of trade investments, an item which is often cloaked in secrecy. This might take the form of a note of the net assets relating to the company's shareholding (when the investment is not quoted) or the market value (when the investment is quoted) and an indication of the profit which has been derived therefrom in the current year.

(22) Audit

(a) Qualifications and appointment of auditors

No observations.

(b) Duties and responsibilities of auditors

No observations.

(c) Exempt private companies

As already noted, there appears to be no real justification for the proviso to Section 161 exempting private companies from filing annual accounts.

(23) Provisions as to Returns

No observations.

(24) Company and Business Names

No observations.

(25) Foreign Companies

No observations.

(26) Internal Management and Administration

(a) *Annual and other general meetings*

No observations.

(b) *Mode of passing extraordinary and special resolutions*

No observations.

(c) *Securing proper disclosure of information in circulars seeking proxy votes*

No observations.

(d) *Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g. by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company*

The current facts about the exercise of voting rights by trustees of pension funds, welfare funds for employees, by unit trusts and other special cases, will no doubt appear in the evidence. Up to 1940 at any rate, the trustees of unit trusts did not ordinarily exercise the large voting powers which they held, and did not, I think, expect the managers to call for their exercise. On the whole, it seems good doctrine that voting rights are meant to be used and should be used without inhibition.

(27) Winding Up

No observations.

(28) Problems of Administration and Enforcement of the Law

No observations.

(29) Any other Matters within the Terms of Reference

No observations.

Supplementary Memorandum by Lord Piercy on Unit Trusts

1. As a Member of the Stock Exchange, London, I provided during the years 1933 to 1939, to an important part of the unit trust movement, services analogous to those (in another field) of an issuing house. These included negotiation with prospective trustees; advice to managers on the form of trust; taking the lead in drafting and settling the trust deed; the design of the portfolio; and drafting the booklet. In this capacity I designed the first trusts holding partly paid shares; devised the appropriation form of flexible trust; devised the first geared trust; introduced (I believe) the first trusts with reserve or cumulative provisions; and was associated with the first block offer. I also undertook other professional services, including the building up of specialised trust funds by careful market dealing, but especially the daily pricing and valuations and appropriations of trust funds, for which I maintained a special organisation. At the end of the period I was doing this work for some 25 to 30 trusts. The trusts with which I was concerned covered at the end of the period probably more than one third of the total issued units. I held a retainer to two groups of managements during the war, but my connection with the movement ceased at the end of the war.

2. I have sketched the history of the unit trust movement in collaboration with Mr. Lewis G. Whyte in a paper to be found in the evidence to the Radcliffe Committee, Volume 3, page 122.

3. With this rather special background I feel I should make some observations on the matters under consideration by the Committee. I key them to the admirable memorandum of the Association of Unit Trust Managers for the sake simply of a convenient reference as regards the order of topics of that memorandum, which in the main I follow. The reference to paragraphs are to the paragraphs of that report.

4. I desire to make it absolutely clear that the purpose of this submission is not in the slightest degree critical of the Association's submission, than which in my opinion nothing better could be desired. If I differ from it in some points, that I hope will be understood as a contribution towards clarifying these sometimes difficult matters.

Definition of a Unit Trust

5. Paragraph 6 is (if I may say so with respect) a description rather than a definition. In a definition, the structure of a unit trust should figure more distinctly, as this is of the essence; together with the mode of valuation of units added to the trust fund or liquidated out of the fund by reference to the contemporary market prices of the underlying securities; the point should also be made that the custodian trustee is, *qua* trustee, the guardian of the principles of the structure of the trust and of the powers and duties of the managers so far as these are prescribed or limited by the trust deed. I believe, at least, that this is good law.

Development of the Unit Trust in this Country

6. It is worth recalling that the original concept of the Fixed Trust, which was the original of the unit trust of today, had a distinctly ideological content. It set out to provide a "spread" investment while eliminating "investment management", and placing the holders' property not merely in safety but almost in sanctity by employing the formidable legal device of a trust. The managers functioned as salesmen and administrators with precise duties; though they found themselves involved forthwith in a jobbing function.

7. Tested by experience, the fixed trust had practical disadvantages which were not wholly removed by adding provisions for substituting securities or adding to the original list from a small number of additional securities. The flexible unit trust once it had made its appearance here rapidly became the vogue. A relic of the earlier form is the practice of specifying the permitted portfolio or range of investments of a trust.

8. The flexible trust first became prominent here in connection with securities which had a difficult or a narrow market—foreign bonds and shares of insurance companies, banks and investment trusts. Clearly a fixed portfolio, i.e. fixed both as regards permitted securities and permitted proportions of each, was in these fields unsuitable or impracticable, or both. And, to create and maintain a well balanced portfolio in such securities required investment (and market) skill. Thus one element of the original concept, the elimination of investment management, was bound to go.

9. There is, however, a distinction to be made. I quote from some former observations:—

“There is a flexibility which, in substance and underlying intention, amounts to nothing more than a certain plasticity in the Trust Fund, intended to enable a specialised Trust to be built up without undue difficulty in markets which may sometimes be narrow—no doubt also with an eye on current variations in the valuation of securities during the period of building up the Trust . . . It all depends on the emphasis which is laid on “Management” so-called.”

My conclusion in 1937 was that “it is open to question whether a fully managed Unit Trust is an improvement on the Fixed Trust or that which is merely plastic.” The wheel now, however, has come full circle. The managed unit trust is the *beau idéal* (compare paragraph 39).

Alternatives to the Unit Trust

10. For that reason, and because investment trust management is at a pitch of esteem in this country as high now as it was low in U.S.A. at the end of the 1920s, it is natural for someone (Mr. S. I. Fairbairn for one) to raise the question, touched on in paragraph 26, as to whether company form, subject to enabling provisions which would require legislation (perhaps drawing from the U.S. Investment Company Act, 1940), might not be a more efficient and economical way (paragraph 22) of doing what the unit trust does. I agree with the Association in rejecting this proposition. The reason it gives, viz., “the protection given to unit holders in the United Kingdom by the trustee” no doubt goes to the root of the matter. One may add the merit for the investing public of the direct approach of managers to the public, now well known and established; and the convenience of unit form and the unit trust mode of pricing. The net effect is very free marketability; and managers have proved over a long period, including the war, that they can and will, and in fact do, maintain a free two-way market, not rivalled by any class of securities other than gilt-edged. The unit trust is now widely and firmly planted and understood. It seems sense to leave the matter at that.

11. The Institute of Chartered Accountants’ submission that unit trusts should be required to be incorporated (paragraph 112 of the Institute’s memorandum) starts from a different angle, which may be summed up by saying “there is nothing like leather”.

The Legislative Issues

12. The existing legislation relating to unit trusts arose from an irruption into the committee stage of the Prevention of Frauds (Investment) Bill in 1939. The provenance of that particular move is of no interest today. But it is fair comment on this legislation, taken together with the Rules, and the Board of Trade’s requirements founded upon it, and in general the administrative upshot of the Act as regards unit trusts, to aver that the net benefit to the investing public has been negligible. The unit trust movement was a well-conducted business, and without doubt would have remained so without legislation.

13. The nuisance value of the operation of the Act nevertheless is considerable. I agree with what the Association says under this head. I agree in hoping that the Committee will recognise the situation and will propound remedies, and that any new legislation should take the form of a separate Act dealing with unit trusts (paragraphs 28 and 29). This, I suggest with deference, would be part of the law relating to trusts, and would be framed from that angle. Where I am not *ad idem* with the Association is in its readiness to see incorporated in the new Act *holus bolus* the present scheduled

matters and the Board's recommendations and perhaps much more (though compare paragraph 38). It would be a mercy if the whole could be streamlined, put in the most general form, and the managers left, within the ambit of the trust deed, with a reasonable degree of freedom corresponding to that enjoyed with other financial administrators (compare paragraphs 38 to 43), including freedom to fix their own charges.

A Standard Trust Deed

14. As regards a model standard trust deed (paragraphs 33 and 34), the suggestion is reasonable, as it always was. True, there was an evolution in the content as well as the form of trust deeds during the pre-war period, but some subtleties might well be sacrificed now for the sake of ready comparability and intelligibility.

Conclusion

15. If, again, I might frame my conclusions on the Association's comprehensive summary (paragraph 44), I would say:—

I agree personally with (a), (b), (d) and (f);

I have suggested a caveat as to (c);

As to (e), this, taken in conjunction with a few expressions in the memorandum, seems to suggest (I speak with deference) that something like regulative powers should be devolved on the Association. The Association, by reason of its membership and composition, will always wield authority, and it will be readily listened to by the Board of Trade or other authorities concerned. To go further than that surely would be a mistake; is it not better for the Association to remain what it is, a voluntary association, with the powers of discipline that appertain to any club?

Supplement on Certain Technical Matters

These topics, dealt with in an appendix by the Association, deserve comment.

Block Offers at Fixed Prices

16. I feel on reading it that the Association's Appendix A (a) must have been difficult to compose. I append an earlier note on this subject (Annex A). The fact is that some block offers today are genuine; there actually is a block; and an advantage is offered to an investor consisting in a slightly lower price, or the opportunity of getting into a difficult class of security, where the securities corresponding to his money have actually been purchased and vested. Many block offers so called are not genuine; there is no block; no specie actually acquired and in unit form corresponding to the price the investor will pay. This form of block offer is misleading; and no ingenuity in drafting can remove the fact that the ordinary investor is in fact misled about the "block". There is a *cri de coeur* perhaps in paragraph 5 about the present prescribed scale of charges, which perhaps points to a way out.

17. Rules to govern block offers could hardly touch the root of the matter, and some of the difficulties are set out in paragraph 9.

Principal Systems and Agency Systems

18. Appendix A (b) will, I hope, give this controversy its quietus. Annex B adds something to this topic.

Cash Fund or Appropriation Fund

19. Appendix A (c) again may lay the subject to rest, the more so as the adoption of cash fund for new trusts has become general.

20. I cannot however say that I regard the controversy as centering round the way in which the "value" of any security is to be assessed at any particular time (paragraph 22*), or the difficulty of assessing the value of a security (paragraph 25*), or there being no way of discovering what the true value of a security is (paragraph 26*). The difference between the two types of trust is set out with admirable brevity and precision in the second and third sentences of paragraph 25*. I quote:

"In the (cash) fund, units are created or extinguished against deposit or extraction of cash in the hands of the trustees. In the (appropriation) fund, units may be created or extinguished against an appropriation or expropriation of securities as well as cash."

A note appended to this submission as Annex C makes the same point, and shows some of the practical consequences of the difference (compare paragraph 27*).

21. The appropriation method conforms closely with the original principle of the unit trust; but it may be considered cumbrous in operation; it inevitably increases in some degree the trading risk of the managers. In contrast to this, the cash fund, which is nearer to the mode of management of the ordinary investment trust company, gives the managers more latitude; any manager will be likely to prefer it for that reason; but the accountability of the managers to the unit holder is in essence less strict.

Pricing

22. Appendix A (c) deals in part with the pricing of units. This is a problem not commonly given its full weight of importance. The first sentence of paragraph 24 states the optimum solution quite clearly. The point which is not brought out is that to ascertain market prices is a skilled technical job; it understates rather than overstates the problem to say that it "involves considerable trouble . . . on the part of the stockbroker concerned". Certification of prices, and valuations in the case of appropriation trust, by a member of a recognised Stock Exchange, is a protection for the managers, though not necessarily a solution to the problem of good pricing, which is a matter of organisation by the stockbroker. In my experience only a minority of trust deeds contain provision for such certification, and I fancy that the Board of Trade missed this point. The introduction of a number of stockbrokers into the pricing picture spreads the task of collecting prices (more a point for stockbrokers than for the jobbers); and they like it, if enough business goes with it; but some sort of central pricing unit might well be an advantage to trust managers collectively, as promoting accuracy, neutrality all round, and perhaps promptitude of service.

October, 1960

ANNEX A

Block Offers

The block offer was invented in the thirties by Trust of Insurance Shares. The notion was to employ techniques something like a public offer of securities as an alternative to what has been called the tap method, and thereby sell now and again a large block of units. I do not think it was done more than two or at the most three times by the Trust of Insurance Shares; as evidently it is a sort of tactic which is most likely to be practicable on rising markets. The largest of such offers was that of the Cornhill Trust; but that was a very special case of a geared trust. No other group employed the method of block offer before the war.

Since the war, the Bank Insurance group have revived the tactics, always on precisely the same basis of accumulating a block of units and offering them *en bloc* (of course as principals) at a price usually a little below the current offer price of newly constituted units; other managers have made similar offers.

* Paragraph numbers relate to those in Appendix A of the Association of Unit Trust Managers' Memorandum.

What is new is to start a cash fund trust (with no doubt an initial deposit of cash) and to make a so-called block offer of a million units, or whatever it may be, which merely amounts, if the units are priced for example at 10s., to inviting the public to subscribe £500,000 of cash, to be subsequently invested. There may have been a slender justification for a suggestion that something was being offered, when Capital Issues Committee consent was needed, and the managers could argue that they were in a position of privilege in being able to invite subscriptions for so many units; but now such a "block offer" is merely a form of words, in fact hocus-pocus.

In the discussions now going on between management groups about the formation of a new Association, it seems that a suggestion has been made that, in making a "block offer", managers should say whether they make it as principals or agents, thus disclosing whether it is an offer of units duly constituted in specie, or not. It would be better to limit the use of the description to the original meaning; but I should not be surprised if there were resistance on the part of the new-comers to giving up this easy and dramatic form of offer, which, moreover, involves no financial responsibility for the managers.

ANNEX B

Principal and Agent

This distinction is not a very appropriate criterion for analysing the operations concerned with unit trust management; and the measure of approbation and reprobation which have been associated with these terms are something of a psychological curiosity. However:—

(1) When units are created, the interest in them is vested in the managers unless and until they are registered in the name of someone other than the managers (if they are registered units), or are held by someone other than the managers (if they are bearer units). This point is sometimes overlooked. The managers are apt to be principals *ab initio*.

(2) When managers re-purchase units they become principals in respect of such units, and remain principals until they sell them again, or liquidate them in terms of the trust deed. In fact they do not as a rule liquidate them, because they are anxious to maintain a two-way market in units at a reasonable "turn"; and the only way they can do that is if they can rely upon being able to re-sell at offer price units which they have purchased at bid price. In short, they must job in units if they want to maintain a normal market; and it is one of the great merits of the unit trust movement that the managers do maintain a pretty free market. But as jobbers, and, ordinarily, holders of some stock of re-purchased units, they are necessarily principals. The importance of this point is that if managers were in a position only to pay to the out-going unit holder the liquidation or break-up value of his units (reached by selling an appropriate amount of the securities out of the trust fund) the turn between the offer price and re-purchase price would be uncomfortably wide. Instead of, say, 5 per cent. or 6 per cent., it would be 10 per cent. or 12 per cent.

(3) To make a "block offer" of the real as opposed to the notional type, it is, of course, necessary for the managers to accumulate units and perhaps to create some in preparation for making the offer.

(4) A further point applies not to units but to securities as such. In the case of some extremely difficult markets, such as insurance shares, investment trust stocks, and some bank shares were in the thirties, it is not practicable, at any rate not reasonable, for managers to crash suddenly into the market if they have to constitute a lot of new units. It is not to their advantage, since higher prices will cause a yield on the units, already low, to appear still lower. The better practice is for the managers to remain "on the feed" and take suitable stock quietly as it comes into the market. They will, of course, be principals in respect of the securities until they are appropriated, even if all securities so bought are appropriated as a matter of practice at the end of each Stock Exchange account—as was, I believe, the practice in Trust of Insurance

Shares Limited—or more or less day by day, which seems to be the new idea of Bank Insurance Trust Corporation. And this will lead to the managers being principals in respect of unsold new units from time to time.

It is perhaps a working advantage (to the managers) of a cash fund trust that if securities are not available the trust fund can remain in cash or in Government securities.

I cannot see objections to any of the above practices; and I should be inclined to describe the principal and agent controversy as nonsense.

ANNEX C

Cash Fund and Appropriation Fund

These terms denote a difference of method in building up a flexible unit trust. In the cash fund type, the trust fund consists primarily of cash (cash paid by the buyer of the unit and credited to the fund, to be then converted into securities); in the appropriation type, the trust fund consists primarily, and all the time, of securities (of securities vested in the trust fund to constitute new units). The basic transaction between the trust fund and the incoming unit holder in the one case is a transaction in cash; in the other case it is a transaction in specie.

One, so to speak, casual result can flow from this difference. A magnified example will show clearly what it is. Assume two trust funds, one of each type, each consisting of 500,000 units, each with a unit value on a given day, let us say, 1st January, of 20s. per unit. An investor buys on that day 1,000 units, cost £1,000, in each of them. Suppose now that the managers of the cash fund trust, for perfectly respectable reasons, do not acquire securities for the fund until 3rd January. They had credited the fund on 1st January with the proper amount of cash, let us say £950, but they do not convert the cash into securities until 3rd January. Let us finally suppose (and this is where the magnification comes in) that share prices have jumped 20 per cent. between 1st and 3rd January. The investor's cash (after deducting the initial service charge), every penny of it, £950, will be laid out in securities; but in effect the investor will be getting securities worth only £792 at the prices of 1st January. So much for the cash fund transaction. Of course, the market might go the other way; then he would benefit. In the case of the appropriation trust, the transaction is in specie. There again, the managers did nothing till the 3rd January. But the investor bought the equivalent (in specie) of 1/500th of the trust fund as it existed on 1st January; and although on 3rd January the trust fund is worth on market values £600,000, he is still entitled to 1/500th of it in specie, in securities added to the fund; and this is what he gets.

In fact, the method of increasing the trust fund by adding the proper proportional amount of securities does something the cash fund pattern cannot do; it assures to the incoming unit holder that he will get precisely what he purported to buy, or has hitherto believed he was buying.

The criterion of principal and agent is irrelevant to the basic transaction in either case. Whether cash fund or appropriation, the provisions of the trust deed will ensure, as the case may be, as regards new units, that the appropriate part of the purchase price is credited as cash to the trust fund, or that the proper proportion of actual securities for constituting the new units will be appropriated to the trust fund.

Appropriation is in strict line of descent from the original fixed trust; and the method, theoretically, is impeccable. In practice the operation of an appropriation trust may throw a certain amount of risk on the managers if they cannot obtain, and appropriate, securities at the level of prices on which the offer price of the unit was calculated.

The cash fund type, on the other hand, gives the managers more freedom of action in buying securities, and it exposes them to no risk. For these reasons, though theoretically a laxer method, I anticipate that it will be generally preferred in the future, especially now that "cash trust" has been made into a selling point.

APPENDIX VI

Memorandum by Gnest, Keen and Nettlefolds, Limited

Guest, Keen and Nettlefolds, Limited (referred to in this memorandum as G.K.N.) is a public company with an issued share capital of approximately £50,000,000 and nearly 60,000 stockholders (the average equity holding being £831 stock). It is the holding company of a group consisting of 83 operating subsidiaries, 57 in the United Kingdom and 26 overseas, employing altogether 75,000 people. The group is concerned with the manufacture and processing of steel and with many aspects of engineering, and the subsidiary companies, nearly all of which are wholly owned, carry out a variety of different functions.

We do not find the present law in practice is particularly difficult or inconvenient, but would like to make certain submissions (which are summarised for convenience of reference in Annex "C") on points where we feel improvements might be made. In particular, as a result of our experience of the application of the Companies Act, 1948, to a large Group of companies we feel that the law should give due recognition to the status of the wholly owned subsidiary, which is becoming a normal feature of industry, and we have accordingly made a number of submissions on this point under heading 14.

(I) Incorporation of Companies—Memoranda of Association

(a) *Minimum number of members*

We feel that there is no longer any justification for the rule that every company must have two members (if private) or seven members (if public) and we suggest that where a company is owned by one person there is no reason why this fact should not be recognised.

This is particularly relevant to the question of the wholly owned subsidiary, and without prejudice to the generality of the proposition mentioned above we will later submit that a wholly owned subsidiary need have only one member (see heading 14 below).

(b) *Memorandum of Association: Objects*

We consider that the objects clauses of memoranda of association, as at present drafted, provide no appreciable safeguards for members or third parties, and we think that the memorandum could well become purely a document as between the company and its members. A third party would then be entitled to assume that a company has the same power as a natural person to do whatever it purports to do.

Furthermore, we are in favour of simplification of the memorandum so that members can see clearly what the company's main objects are, and we think it would be helpful if the objects clause of the memorandum were restricted to the real main objects. The general clauses included in an objects clause at present really represent powers to be exercised for the carrying out of the main objects of the company, and should be separately designated as such. Consideration might be given to the procedure used in the New Zealand Companies Act of 1955, where the ancillary and incidental objects and powers are set out in Schedule II of the Act (given as part (ii) of Annex "A" to these submissions†) and deemed to be included in every Memorandum.

Such an amendment might affect the rules relating to change of objects, which in the context of the present law we consider to be adequate, but in any event we do not think that it should be necessary to file a reprint of the Memorandum on each change in the objects clause.

* Annex "C" has been omitted from this memorandum.

† Annex "A" has been omitted from this memorandum.

(d) Shares of No Par Value

We do not wish to make any submission relating to shares of no par value, except that if shares of no par value are to be permitted it is essential that companies should be free either to adopt this system or not, as they think best.

(3) Classification of Companies

Although it is conventional to divide companies with a share capital into public and private companies, and since 1947 to divide the latter into exempt and non-exempt private companies, there are two other categories to be found in the Act which are of some importance to the G.K.N. Group, namely:

- (i) private companies which are subsidiaries of public companies;
- (ii) wholly owned subsidiaries.

1. Private companies which are subsidiaries of public companies

Private subsidiaries of public companies are only dealt with in the Act in connection with the retirement of directors at the statutory age limit (sections 185, 186 and 200).

Because public companies are not defined in the Act, private companies which are subsidiaries of public companies have to be described for this purpose in section 185(8) of the Act as private companies which are subsidiaries of companies which are not private companies, which we consider an excessively cumbersome description.

2. Wholly owned subsidiaries

"A wholly owned subsidiary" is mentioned three times in the Act. In each case matters connected with such a subsidiary are exempt from certain provisions of the Act, and the phrase "a wholly owned subsidiary" is defined (in identical terms). These references are:

section 150(2)(a): exemption of a wholly owned subsidiary (as defined in section 150(4)) from grouping its accounts with those of its subsidiaries (but by paragraph 15(4) of the Eighth Schedule the wholly owned subsidiary which takes advantage of the exemption has to annex to its accounts certain additional information together with a statement giving the reasons why subsidiaries are not dealt with in group accounts);

section 195(1) proviso: exemption from showing shares in a wholly owned subsidiary in the Register of Directors' Shareholdings;

section 200(2) proviso: exemption from showing in the Register of Directors of a company particulars of directorships in companies of which the company concerned is the wholly owned subsidiary or which are the wholly owned subsidiaries of the company concerned or of another company of which the company concerned is the wholly owned subsidiary.

It will be noted that the two latter exemptions merely exclude from the records of some companies in the group certain information relating to wholly owned subsidiaries, whilst the first one imposes on a wholly owned subsidiary conditions almost as onerous as if it had submitted group accounts.

These categories are not mutually exclusive (e.g. it is possible for a wholly owned subsidiary to be a public or private company, or even an exempt private company (paragraph 6 of the Seventh Schedule) and for the holding company to be a public, private or exempt private company). The division of subsidiaries into those of public and those of other companies cuts across this classification.

Classification in Commonwealth Companies Acts published since 1948

The Companies Acts published since 1948 of countries which model themselves on English Law have not endorsed the classification in the United Kingdom 1948 Act.

(i) The Indian Companies Act, 1956, although its elaborate provisions run into 658 sections, contains a simpler division of companies into:

- (a) public companies (which are defined as such);
- (b) private companies (which have to file their balance sheets but not their profit and loss accounts); and
- (c) private companies which are subsidiaries of public companies.

The clauses equivalent to sections 195 and 200 of the United Kingdom Act referred to above (there is no equivalent of section 150) make no mention of wholly owned subsidiaries, but the concept of a private company which is the subsidiary of a public company is very frequently utilised in the Indian Act where it enjoys some of the benefits and restrictions imposed on public companies generally (e.g., by section 273 the time limit for taking up qualification shares applies to it, by section 274(3) a person cannot be disqualified for appointment as a director except on the grounds given in that section).

(ii) The New Zealand Companies Act of 1955 does not mention exempt private companies. It deals with a number of matters affecting private companies in a separate part of the Act (Part VIII) and a separate schedule (the Ninth Schedule) specifies the provisions that do not apply to private companies. Although the New Zealand Act is very similar to the United Kingdom Act, there is no provision comparable to section 185 of the United Kingdom Act (relating to a Director's retiring age) which is the only place where a "private company which is a subsidiary of a company which is not a private company" is defined. Such a company is therefore not mentioned in the New Zealand Act. The result is that the New Zealand Act recognises only three types of companies and the wholly owned subsidiary has the same marginal existence as in the United Kingdom 1948 Act.

Defects of existing United Kingdom Classification

We feel that the present United Kingdom classification does not bear a proper relation to economic circumstances. In particular a company designated as private may be:

- (i) the holding company of a group of companies (including public companies);
- (ii) a large private business with well over 50 members (because section 28 (1) (b) excludes persons employed by the company—presumably including executive directors—and former employees, and further because by section 28 (2) joint shareholders, except first shareholders, are counted as one);
- (iii) a one-man company;
- (iv) a large, small or medium-sized subsidiary, wholly or partly owned;
- (v) a company jointly owned by two or more companies (none of which owns more than 50 per cent. of the equity share capital) and therefore not a subsidiary at all.

All these may in appropriate cases be exempt private companies as well.

The categories of wholly owned subsidiaries and private companies which are subsidiaries of public companies are only mentioned on comparatively minor points and do not seem to be integral to the Act, whereas the companies they comprise are both numerous and often important.

Submissions

We therefore submit

(A) that the classification of companies should be revised and in particular that the wholly owned subsidiary should have a position commensurate with its practical importance. A number of submissions on the function and status of a wholly owned subsidiary will be found under heading 14 below.

(B) That public companies should be defined as such in the Act. Not only would it obviate the cumbersome description in section 185 (8) referred to above, but also in present circumstances, with private companies outnumbering public companies about 30 to 1, it is unrealistic to continue with the supposition that all companies are public companies unless they fulfil the definition of private companies.

In our opinion the definition of public companies should refer to quotation for any part of its share capital on a recognised Stock Exchange. This would also have the effect of strengthening the hand of the Stock Exchange if it had to use its powers to stop quotation.

(C) That a public company which becomes a wholly owned subsidiary should lose its character as a public company.

(5) Exercise of Powers of Companies by Directors

In general we think directors exercise their powers with proper regard to the interests of shareholders.

We consider that every board of directors of every company (or at the least every public company) should obtain the approval of its shareholders to

- (i) a change in the activities of the company or its subsidiaries which is fundamental to the undertaking as a whole;
- (ii) the disposal of all of its undertaking or assets or a material and substantial part thereof. The definition of assets in this context should include interests in subsidiaries.

(c) Issue of Shares

On the question of the issue of shares other than to existing holders, we appreciate the point of view of those who already own the equity. There are however cases where an issue of a relatively small proportion of shares may justifiably be made by a Board without the previous consent of the existing shareholders, as in the acquisition of another business or company. If legislation is to be passed on this subject we feel that the interests of the existing shareholders would be adequately protected, and the administrative complexities of ordinary business life not augmented, by a provision that previous consent of the existing shareholders of any class of issued capital should be obtained before an issue of more than a stated proportion of such class, say 15 per cent. or 20 per cent., was made other than to the existing shareholders. We do not think an obligation to obtain the consent of existing shareholders in every case is warranted.

(6) Directors' Duties

(d) Disclosure of Directors' interests

We submit that holdings and dealings in securities *bona fide* for investment purposes only in a public limited company quoted on a recognised Stock Exchange should not be required to be disclosed under section 199.

Names of Directors to be shown on certain documents

We submit that section 201 of the Companies Act, which requires certain companies to show the names of their directors on certain documents mentioned in that section, should be reconsidered. If it is thought that it still serves a useful purpose it should nevertheless define more accurately the documents on which the names of directors must appear and should remove from that definition certain documents, such as trade catalogues, where the requirement is almost universally ignored.

A submission on the effect of section 201 on wholly owned subsidiaries is mentioned under heading 14 below.

(7) Shares with Restricted or No Voting Rights

We feel that regulation of shares with restricted or no voting rights is a responsibility which belongs to the Stock Exchange, and should not be dealt with by legislation.

(10) Board of Trade Powers to Appoint Inspectors

At present shareholders often seem to take little interest in the activities of companies in which they invest until circumstances arise which may make their intervention too late. For this reason we think that consideration should be given to a strengthening

of independent bodies in order that skilled and prompt assistance should be available to protect the small shareholder. There are two bodies which are obviously suitable for this role, namely, the Board of Trade and the Stock Exchange.

We think that whilst the existing powers of the Board of Trade are adequate, there are grounds for suggesting they are not used as often or as promptly as they might be. Even when an investigation is ordered it is likely to be overtaken by Stock Exchange action or by the criminal law, presumably dealing with the same facts on the same information. Stock Exchange action may make the investigation unnecessary and in a recent example criminal proceedings have had the effect of delaying the publication of the results of the Board of Trade investigations for a considerable time.

We would therefore be in favour of any recommendation designed to enable the Board of Trade to exercise its existing powers (which we consider to be generally adequate) more quickly and effectively.

As far as Stock Exchanges are concerned, we recognise that they cannot be expected to interfere in the internal direction and management of companies but we would support any proposals designed to strengthen their powers of obtaining and enforcing publication of full and proper information, as a condition both of the granting and of the maintenance of quotation.

(11) Disclosure of Ownership and Control

There are a large number of nominee holdings in G.K.N. (three out of the ten largest holdings of ordinary stock at 5th January, 1960, were registered in the names of nominee companies), but we see no need for the directors of a public company of our size to discover who owns the beneficial interest in these shares. It is conceivable that the position may be different in the case of a smaller company, but even there, if it is a public company, there is little a Board of Directors can or ought to do if ownership is changing.

The position of a shareholder is different. He is entitled to know who are the real co-owners of the company. He may, for example, justifiably fear being left as a minority shareholder in a company which, through acquisition of its shares, comes under the effective control of another, when he thought he was one of many shareholders in an independent company; or he may not wish to invest in a company if he knows that a certain interest holds a substantial measure of control. It is also conceivable that the position of a shareholder in a private company may be affected, through evasion of the restriction of transfer provisions in its Articles.

We are conscious of the fact that the growth of Unit Trusts, Investment Clubs and other means of spreading share ownership would make much more difficult the keeping of a register of beneficial ownership (which may have to be traced through three or four layers before the real beneficial owner is reached) and we are aware that although the Cohen Committee recommended that the beneficial owner of more than 1 per cent. of a company's capital should be obliged to disclose his interest, this proposal was later dropped because it was considered that banks and nominee companies would be placed in an impossible position.

In our opinion the crux of the matter is the secret acquisition or attempted acquisition of control, bearing in mind that effective control of a publicly quoted company can be obtained by holding considerably less than a 51 per cent. interest.

Although ideally the answer would be for all Registers of Members to show the real beneficial owners, we think the volume of work required to effect such a change would be prohibitive. For instance there is an average of 12,000 to 14,000 bargains recorded every day on the London Stock Exchange alone, without considering provincial Stock Exchanges, transactions not going through Stock Exchanges and transfers in private companies. It would not be surprising if there were at least 5,000,000 share transfers registered every year and we think that to require additional details in the case of every transfer would not be commensurate with the benefit to be obtained if the real beneficial owners were disclosed. This is without considering the enormous task of ascertaining the beneficial ownership of existing shares.

We also bear in mind that the Cohen Committee was of the opinion that in any event it might be difficult to ascertain the real beneficial owner. There is, in our opinion

something to be said for requiring that the owner of a substantial proportion, say 20 per cent. or 25 per cent. of the voting rights of a company should notify his interest to the company and the Registrar of Companies, but in our opinion a simpler method of preventing surreptitious acquisition is to be found. Generally speaking the restriction of transfer provisions in private companies make this a problem for public companies only and, in particular, the smaller public companies. However, in the case of public companies it is unlikely in present economic circumstances that a concealed take-over could be effected by a private person. It, therefore, seems to us that a substantial measure of control over the type of abuse which may occur would be effected by a provision on the lines of section 49 of the Indian Companies Act, 1956, which provides that all investments made by a company on its own behalf should be made and held by it in its own name (with a proviso that the holding of qualification shares by nominee directors must be in the joint names of the company and the nominee, or in the name of the nominee expressly described as a nominee of the company).

We do not pretend that this would be a complete answer to all types of abuse, but feel that this is a case where there must be a compromise between the protection of shareholders generally and the free and normal functioning of share ownership and dealings.

Consideration might also be given, in order to prevent votes being cast at General Meetings without disclosing the identity of the true owner of the shares, to a statutory provision whereby if a poll is demanded the Directors may circulate new proxy forms which, to be valid, would require disclosure of ultimate beneficial interests (with a reasonable definition of beneficial interests to permit, for example, general disclosure of wills and settlements). Such a rule should include a further provision that a poll on such proxy forms could be postponed for sufficient time to enable any material and relevant information to be circulated to the general body of members. This provision would be ineffective to prevent a person investing in a company controlled by persons of whom he did not approve, but it should ensure that control could only be exercised openly and with the knowledge of the other shareholders.

(14) The Practice of Carrying on Business through Subsidiary Companies

As far as the G.K.N. Group is concerned, there are several reasons for conducting business through the mechanism of a holding company and subsidiaries, generally wholly owned subsidiaries.

The parent company was formed in 1900 to combine a number of existing businesses. However, as the company grew, it acquired a number of other businesses. The simplest and most convenient way of absorbing a newcomer was to acquire its share capital, obtain representation on its Board, lay down certain rules of policy and allow the company to continue under separate management. This has been especially necessary as G.K.N. has developed into a vertical organisation from ore mining through iron and steel making to finishing, engineering and merchanting, and new acquisitions have not necessarily fallen within the previous operational experience of the Group. The fact that acquisitions were often widely dispersed in the United Kingdom, and later through the world, was an additional reason for this procedure.

Secondly, where a new enterprise is to be developed, it is in many instances desirable to segregate it from any of the existing companies. Although theoretically the enterprise can operate as part of an existing company, in practice administrative considerations often make it desirable to give the new enterprise a separate identity.

The third reason for the present form of organisation of the G.K.N. Group arose out of nationalisation. When the steel industry was under threat of nationalisation in 1948 it was considered advisable to transfer the steel making activities to separate companies, so that only that part of the Group directly concerned with steel production would be affected.

Fourthly, it is our experience that the division of general policy control and ultimate financial authority from day-to-day activities of the various companies operates efficiently. The holding company is the link between the owners and the manufacturing and selling units and as such is free to concentrate on the overall policy and direction of the Group when the detailed management of trading activities has been separated from it.

The number of wholly owned subsidiaries

The exact number of wholly owned subsidiaries (and the number of subsidiaries generally) is unknown. Neither the Companies Registry nor the Insurance and Companies Department of the Board of Trade nor the Stock Exchange keep records of how many are in existence.

We have therefore taken a sample of slightly over 5 per cent. of the companies listed in the Commercial and Industrial section of the Stock Exchange Official Year Book for 1959. The information obtained has certain defects (in particular it tends to under-emphasise the importance of subsidiaries generally and wholly owned subsidiaries in particular) but nevertheless we think it is a significant sample, and fuller details of the methods used and the information obtained are given in Annex "B".

The sample consisted of 200 companies, of which 5 were in liquidation (none of these has any subsidiaries). Of the remaining 195, 122 (62.6 per cent.) had subsidiaries, including at least 84 (43.6 per cent.) which had wholly owned subsidiaries. These companies have at least 647 subsidiaries, of which at least 319 are wholly owned.

Although the Year Book deals only with public companies which are quoted on the London Stock Exchange, we think we would be justified in saying that nearly half of all active public companies have wholly owned subsidiaries and the number of such wholly owned subsidiaries greatly exceeds that of all public companies. The amount of formal requirements is therefore appreciable. This is without considering the question of private companies' wholly owned subsidiaries, which we know to be numerous.

Importance of the wholly owned subsidiary

The wholly owned subsidiary represents a widespread and growing method of industrial organisation and, provided that the fundamental principle of independent corporate existence is recognised and the statutory safeguards applicable to companies generally are not affected, it should be as free as possible from rules and regulations governing its internal procedure and formalities.

The proposals we make would not adversely affect the interests of creditors or the public, or authorise any corporate activity affecting these interests which is not now possible with the necessary consent or approval of the members.

Submissions relating to wholly owned subsidiaries

(A) General

All restrictions applying to companies generally should be reconsidered to see if they are necessary in the case of wholly owned subsidiaries.

(B) Number of members of a wholly owned subsidiary

A wholly owned subsidiary is by definition owned by one person and that fact should be recognised by permitting a wholly owned subsidiary to have only one member, namely, its holding company.

This would probably require amendment of the following sections of the present Act:

section 1: Mode of forming company

section 31: Reduction of number of members below legal minimum

section 134(c): Quorum for meeting

section 222(d): Winding up by Court where number of members falls below legal minimum.

(C) Definition of a wholly owned subsidiary

There should be only one definition of a wholly owned subsidiary instead of the three in sections 150(4), 195(1) proviso and 200(2) proviso (ii).

(D) Table A, Part III.

Table A in the First Schedule to the Companies Act should be amended to include a Part III containing regulations applicable to a wholly owned subsidiary company, such regulations covering, *inter alia*, the following points:

- (a) that a written memorandum under the Common Seal of the holding company or signed by a responsible officer thereof, shall be as effective as any meeting resolution or proceeding which would otherwise require to be held or approved by the members, but so that any such memorandum which would otherwise require a resolution or other document to be filed at the Companies Registry, shall be so filed; and
- (b) that the appointment, rotation, removal and remuneration of Directors shall be capable of being authorised in a similar manner to (a).

(E) Resolutions

The Companies Act should be amended to permit *all* resolutions (special and extraordinary as well as ordinary resolutions) of a wholly owned subsidiary to be valid if not passed at a meeting but signed under authority of the holding company.

At present the situation is governed by the Common Law rules that members of any company, acting honestly and *intra vires*, may assent to a transaction which should be approved by an ordinary resolution, even though they do so without formality and at different times (i.e. not at a meeting). This rule has never been extended to extraordinary or special resolutions, the statutory definitions of which require "a meeting" i.e. more than one member present.

There is however a reference in the Companies Act 1948, section 143(4)(c) to "resolutions which have been agreed by all the members of company, but which, if not so agreed to, would not have been effective for their purpose unless, as the case may be, they had been passed as special resolutions or as extraordinary resolutions".

Section 143 is a purely administrative section which deals with the obligation to register special and extraordinary resolutions and it seems unlikely that it is intended to lay down new law. Section 141, which deals with the substantive rules as to extraordinary or special resolutions, merely permits relaxation of certain notice requirements for meetings at which extraordinary and special resolutions may be passed.

It is therefore difficult to see what section 143(4)(c) means and it should be deleted or clarified by the insertion of the amendment we suggest.

Where there are a number of members, each with his own interests or views, a meeting may be the most appropriate means of obtaining their agreement to a certain course of action (although we do not see why they should not be permitted to agree in any other manner—see heading 26(b) below): but as there is only one owner of a wholly-owned subsidiary, such an owner should be permitted to express his wishes with the minimum possible formality.

There is a somewhat similar provision for private companies in the New Zealand Companies Act, 1955, section 362, which is given in Annex "A" hereto.

(F) Annual General Meetings

Whilst the Annual General Meeting of a company with a number of members is obviously essential to the whole system of membership control, where the company has in effect only one member, i.e. its holding company, the holding of an Annual General Meeting has become an unnecessary formality. We therefore suggest that wholly owned subsidiaries should not be required to hold an Annual General Meeting, so long as

- (a) the Accounts, with the statutory reports attached thereto, are approved in writing by the holding company and a minute to that effect inserted in the minute book of the subsidiary, and
- (b) an Annual Return is filed as if a meeting had been held on the date of such approval in writing.

Alternatively we suggest that the Act be amended on the lines of section 362(2) of the New Zealand Act, which lays down that an Annual General Meeting of a private company need not be held if the necessary resolutions are recorded as being passed (Annex "A"). The relevant amendment to the United Kingdom Act should deal with wholly owned subsidiaries (and if thought appropriate private or exempt private companies).

* Annex "A" has been omitted from this memorandum.

Nothing in this proposal should affect the accounts of a wholly owned subsidiary, which, unless it is exempt, should be filed at the Companies Registry with the Annual Return.

(G) Annual Return

It should be permissible for a wholly owned subsidiary to file in lieu of an Annual Return a Certificate signed by its secretary, stating that there has been no change in its status as a wholly owned subsidiary, of a specified holding company, nor in its share capital or particulars of indebtedness, since the date of the last Return or Certificate.

(H) Directors' Emoluments

Section 196 of the Companies Act requires that there shall be shown in a company's accounts the aggregate amount of directors' emoluments, pensions and compensation for loss of office.

The purpose of this requirement is to disclose to members of a company the emoluments of the directors. But as the only members of a wholly owned subsidiary is its holding company (which itself includes in the information given to its shareholders such of the emoluments of its own directors as are paid by the wholly owned subsidiary, as required by section 196(2)) no useful purpose seems to be served by imposing these requirements on wholly owned subsidiaries and we submit that they should be exempted from the provisions of section 196.

(I) Register of Directors' Shareholdings

It seems unnecessary for a wholly owned subsidiary to be subject to the provisions of section 195 as the holding company can, if it so wishes, require disclosure to it by directors of a wholly owned subsidiary of their holdings of shares and debentures in itself, which are not ascertainable on the face of the Register, i.e. nominee holdings, and the holding company will already be informed of the holdings of such directors in shares and debentures of other wholly owned subsidiaries.

It should not in any event be necessary to duplicate in the Register of Directors' Shareholdings of a wholly owned subsidiary any information which appears in the Register of the holding company, i.e. in the case of directors of the holding company who are also directors of the wholly owned subsidiary.

(J) Section 201 of the Companies Act, 1948

We submit that section 201 of the Companies Act, 1948 (which requires the names of directors to be stated on the documents specified in that section) be amended in respect of wholly owned subsidiaries (and other subsidiaries) by incorporating the usual conditions stipulated in the Orders of the Board of Trade under its powers in the proviso to section 201(1).

In practice these conditions appear to be:

- (i) that all documents to which the section refers disclose the fact that the company is controlled by the holding company of the group,
- (ii) that if any directors' names are shown, all are shown,
- (iii) that any change in the directors or in the name of the company or control of the company be notified immediately to the Board of Trade.

(K) Grouping of accounts by wholly owned subsidiaries

We have mentioned previously that by section 150 (2) (a) a wholly owned subsidiary does not have to submit group accounts. However, by paragraph 15 (4) of the Eighth Schedule it has, in such cases, to give certain additional information. These provisions apply to all cases where group accounts are not submitted, i.e.,

- (i) where a wholly owned subsidiary takes advantage of section 150 (2) (a), or
- (ii) where the directors of any company consider the inclusion of group accounts would be impracticable, or no real value, or too expensive or too delayed, or

misleading, or harmful, or the business of holding company and subsidiary cannot reasonably be treated as a single undertaking (section 150 (2) (b)).

In practice this means that accounts of wholly owned subsidiaries which are themselves holding companies are consolidated, to obviate the requirements of the Eighth Schedule, paragraph 15 (4).

In our opinion the case (ii) above stands on an entirely different footing from case (i) and we submit that these additional requirements in paragraph 15 (4) of the Eighth Schedule be waived in the case of wholly owned subsidiaries.

(L) Auditors' remuneration

The Eighth Schedule, paragraph 13, requires the auditors' remuneration to be shown in the Profit and Loss Account if not fixed in General Meeting. The practical effect of the present rule, taken together with the rules on consolidation, is that in a group of companies like the G.K.N. Group where the fees of the auditors of some subsidiaries are fixed at Annual General Meetings and those of others are fixed by the Boards of the companies concerned the total auditors' fees have to be shown to give a true and fair view. This is quite inappropriate; auditors' fees for subsidiaries are paid to protect the holding company, auditors' fees for the holding company are paid to protect the shareholders.

We therefore submit that this provision be repealed as respects wholly owned subsidiaries.

(M) Auditors' Report

We submit that if a wholly owned subsidiary should be required to hold or elect to hold an Annual General Meeting (depending on the effect of any new legislation) it should not be necessary to read the Auditors' Report.

(15) Loan Capital

We feel that the time has now come when it should be obligatory under the Act for a company to keep a register of debentures, which appears to be a generally accepted practice so far as public companies are concerned.

We consider however that in view of the wide definition of "debentures" in the Companies Act, 1948, there should be a more specific definition of the classes of debentures of which a register should be kept.

(16) Take-over Bids

We think that the primary object of any variation of the law in connection with take-over bids should be the public provision of full and adequate information. We do not think that the rights of shareholders to sell or keep their shares should be interfered with.

We also think that the circulation of information required by statute as is now proposed in the Licensed Dealers (Conduct of Business) Rules, 1960, represents the correct method of revising the provisions of the Prevention of Fraud (Investments) Act, 1958, in this connection and we submit it should be permissible to despatch circulars which fulfil any one of the following conditions:

- (i) they are approved by the Board of Trade, or
- (ii) they are despatched by an authorised or licensed dealer under the Prevention of Fraud (Investments) Act, or
- (iii) they contain the information and particulars to be specified in a schedule to the Act, or in regulations to be made thereunder similar to the Licensed Dealers (Conduct of Business) Rules, 1960, with penalties similar to those applying in the case of prospectuses.

In any case it should be obligatory to give the name of the person making the offer.

In our opinion a great deal of the abuse resulting from take-over bids arises from operations which appear to be conducted in clear breach of section 54 of the Companies Act, 1948, and we consider that either that section should be revised and enforced so as to make the penalties more realistic, or the extent to which a company's resources can be used, after the event, to finance the purchase of its own shares should be specified by statute.

(g) Section 209 of the Companies Act, 1948

We suggest that Section 209 should be amended as follows:

- (a) by substituting the words "nominal value of the capital paid up on" for the words "value of" in the eighth line of subsection (1), so as to make it clear that where an offer is being made for the whole of the share capital of a Company, consisting of shares of different classes, it is sufficient to obtain acceptances from holders of 90 per cent. in nominal value of the total paid up capital. Any minority adversely affected would still be entitled to the protection of the Court under the section.
- (b) by permitting the periods in subsection (1) and (2)(a) to run concurrently, which could best be effected by making the period in subsection (1) date from the date of acceptance by the requisite majority, and by making it unnecessary to serve a notice under subsection (2)(a) if a notice to acquire under sub-section (1) has already been served.

(21) Accounts

We think the accounting provisions of the 1948 Act, considered as a means of obtaining adequate financial information about a company, are generally satisfactory, and that the amount of information at present required to be given is sufficiently detailed.

We would however make the following submissions:

(b) Share Premium Account and Capital Redemption Reserve Fund

We have two comments to make on the Share Premium Account and the Capital Redemption Reserve Fund.

In the first place we regard these two reserves as being wholly different from other capital reserves normally grouped with them on a Balance Sheet. The Share Premium Account, by section 56(1) of the Act, is subject to the same rules as to reduction of capital as the company's paid up share capital, and by section 58(1) proviso (d) so is the Capital Redemption Reserve Fund, although both reserves can, of course, be used for the purposes mentioned in sections 56(2) and 58(5) respectively. We therefore think that these two reserves are in the same category as capital, and should be grouped with the share capital and not, as at present, with the capital reserves, as defined in paragraph 27(1)(c) of the Eighth Schedule.

Secondly, it should be made quite clear in any revision of the relevant parts of the Eighth Schedule that all movements of the Share Premium Account and Capital Redemption Reserve Fund should be shown in the accounts. Although we think this follows from the definition of "capital reserve" in paragraph 27(1)(c) as not including "any amount regarded as free for distribution through the profit and loss account", a reference to paragraph 2(c) (which only requires that the amount of the Share Premium Account shall be disclosed) might imply that movements need not be shown.

(c) Pre-acquisition profits

We submit that the present legal position of pre-acquisition profits should be clarified.

The only reference in the Act to pre-acquisition profits, so far as we are aware, is in the paragraph 15(5) of the Eighth Schedule. This paragraph begins as a qualification

to paragraph 15(4) (which deals with the information to be supplied by company not grouping its accounts with those of its subsidiaries) and the general rule that the distribution of pre-acquisition profits to a holding company cannot be treated by the holding company as revenue profits appears to depend solely on the parenthesis "for that or any other purpose" in the middle of the sub-paragraph. This seems to us to be quite the wrong way to deal with a rule of such great practical importance and we recommend that sub-paragraph 15(5) be clarified.

If, and there has recently been some doubt cast on it, the law is that the pre-acquisition profits are not available for distribution, we consider that exceptions are necessary for re-organisations internal to a group of companies, where the legal structure may have been altered but no change has taken place in the business carried on. The saving clauses in (a) and (b) of paragraph 15(5) of the Eighth Schedule do not cover all possible transactions which may occur in a group of companies (e.g. where a holding company acquires a sub-subsidiary from a subsidiary).

Treatment of taxation on profits earned overseas

Paragraph 12(1)(c) of the Eighth Schedule requires United Kingdom taxation on profits to be shown in the profit and loss account including, where practicable, overseas tax to the extent of the relief, if any, from United Kingdom income tax.

This provision seems to have been primarily drafted to cover the case of a company trading overseas through branches, and it is not appropriate in its application to a consolidated profit and loss account of a United Kingdom holding company with overseas subsidiaries which are taxed overseas but which may remit the whole or part or none of their taxed income as a dividend.

The present requirements therefore do not give to shareholders in the holding company a true and fair picture of the total tax suffered by the group. To do this it would be necessary to amend the Eighth Schedule, paragraph 12(1)(c), to require that a consolidated profit and loss account should show

- (i) the total overseas tax paid by the companies in the group, and
- (ii) the total net United Kingdom taxation on profits paid by the companies in the group, distinguishing between income tax and any other taxation on profits.

Consideration might be given to applying this formula to companies trading overseas through branches.

(22) Audit

We think that in general auditors' duties and responsibilities are already sufficiently wide to protect shareholders and that no extension is required at present. This opinion is confined to public companies and their subsidiaries; we are not in a position to comment on audits of exempt private companies.

Two specific points relating to the audit of wholly owned subsidiary companies are mentioned under heading 14 above.

(23) Returns

As a general comment we are of the opinion that any possible simplification of returns would be beneficial.

Annual Returns

Under heading 14 above we suggest that a wholly owned subsidiary should be permitted to file in lieu of an Annual Return a Certificate containing certain details. We think that a similar concession might be allowed to a non-trading company, which should be permitted to file in lieu of an Annual Return a Certificate by its secretary stating that it has not traded, and that there has been no change in its status nor in the required particulars since the last Return or Certificate. Such companies are often retained for name protection purposes.

By proviso (c) to section 124 (1), for two years following a year when a complete list of members has been filed, the return need only show transfers of shares, but in the

third year, when all members must be shown, by paragraph 5 (b) of the Sixth Schedule, transfers must also be shown. It is impossible to trace share dealings through this procedure and we think it involves a great amount of work for no apparent reason. In fact we do not take advantage of this concession because it is inconvenient for us to do so and we believe the same to be true of other companies where share dealings are numerous. We take the purpose of the Annual Return to be a record of the position of the company on a certain date, and therefore suggest that the Return should show only the members at that date, with their holdings, and not concern itself with transfers. Any person who wishes to have full details can always inspect the company's Register of Members.

We suggest that in section 3 of the Annual Return, paragraph (b), the sub-paragraphs dealing with total calls received and total amounts considered to be paid up, whether the shares are issued for cash or not (usually numbered 9, 10 and 11 on Annual Return forms) should be clarified as regards information to be given as to premiums received on the issue of share capital, whether for cash or otherwise, since the information given may not correspond with that given on the Return of Allotments.

We also suggest that under section 3 (a) of the form of Annual Return given in Part II of the Sixth Schedule a sub-section should be introduced to enable particulars to be given of the conversion of the share capital, or part of it, into stock.

Return of Allotments

Descriptions should not be required on Returns of Allotments.

Return of Particulars relating to Directors

We wish to make two submissions regarding the Return of Particulars relating to Directors.

- (a) We submit that the proviso to section 200 (2) of the Act (which permits directorships of the holding company of a wholly owned subsidiary and fellow wholly owned subsidiaries within the group concerned to be omitted from the particulars contained in the Register of Directors) should be extended to subsidiaries generally, and that the particulars of other directorships required to be contained in a Company's Register of Directors should be confined to those held in holding companies and independent concerns.
- (b) As the law now stands, every time a director is appointed to a company, every company of which he is a director (in addition to the company to which he is appointed) should file a return recording this information. We doubt whether this procedure is consistently followed, and we think it is unnecessary. We consider that if a record of other directorships held by the directors of a company is still considered to be necessary it should be required only once a year, as part of the Annual Return. A Return of Change in Particulars relative to Directors should only be required between Annual Returns from the Company whose board has changed.

(24) Company and Business Names

Where a company's name has been approved by the Registrar of Companies, an existing company with a similar name has no remedy except a passing off action. We therefore recommend that a company which considers itself aggrieved by the fact that another company has been formed or is trading under a name calculated to mislead (whether or not the first company has suffered damage) should be permitted to apply to the Court for an order that the other company should change its name in such a manner as to remove the possibility of confusion.

We also suggest that where a company trades under a name other than its own it should be necessary to file particulars at the Companies Registry, in addition to the Registry of Business Names. In practice the latter registry is rarely searched, and the company's file is the logical place to look for this information.

We should like to see a provision similar to our suggestion in heading 24 above (that a company should have the right to apply for cancellation of a name calculated to mislead) operate with regard to overseas companies as defined in section 406. However, we realise that United Kingdom legislation cannot be used to alter the names under which companies are constituted or trade abroad and we therefore suggest that a company should have the right to apply for an order that an overseas company registered in the United Kingdom should not be allowed to trade here under a name calculated to mislead.

We further suggest that a provision similar to section 17 (prohibition of registration of companies by undesirable names) should be included in section 407 which deals with the documents, etc., to be filed by an overseas company, so as to ensure that a company proposing to trade in the United Kingdom is not permitted to do so under an obviously objectionable name.

(26) Internal Management and Administration

(a) *Annual and other General Meetings*

A suggested relaxation of the rules relating to Annual General Meetings of wholly owned subsidiaries is given under heading 14 above.

(b) *Extraordinary and Special Resolutions*

Under heading 14 above we recommended that a wholly owned subsidiary should be permitted to pass special and extraordinary resolutions, as well as ordinary resolutions, by a memorandum signed by all members.

Whilst this simplification of formalities is particularly desirable in the case of wholly owned subsidiaries, we suggest it might well be extended to all companies. In practice it will only apply to companies with a small number of members and such a memorandum seems a more accurate indication of the wishes of the members than a meeting at which only a small percentage of the members are present.

Limitation periods

The lack of any general provision with regard to limitation periods in company matters causes difficulty in practice. In particular we should like to draw attention to two aspects of this problem, which we submit should be dealt with in any revision of the Act:

- (i) Documents relating to share and debenture transactions;
- (ii) Unclaimed shares and dividends.

(i) *Documents relating to share and debenture transactions*

A considerable amount of inconvenience is caused by the fact that no statutory period has been laid down after which the various documents relating to title to shares or debentures in a company can be destroyed. The result is that at present we are forced to keep for an indefinite period all transfers and all "dead" accounts, i.e. the sheets of the register relating to persons who have ceased to be members or debenture holders.

As an average of 100 stock accounts are closed every week we have to keep documents for 5,000 "dead" accounts each year: we also receive approximately 20,000 stock transfer forms every year, all of which are retained indefinitely. In common with other companies we find that we are collecting a vast amount of paper hardly any of which is required.

We therefore suggest that any revision of the Act should include a provision to permit a company to destroy all records relating to share transactions which have occurred earlier than, say, 12 years previously.

(ii) *Unclaimed shares and dividends*

Considerable difficulty and inconvenience is also caused when public companies are unable to trace the owners of their shares. We recognise that any proposal to repay such capital may be objectionable on the ground that the interests of creditors may be prejudiced, but we suggest that subject to appropriate safeguards, such as advertisements in prescribed papers, a company should be empowered to dispose of such capital after a specified period by sale on the open market and then credit the proceeds, together with all unclaimed dividends attaching thereto, to an account similar to the Companies Liquidation Account.

Annex "A"

This Annex, which consisted of Section 16(1), and 362 and the Second Schedule of the New Zealand Companies Act, 1955, has been omitted.

Annex "B"

The Wholly Owned Subsidiary

Sample of Companies in The Stock Exchange Year Book, 1959

1. Basis of sample.
2. Defects.
3. Results.
4. Confirmation of results.

1. *Basis of sample*

The sample was taken from the Commercial and Industrial Section of the Stock Exchange Year Book 1959, and consisted of 200 Companies (i.e. rather more than 5 per cent.).

To avoid any possible bias a table of random numbers was used. As companies are not numbered, page numbers were selected and the first company on each page was recorded. As on average there are between two and three companies on a page, some page numbers were repeated in the table; in these cases the first and last companies on that page were taken.

2. *Defects of Sample*

The sample has the following defects:

- (a) The information is not complete. It is clear that in some cases not all subsidiaries are shown. In particular non-trading or name holding subsidiaries are rarely given, and sometimes it appears that overseas subsidiaries have not been listed.
- (b) Wholly owned subsidiaries are not always shown separately. The phrase most common used is "direct control" which may or may not mean that a subsidiary is wholly owned. We have assumed it means a subsidiary not wholly owned.
- (c) Overseas companies are included. The sample caught 9 (Eire 3; U.S.A. 2; Australia, Holland, S. Rhodesia and the Isle of Man 1 each). However between them they only listed 3 wholly owned and 3 other subsidiaries.

It will therefore be clear that the Stock Exchange Year Book under-emphasises the importance of subsidiaries generally, and the wholly owned subsidiary in particular.

- (d) The Year Book only deals with the public companies quoted on the Stock Exchange, London, and not:

- (i) other public companies; or
- (ii) private companies.

We do not know that there is any evidence that other public companies are different. Private companies have no doubt fewer subsidiaries (though we know large groups of private companies).

3. Results

(a) Numbers of subsidiaries and wholly owned subsidiaries

Companies			Subsidiaries		Total
			Shown as wholly owned	Not shown as wholly owned	
Companies in Liquidation ..	5	2.5%	—	—	—
Companies which are themselves subsidiaries ..	33	16.5%	32	11	43
Companies which are not themselves subsidiaries ..	162	81.0%	287	317	604
	200	100 %	319	328	647
			(159.5%)	(162.0%)	(323.5%)

The number of Companies which were themselves subsidiaries included 2 wholly owned subsidiaries.

(b) Number of Companies with subsidiaries

					%
Number of companies in sample	200				100.0
Number with wholly owned subsidiaries	84				42
Number with other subsidiaries	53				26.5
Companies with only wholly owned subsidiaries	62				31
Companies with only non wholly owned subsidiaries	31				15.5
Companies with both	22				11
Total	115				57.5
Companies with subsidiaries which are not described	7				3.5
Total number of companies with subsidiaries	122				61

(c) Duplication

There were two cases of duplication i.e. two of the companies sampled were subsidiaries of two other companies sampled. However as the same rules and formalities apply to subsidiaries whether they are subsidiaries proper or sub-subsidiaries, and also to groups and sub-groups, we did not eliminate the sub-subsidiaries (one subsidiary had itself no subsidiaries, the other had 10 subsidiaries, 9 wholly owned and 1 not wholly owned).

(d) Maximum number of subsidiaries

One company had 1 wholly owned and 49 other subsidiaries, total 50. However we happen to know that the second largest group (shown as possessing 19 wholly owned and 14 other subsidiaries, total 33) in fact possesses 56 subsidiaries.

(e) Holding Companies

20 companies (10 per cent. of the sample) described themselves as, or were otherwise identifiably, holding companies, i.e. not themselves manufacturing or trading. One of these holding companies was itself a (non wholly owned) subsidiary.

(f) Jointly owned companies

The number of jointly owned companies, which are not usually subsidiaries, was 12. As we understand there is no obligation to refer to such companies this figure may be understated.

4. Confirmation of results

The results have been cross checked

- (a) by making a spot check of the first 100 companies in the Industrial and Commercial Section of the 1956 Year Book. Though in theory this might show bias, the results showed almost exactly the same ratio of total subsidiaries to total companies sampled (3.27 as compared to 3.25 above), but the ratio of wholly owned subsidiaries to other subsidiaries was 146:100 as compared to 97:100 above. We would not be surprised if this were not in fact more accurate (whether a subsidiary is shown as wholly owned or not depends on what information is supplied by the company concerned).
- (b) The sample was used also to calculate the number of companies listed in the Commercial and Industrial Section (between 3,600 and 3,700). The Index (as adjusted for volume II only) contains about 14,000 to 15,000 references. This corresponds to approximately 3 subsidiaries to every company listed.

Both these checks are based on the Year Book and are therefore subject to the defects mentioned above.

Annex "C"

This Annex, which consisted of an index to the submissions contained in the memorandum, has been omitted.

Supplementary Memorandum by Guest, Keen & Nettlefolds, Limited

Issue of Shares by Directors

We should like to comment on a point raised during our oral evidence to the Committee. It will be recalled that on page 8 of our written submissions (in reply to Heading 5 (c) of the Committee's Questionnaire—the exercise of the powers of a company by its directors in issuing shares) we stated that, if it was desired to protect the equity owners of a company by passing legislation prohibiting further issues of shares to persons other than such existing owners, we felt that it was essential that the directors should have the power to make small issues of shares other than to the existing shareholders.

During our oral evidence, the point was raised of differentiating between shares issued for cash and shares issued otherwise than for cash, and we do not feel that we made our position, in respect of this distinction, absolutely clear.

In the first place cash can be obtained almost as easily by an exchange of shares as by making an issue strictly for cash. If Company "A" has large liquid resources (or even fixed assets which can be converted to money, as by the selling and leasing back of premises) Company "B" can obtain cash without going to its own shareholders by acquiring Company "A" by means of a share exchange. As the proportion of liquid resources to total assets varies from company to company, and as each company must find it essential to have a certain amount of cash, we do not see any practical means of closing this loophole, and we feel that any requirement that issues for cash must be made to existing shareholders could be circumvented.

Secondly, if any restriction is to be placed on issues purely for cash, we do not see why a company should be prohibited in all cases for going to persons other than existing shareholders. No doubt it is prejudicial to the existing shareholders if large issues were made for cash to a substantial outside interest but we do not see why a company should be prevented from approaching a few people provided that the issue is so small as not to alter fundamentally the existing voting position, that the issue is made *bona fide* in the best interests of the company, and that the issue is made at or near the market price.

We should like to point out that the provisions of Section 52 (relating to the supporting contracts to be filed with the return of allotments of shares otherwise than for cash) are not effective to disclose to anyone inspecting the register exactly how much cash, if any, has been acquired when shares have been issued otherwise than for cash, and we feel that Form 52 (which must be filed when no written contract has been entered into) is out of date and could profitably be revised.

We feel that any legislation might well be ineffective unless drawn with exceptional care with regard to present economic circumstances.

Limitation Periods

In our written evidence we suggested that there should be a statutory period of limitation after which the various documents relating to title of shares and debentures in a company could be destroyed. We went on to speak of transfer forms and sheets from the Register of Members, but as title can be derived from allotment as well as transfer, and as documents relating to dividends are also retained, any legislation should deal with at least the following categories of documents in respect of both shares and debentures:

- (i) Transfer forms;
- (ii) Registers of Members and Debenture holders, or where these Registers are kept in a loose-leaf form, such sheets as relate to persons who have ceased to be members for the proposed statutory period;
- (iii) Allotment lists;
- (iv) Allotment letters;
- (v) Dividend lists and paid dividend warrants.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
THIRD DAY

Friday, 7th October, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D. (*Questions 846 to 978*)

MRS. M. NAYLOR

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

PROFESSOR W. T. BAXTER and MR. H. C. EDEY called and examined

722. *Chairman:* For the purpose of the record, you, Professor Baxter, are Professor in Accounting at the University of London, are you not?—Yes.

723. And you, Mr. Edey, are Reader in Accounting at the same university?—That is right.

Chairman: We are very much obliged to you both for the interesting memoranda which you have contributed, and for coming to help us here today. The matters with which you are concerned bear largely on accounts, and I therefore propose to ask Mr. Lawson to open the discussion.

724. *Mr. Lawson:* Mr. Edey, would it be a fair summary of your very interesting paper to say that your main suggestions are: (i) increased flexibility in the use of accounting conventions, (ii) increased information to shareholders, (iii) the provision of that information partly in the annual accounts and partly in a statement of accounting procedures to be filed annually with the Registrar?—*Mr. Edey:* Yes, I think that is a fair summary, Mr. Lawson.

725. Professor Baxter, you, I think, also advocate a greater flexibility and more

disclosure in line with Mr. Edey, but your suggestions vary in detail. Have you any views about Mr. Edey's proposal for filing a statement of accounting procedures?

—*Professor Baxter:* It is a very interesting idea. On the one hand one should, I think, regard the underlying principles as of immense importance and something the public should know about; on the other hand, I am a little disturbed at the idea of having the accounts in the shareholders' hands, and then a sort of form book hidden somewhere else without which you cannot understand the accounts, even though you are told you must go and look at the "form book". I would like to see whether one could put enough information in the accounts themselves to obviate the need for this book of principles somewhere else. If you cannot put enough information in the accounts without making them very cumbersome, then I certainly think the book of principles with the Registrar is necessary.

726. Thank you. Perhaps we could come back to that point a little later on, because in the process of discussion we may be able to throw some light on the question as to whether it is necessary or

not. I would like now to start if I may by asking you something about the purpose of annual accounts. You are no doubt familiar with the definition of the function of a balance sheet which was quoted in paragraph 98 of the Cohen Committee's Report as follows:

"The function of a balance sheet may be stated briefly to be an endeavour to show the share capital, reserves (distinguishing those which are available for distribution as dividends from those not regarded as so available) and liabilities of a company at the date as at which it is prepared, and the manner in which the total moneys representing them are distributed over the several types of assets. A balance sheet is thus an historical document and does not as a general rule purport to show the net worth of an undertaking at any particular date or the present realisable value of such items as goodwill, land, buildings, plant and machinery, nor, except in cases where the realisable value is less than cost, does it normally show the realisable value of stock in trade."

What changes, if any, do you think are needed in that definition?—*Mr. Edey*: I have of course been familiar with this definition for some years. My view is that the definition is applied to one particular aspect of the balance sheet. It seems to me that it is concerned really with the accounting aspect in its narrow sense; in other words, it is dealing with the balance sheet as a very important proving device—a device which is the culmination of all your accounting for the year, and which is very essential to prove out your figures and make sure you have not forgotten anything. But my own view is that this neglects the point of view of the balance sheet as representing something to help the shareholders. I would have thought the main things one wanted from a balance sheet, or from the documents associated with a balance sheet—because I would not insist that this information should necessarily all come purely in the form of a balance sheet—were as follows.

I should have thought first of all you wanted to know the liquidity situation of the company, if you were a shareholder or a prospective shareholder; you would

want to know the possibilities of the company running short of finance in the near future. This is given I think to quite a considerable extent already by the existing balance sheet, you get this from the current assets and current liabilities. You are helped by the note at the foot of the balance sheet which tells you what capital commitments the Board have undertaken—although as I have said in my memorandum, that note is restricted to commitments which have been made contractually and excludes commitments which the directors intend to undertake: so I think the liquidity position is not fully disclosed.

Secondly—and this is still part of the liquidity situation—I think one wants to see from the balance sheet what potential liquidity might be available if full use was made of the mortgaging capacity of the assets. You might have extensive fixed assets capable of being mortgaged and not yet mortgaged, or on which there was no charge of any kind, and for this purpose one wants to look at the fixed asset part of the balance sheet: one would want to find out what capacity there was for raising further money.

Thirdly, I think the balance sheet, or documents relating to the balance sheet, can give the shareholder quite important information about the possible profitability in the future—if a company has been going in for extensive capital investment this may not have matured yet, and by looking at the fixed asset part of the balance sheet one can see that there have been investments made which one hopes will be profitable in the future. This too, I think is given by the present form of balance sheet to a certain extent.

Then I think one wants to have a look at the claims on the profits which will be available or on any distributions other than profits which are made, for example in the form of a partial return of capital or liquidation, and for this one looks to the shareholders' claims section and to the liabilities side of the balance sheet. I think on the whole the present form of the balance sheet does give you a fair idea of the relative claims of the different people interested in distributed profits and distributed assets other than profits, although I think it is possible that perhaps a little more information might be given

about the precise rights of, for example, preference shareholders.

Finally, I think the balance sheet, or documents attached to the balance sheet, ought to provide to shareholders as much opportunity as possible of calculating whether the return on the resources which are in the hands of the directors is justifying the retention of those resources in the company, or justifying their use as they are being used at present. Of course this cannot be done from the balance sheet alone; one has to look at the profit and loss account as well, but I would like to see from the balance sheet as much information as possible as will help me to gauge the value of the resources tied up in the company, because these are what the directors have in their hands and what they should be using to the best economic advantage. This I think is one of the main points towards which my memorandum is directed, that at present the balance sheet does not give that information to a sufficient extent. The definition of a balance sheet which you have quoted seems to me to ignore this latter aspect altogether.

I am afraid that is rather a long reply, but I have tried to summarise what I have said in my memorandum.

727. If I may say so, I think it is an extremely interesting reply, and I think it is very helpful to us to have it. Have you anything you would like to add to that reply, Professor Baxter?—*Professor Baxter*: Just this, that the definition given is absolutely true as an explanation of a book-keeping technique, but I think it would be a great pity if one took refuge behind that, and said that what the outside person wanted must therefore take the form of this internal control document. I think something different is necessary for the outsider, partly because the outsider does not appreciate the technical point, and partly because if he is sophisticated then it does not give him the information he wants. He wants the sort of thing Mr. Edey has spoken about. In a nutshell, one could say that the balance sheet should convey the information which will prevent things like take-over bids coming as a surprise. I am not arguing against take-over bids, but I am arguing against ones that come unexpectedly because of lack of information.

728. Thank you. I think I should perhaps just put this to you: it really is not quite correct, is it, to say that the present form of accounts has only, or at any rate even primarily, this book-keeping function? Would it not be right to say that the primary function of the annual accounts is intended to be an account of stewardship by the directors to their shareholders; and the view of those who supported the definition in the Cohen Report was that that was the best method of giving an account of stewardship. Would you like to comment on that? I think it is quite important.—*Mr. Edey*: I think this definition does overlook one very important aspect of stewardship. I think the definition in the Cohen Report emphasises the aspect of stewardship which one associates with trust accounts, namely, that you have received money and that you have accounted for it in such and such a way within the terms of the trust deed, and in the case of a company the auditors are there to see that, so to speak, the trust deed has not been violated. It seems to me that stewardship is really a broader thing than that. It is not enough for the directors to bury their talents in the ground. You are, if you are a shareholder, interested in the use which is being made of the funds, and for that purpose the important thing is the current value of the funds, the way in which these funds could be used if they were turned to alternative uses, either by distribution to the shareholders or by some alternative employment inside the company: this aspect of stewardship seems to me the one which the conventional form of balance sheet does not at present fully deal with, although I must admit it does go some way towards dealing with it.

729. I quite see that. In order to get the position quite clear, do you think that it is advisable to give an account of stewardship in the form outlined in this definition, even if one were to give in addition the wider form of accounting for stewardship which you have in mind; or do you think your wider form can wholly take the place of the present form?—I think much of the additional information, which I am suggesting should be provided, could very well be provided by way of note, without interfering with the existing double entry process at all.

Professor Baxter: If you have the elaborate statement of what has happened to fixed assets (their sales and purchases during the year and so on) the same document could I believe serve both purposes.

730. I wanted just to get that clear, because I was not absolutely clear on reading the papers of either of you as to what it was you had in mind, but I think that makes it clear, that you feel this other type of statement could be combined with the more conventional form of balance sheet?—*Mr. Edey:* Yes, but with one qualification, that if one did require companies to produce a lot of conventional information which did not happen to fit in with what it was thought was useful for shareholders, this might be imposing additional accounting costs because the companies would be required to account in two ways. I have not perhaps pursued this thought sufficiently deeply, but I have in mind the question of stock valuation. As you know, at present many companies use standard costs for stock valuation, which means that their stocks will be valued roughly at current cost in their management accounts, but if this standard cost should be substantially different from the original cost of the stock I think it would be thought by most auditors necessary, at present, that the original cost should also be recorded, and should be not only recorded but should be extracted and put into the balance sheet. And I should have thought that in some cases this put an unnecessary amount of work on the company and did not give information of great value to the shareholders.

731. I see your point. That really leads into your suggestion of greater flexibility, does it not, in a sense?—I think so, yes.

732. I think we can now move from that and ask you about the profit and loss account. You both refer to the difficulty resulting from the changes in the value of money. Professor Baxter, you suggest that it should be optional for the profit and loss account to show either the "money" profit or what might be termed the "real" profit. You do not think either should be compulsory. Mr. Edey, do you support that view, or have you a different view on that?—No, I do not

think it should be made compulsory, I think this should be left to the directors.

733. Would you agree that there are many different ways of arriving at the "real" profit and that there is considerable difference of opinion amongst experts on this difficult subject as to how the calculation should be made? For example, differing views are held as to (a) the appropriate price index to be used, (b) the method of treating loan capital, and (c) the extent to which allowance should be made for technical improvements which offset the effect of general price increases. Would that be correct?—Yes indeed, there are of course many differing ways of doing this and there is no single consensus of opinion.

Professor Baxter: It is precisely because we cannot feel at all sure what the truth is that we feel there should be room for experiment, room for discussion still, and that no new norm should be prescribed rigidly.

734. Yes. If some companies show money profits and others show the "real" profit calculated by one or other of the many different methods which are in use for making that calculation, would not this make it difficult to compare the results of one company with those of another? For example, in the case of prospectuses, if there was this degree of flexibility which you are advocating, would there not be danger of some confusion amongst the public, especially in these days when many shareholders may not be sophisticated about these technical matters?—There is an implication in your question that on the one hand you have a group of new figures from some companies which show real profits, and then on the other you have a large group of companies showing conventional figures, which though not ideal are nevertheless mutually consistent. But, in this large group, some companies' profits may be based on depreciation of plant bought in 1939, and others on depreciation of plant bought in 1960; their figures are inconsistent. What one hopes is that increasingly companies will switch over to the reformed group. I do not think you could say it would be moving away from consistency to inconsistency. It is just unfortunately inherent in the facts

now that the figures of two different companies, prepared by conventional methods, might not be consistent; and I think all one can do in prospectuses and so forth is to point out clearly what particular basis has been used in each case.

735. Perhaps Mr. Edey would like to comment, before I move from that?—*Mr. Edey*: I agree with Professor Baxter fully on this. I do not think we really have consistency now, and in a certain sense if you do make your money value adjustments you may be approaching nearer to consistency, in that your assets will be valued more approximately at the same date. My main point though would be that this is a case for information, and if I may make the point, in a sense the whole philosophy of my submission is that information and enlightened opinion is the most satisfactory way of dealing with this problem. I feel if you do give full information, or as much information as is reasonably possible, about how you have made your calculations, this will give greater enlightenment to people who are investing. I do take your point that there are many people investing who will not understand what you are doing, and my answer to that can be divided into two branches. The first branch is that if you give them the present figures, even though they may think they understand them, they may not really understand them because of this price level problem, for example; so by giving an apparent consistency—by not making adjustments for changes in price levels—you may be leading these investors, in a sense, to deceive themselves. Secondly, and I think this is a very important point, I do feel that business is after all a very complicated thing, and I think the investing public must rely upon investment analysts, upon informed criticism in the financial press, upon the advice of their professional experts, and I think that one of the main aims of the legislation should be to put these professional experts and the press in the position of being able to comment in an informed way. I think it is true that there is increasing interest in investment, and that this is being matched by an increased reading of informed analysis in the press.

736. Thank you. I do not want at this stage to get into a discussion about price

adjustments, I would like to come to that a little later. There is another wider principle, which Professor Baxter mentioned when he said that accounts are not uniform or consistent today. This is true up to a point of course, but they were even less consistent before the 1948 Companies Act, and it is clearly a matter which this Committee will have to consider in due course, as to whether the aim of the Companies Act should be to bring about a greater degree of uniformity as far as that is practicable; whether to maintain the same degree of uniformity as there is now, or whether to create greater flexibility. I am not quite sure, Professor Baxter, what your view is on that. Are you in favour of flexibility for its own sake, that is to say, allow companies within reason to do anything they like as long as they say what they have done? Do you think there is no advantage in uniformity? I am not quite sure how far you go.—*Professor Baxter*: I think perhaps there are two points I should stress: firstly, as far as this inflation aspect goes I would hope that the new Act would show a very clear bias in favour of companies allowing for inflation in their accounts. I would suggest perhaps the approach should be something like it is for depreciation nowadays: you are not obliged to charge depreciation, but if you do not then you must explain why you do not. I would prefer that sort of approach to inflation, so that there would be a strong pull towards uniformity on the lines that I like—one always brings in a certain personal bias, I am afraid. Then with regard to principles in general, I think one is entitled to say that there is some consensus of opinion amongst accountants and business people about how accounts should be drawn up, and that if nothing is said to the contrary we should be entitled to assume that accountants have followed this normal method of doing things. Certainly that is an advantage, and it is unfortunate if people are eccentric just for the sake of being eccentric; but on the other hand if you do not allow people to experiment then your systems get ossified in time.

737. But it is a question of how far you go, is it not?—Yes.

738. I think we will leave that, if we may. The way in which distributable

profits are arrived at does of course have an effect upon the rights of different classes of shareholders. To test the view which you have been expressing about real profits, would you permit a company which has an issue of preference shares to prepare its accounts on the basis of "real" profits—in particular taking into account this item of "real" depreciation we have been talking about—if that meant the passing of the preference dividend, which could have been paid if the accounts had been prepared on the basis of "money" profits?—The academic answer is quite clear, I think this sort of thing should have been foreseen. It should be dealt with in the prospectus, and there should be a clear contract either one way or another—stating that preference shareholders were entitled to come in on the one basis or the other. There is no doubt at all, I think, that it would be desirable in future that this matter should be cleared up. But we all know that in practice there are many companies which have issued preference shares and have not dealt specifically with this point. I must confess I find this a completely baffling problem, and I think I would rather look for guidance to the lawyers present.

739. I do not know what the lawyers will say, but it might be quite a task to define profits precisely for this purpose—there are so many different ways of arriving at real profits. I will not pursue it further now.—*Mr. Edey*: At the moment the directors have the right to pass preference dividends even if there are profits in the conventional sense in the accounts; for I should have thought almost all articles of association allowed directors to put to reserve what they thought appropriate before paying dividends. Secondly, I would not have thought this was a very serious practical problem in view of the fact that the vast majority of preference shares are cumulative—even in liquidation—for dividends, so that at the worst the preference shareholder's return is being deferred, but benefit is not being given to the ordinary shareholder instead. But I do see that there is a point of great uncertainty here, and I would like to throw out the suggestion (which is not perhaps a very good one—it is not in my memorandum) that if this were felt to be a difficulty it

would be possible, for example, to put either into the legislation or into preference share contracts that for the purposes of considering whether profit was available for dividend for preference shares the income tax assessment should be regarded as the appropriate criterion.

740. That is another suggestion. You see, the difficulty we are in is that there are really today three broad types of profit: there is the income tax profit which you have just referred to, which is based on statute and on case law; there is the accountant's idea of profits, based on the present Companies Act and the profession's recommendations; and thirdly there is economic profit, or what we might term real profit. They are three different profits in a sense, and how they fit in together, or whether one should rely on a combination of them, is quite a problem.—Of course, it is the case now, is it not, that if the directors thought they should depreciate on replacement level they can put into reserve the additional amounts and say to the preference shareholders: "We are very sorry, we do not think there is a dividend".

741. I would not know about that, but in a highly geared company you could get a situation in which by providing for this additional depreciation you would be unable to pay your preference dividend until you went into liquidation. You could get into that rather absurd position, could you not?—Yes, it is possible, certainly.

742. Coming now to the balance sheet, you both suggest that more information should be given about the value of fixed assets. Professor Baxter, you, I think, would like to see valuations included in the balance sheet itself, whereas Mr. Edey considers that it would be sufficient to give the information in a note. Would you agree with Mr. Edey, Professor Baxter?—*Professor Baxter*: Yes. When I say "in the balance sheet", I mean somewhere in the accounts.

743. In referring to the valuation of fixed assets, do you include all fixed assets, including those with a relatively short life—such as machinery—or would you accept the views of some of our other witnesses that for practical purposes it would be sufficient if revaluation were

confined to such assets as buildings and land, and so on?—I think it is a question of degree, in other words that assets should be revalued if the new figure was materially different from the old one; it would depend a great deal on the size of the asset and the speed of inflation. I do not see how one could lay down any rigid rules.

744. We have had quite a lot of evidence on this subject, and the view has been put that as regards relatively short life assets the complexities and difficulties are so great as to make the exercise not worth while, whereas with land and buildings the situation is rather different. I do not know how far you have considered it?—I would not have thought that was true. After all, the shortest lived fixed assets are things such as tools and patterns and so on, which are usually revalued every year as it is, rather like stocks. I suppose that plant usually has a life of about twenty years, and that is long enough to make the depreciation figures significantly different if they are based on historical cost or real cost. The man who was responsible for the depreciation figures of one of the biggest companies in the country has said, I remember, that as an experiment he tried to find the figures of real depreciation and that it took two man-days to get the extra information compared with over a hundred man-days to calculate depreciation in the ordinary way; so it would not involve a great increase of costs, I gather. I think once you get into your stride in this sort of thing you can roll off the extra calculations pretty easily.

745. Mr. Edey, you draw a distinction between assets which are fairly non-specific, such for example as freehold properties in a large town, and other fixed assets which are specific to the particular business. Dealing first with what you term non-specific assets, these would I suppose be found in many commercial enterprises, retail shops and the like, but would be much less common in industrial concerns; is that right?—*Mr. Edey*: I would not have thought that this was necessarily right as a generalisation. I would have thought specific assets were perhaps more common in industrial undertakings, machinery which is specific to a certain purpose for example, but after

all industrial undertakings must own large quantities of buildings of a general purpose type. One can imagine engineering concerns which own very large quantities of general purpose machinery. Really my distinction between specific and non-specific bears particularly on the market. If you have something which is fairly non-specific it is relatively easier to price it. Somebody else is prepared to use it for another purpose, and there is usually a fairly good secondhand market for machinery, a property market for real estate, and so on.

746. If you are thinking in terms of machinery as well as land and buildings, I see your point. In putting my question I had in mind that market valuation would apply to machinery with a long life, the twenty years of which Professor Baxter spoke, and to land and buildings, rather than to machinery which had perhaps five or ten years' life. If of course you include your machinery with five or ten years' life, then you are right, but I should have thought that from the point of view of willing buyer and willing seller, the non-specific value of that type of machinery would probably be less than the specific value, would it not?—I confess I am not an expert, but I would have thought it varied with the type of undertaking, the type of industry.

747. It would, but so much machinery nowadays is specific to the particular business and, after the cost of dismantling, its value would be very small?—It is not only machinery, it is vehicles and things of that kind.

748. Yes, I see. Am I right in thinking that you would like to see these non-specific assets valued at intervals of, say, five years on the basis of a general market value as between a willing buyer and a willing seller? The difficulty is of course that until a property is placed on the market it is extremely difficult for anybody to say what its market value is; also, of course, there may be wide fluctuations in market values within a period of five years. Would you care to comment on this aspect of the problem?—The five years was put in as a compromise. Naturally one would like to see it done every year, but one realises that annual valuations would probably be impractic-

able. Five years of course is recognised in the insurance world as an appropriate period over which to have a valuation. My aim is to try and get at the point which I have made earlier, namely, what use the directors are making of the value which is in their hands, the value represented by the assets on an open market valuation.

749. I think I am clear on that. But it is very difficult to say what is the value between a willing buyer and a willing seller until the assets are offered for sale. —I would agree that it is difficult, but I would also say that I would regard it as one of the duties of the directors from time to time to ask themselves this question, because it seems to me if they do not do so then they are not really fully looking after their shareholders' interests.

750. It is one thing to ask themselves the question, but it is another thing to answer it, is it not?—Yes, but the business has to be carried on, and when they make their business decisions there is a valuation implicit in the decisions.

751. That might often be the case, but the point really is whether they should communicate their view to the shareholders, whether it is a sufficiently reliable and valuable view for the shareholders. —I admit this does raise the question of who should carry out the valuation, and whether the directors are the appropriate people, and of course the nearer you get to the specific end of the spectrum the more clearly it has to be the directors, because it depends on the business itself. Certainly when you are dealing with interests in land I would have thought you could have got valuations which were good enough to put in the balance sheet from outside people. After all, they go into prospectus statements.

752. There is a lot of difficulty on land valuation, is there not? It is very technical.—I do not want to underestimate the difficulties. I do admit there are extreme difficulties here, but I do think this is a very important thing from the point of view of the functioning of the economic system. For example, I think it is true that if the balance sheets of some of the stores which have been subjected to take-over bids had carried even a

rough estimate of the value of the property owned by the company, the shareholders would have been aware of the situation very much earlier. I am indeed aware of the fact that this is an area where you cannot work to very fine tolerances; I am looking for the cases where there are gross discrepancies between what the directors are earning and what the assets are worth. I admit there must be big tolerances in valuations. This is inherent in economic matters.

Professor Baxter: I would hope that any new legislation would not convey the idea that one must try and get an accurate figure, because that would be absurd. There can be a very large margin of error, but one does like to know the approximate order of magnitude.

753. I think you have made that very clear. May we now turn to specific assets. Let us take first the case, the extreme case, of assets which are so specific that they would have virtually no value apart from their use in the business concerned, for example an electric power station or steelworks. Would you agree that in such cases the value of the fixed assets is intimately connected with the profitability of the business? It could follow from that, could it not, that if a fair statement of profits is shown, that is all that is required? What would a valuation in those cases add to the knowledge of the shareholders?—*Mr. Edey:* I think as a general proposition I must agree with what you say, that it is very difficult to assess any value for such assets except in terms of their own earning power. The only alternative value is their break-up or scrap value, which is in most cases likely to be so much lower than their value in present use that it is not significant. Ideally the scrap value is a relevant figure, but I think it would probably be intolerable to impose upon companies an additional requirement of stating the scrap value of their assets. But, as I think you will agree with me, there may be circumstances when it would be right to liquidate and get the scrap value rather than continue.

754. I think you have touched on a very important question. It is generally assumed that it is not the purpose of the balance sheet to show the position which

would prevail in liquidation. I was perhaps rather too readily assuming that you accepted that view.—I think I really was making an academic point, because I think it would be impracticable to ask companies to show the scrap value. What I wanted to say was that in certain circumstances I think this is a relevant figure. Your general proposition I do accept, that with very specific assets the valuation hinges entirely on profitability.

755. Professor Baxter, I had the impression from your paper that you would like to see even very specific assets depreciated on the basis of a price index?—*Professor Baxter*: There is still another value, and that is what one might call the replacement cost, and we suggest that this could be represented by the insurance value: for example, in the case of machinery presumably the directors have thought of some figure which they would regard as adequate compensation if the assets were destroyed by fire, and I think that would give a very useful indication of the general size of the factory or whatever it is.

756. Would that not lead to abuse, because after all you can insure your property for anything you like? I can see certain dangers in that.—I think perhaps there might need to be some safeguard. I think some such phrase as "valuation in good faith" should be introduced into any new statute.

757. You do refer quite a lot in your paper to replacement costs; I wonder if you would like to develop that a little? You do indicate that in certain instances—I am not quite sure which instances you have in mind—that it is a useful thing to write your assets up on the basis of replacement costs, and indeed some companies have done it. Sticking for the moment to the very specific assets, the steelworks and so on, would you favour writing them up on what is broadly called the replacement cost basis?—Yes, I think so, because that seems to me the logical heir to the old accounting idea of showing things at historical cost. As long as the price level was stable, the historical cost (less some allowance for depreciation) did give us a vague idea of the size of the concern. When prices are going up all the time, the statistical equivalent of historical cost, it seems to

me, is historical cost written up by some index which shows the current cost of replacement; and I think for that reason there is a certain logical justification for putting in such a figure. There is the further reason of course that it is an extremely easy one to arrive at from the standpoint of the statistician.

758. You say it is easy to work out but you have a number of problems, do you not? For example, the problem of the appropriate price index; I think possibly the greatest difficulty is whether allowance should be made for technical improvements which affect the type of plant which is ultimately going to replace that which is now in existence, and also for improvements in the layout of buildings and so on which may effect economies. But I suppose you would say that it should be a purely arithmetical calculation and that no allowances of this kind should be made?—I think it must be purely an arithmetical calculation. One can justify this again by considering what is done when one is working on original cost basis. One does not allow when you value your fixed assets on that basis for the fact that they could possibly be replaced now by cheaper or better ones.

759. In view of that answer, I would like to put to you a paragraph which I take from the report which has just been published of the Central Electricity Generating Board for 1959-60, where, referring to technical improvements, they say:

"As a result of these and other improvements, conventional stations are being built today at an average cost in the region of £50 per kilowatt of installed capacity, which, despite substantial rises in costs of materials and labour, is no greater than the corresponding figure in 1948. Still lower average costs are estimated for stations now being planned, of the order of £40-45 per kilowatt."

If you provide in an Act of Parliament that something should be done on the basis of an index alone, what are you going to do about that type of case, which is quite common? This is perhaps an extreme example of it.—May I say I have not suggested that in an Act of Parliament you should force people to follow any particular method. All I say

is that there should be a bias in favour of trying to improve on historical cost.

760. What should you do if the price of construction falls? If you can visualise a situation of stable currency the price of construction would usually be downwards. Do you think in those cases the balance sheet should show lower figures?—Yes, I would be prepared to be consistent even when that would perhaps be rather distasteful to the company concerned.

Mr. Edey: When it comes to the balance sheet valuation of assets I think in the last analysis one is really getting at the value one would have to invest to get what the company is producing with the latest methods, with new assets, as you say. I do not think you can ask a company in an Act of Parliament, or probably in any other way, to calculate for its shareholders the value which would have to be invested in order to produce its present output under existing conditions. So I would suggest that the original cost of the assets might be given subject to a note of their current value based on replacement cost, of which the insurance value might be taken as a reasonable index provided there is good faith. The object is not to get a figure which in the last analysis is significant in itself, but to get the best approximation available of how much you would have to invest now to produce what you are producing. In other words, if technique did remain constant then by applying either a price index or by just reporting the insurance value, which after all the directors must have arrived at by some similar process, you do, so to speak, give an original cost value in terms of current prices, and this does give you some information. It does not, I would agree, give you all the relevant economic information. I do not think it is possible to do that. I think this is just a *pis aller*, to give something extra which is of significance. And (although this is not directly relevant for company law) this is of very great importance in pricing. If you were selling your produce in a foreign market (and if there had not been substantial technical improvements) you might be losing the country large sums of foreign exchange if you were not calculating your costs in terms of current price levels. I agree these accounts are not of course being presented for this purpose, for calculating prices and so on, but I

think the argument is similar. I think the shareholders should be given some idea of what it would cost to build the assets they have got if they were being built now.

761. But you do agree with Professor Baxter that the figure you should take is what it would have cost to erect those assets if you had built them now, and not the cost of what it would be to provide an equivalent amount of productive capacity having regard to technical improvements?—That is easy to answer, because I would like to see the second, but I do not think it is practicable, and I think therefore you take the first as a *pis aller*. For example, in the case of the railways, if you would substitute a diesel engine for a steam engine you cannot just put the value of the diesel engine in the balance sheet, because there is also the fact that it can carry more traffic. So I do not think it is practicable to make the calculation.

762. But I gather from what you said earlier that you would qualify that statement if in fact the circumstances were as they were stated in the Report of the Central Electricity Generating Board?—I think the only thing one can ask for is that it should be made very clear how the figure has been calculated, and the implications of it.

763. I think I see that. We have had quite an amount of evidence which suggests to us that it is important for shareholders and their advisers to be able to calculate the ratio of profit earned to capital employed. You have made the same point. The difficulty is this, is it not, that if businesses use different methods of arriving at the value of capital employed and different methods of arriving at the profit, it really will not be possible for shareholders to compare one business with another, and therefore if you say that this particular business has earned 10 per cent. on its capital employed, and another has earned 15 per cent., it does not necessarily show that the second business has done better than the first, it may be exactly the opposite.—*Professor Baxter:* I think that type of ratio is so suspect anyway that any further suspicion would not do any harm. After all, such a ratio now measures present return as a percentage of odd sums of capital perhaps put in at all sorts of different dates, from

the nineteenth century onwards; the value of such a ratio may well be negligible.

Mr. Edey: I would say first that, from the point of view of the efficiency of a company from year to year, perhaps it is the increase of profit in relation to the increase of capital value which is of particular significance, and these are much more easily got than the absolute level of the capital. But nevertheless in certain circumstances one would be interested in calculating a ratio of the kind to which you have referred, even though one knew it was not going to be a very accurate calculation. After all, it seems to me that the take-over bid question does require this kind of investigation. And I would not really agree that our suggestions would tend to make it more difficult to calculate this ratio. I may be wrong, but my aim in making the suggestions is to provide more information so that informed people can make these calculations, bearing in mind of course the nature of the company—because you cannot interpret any figures without taking into account facts outside the balance sheet, such as the conditions of trade, and so on. And I would have thought, although this kind of calculation was a difficult one, the kind of information we have asked for would in fact make it easier to carry out than is at present the case. You would get a better result. But I would be the first to agree that no such calculation can be absolutely right in any sense of the word, that again it is the gross discrepancies one is looking for rather than fine measures. If for example one found that one company was returning 100 per cent. on capital invested, against another one returning 2 per cent., I think perhaps one would then have something significant, but if the difference was one say between 40 per cent. and 45 per cent. I would suspect that this was not very significant.

764. We have had suggestions that the company should give more information about the age of their assets—that is to say the capital expenditure, year by year or in groups of years. I suppose if that type of information were given by all companies the investment analysts who wanted to make the type of calculation which Professor Baxter has in mind could do so?—*Professor Baxter:* Yes, that would be an enormous help. But it would

mean that a very clumsy sort of statement would be produced, and I think the company ought to provide that in nutshell form, which is what you get when you give the real profits.

Mr. Edey: Of course, shipping companies have sometimes provided such information about their ships which has enabled one in many cases to make this kind of rough calculation.

765. On another matter, Mr. Edey, you suggest a new form of auditors' report in which you refer to "a fair view of the company's affairs in the light of generally accepted accounting principles". What kind of accounting principles have you in mind?—I must admit I am not very happy with the word "principles". I think perhaps "accounting rules" would be a better term.

766. Later on you do refer to accounting procedures, and you also refer to accounting principles. Perhaps you would like to say how you distinguish between the two?—I think what I had in mind, in distinguishing between the two, was that there are certain fairly wide rules available which are followed by most accountants, and I think one could say that these are broadly speaking the rules embodied in the recommendations of the Council of the Institute of Chartered Accountants. They are not a single set of rules, because as you know stock valuation can be done in many different ways, nevertheless there are several sets of such rules or principles, and I think it was this which I had in mind in talking of principles. Whereas in talking of procedures I had in mind that when one was working within a given principle or rule one might very well like to have more information about just how it was being applied. So if it was really a matter of greater detail—for example, one might be told that depreciation was being calculated on a straight line method, which is one of the possible rules or principles which are included in the Chartered Accountants' list: then one would like in relation to a particular company to know the number of years' life which was being assumed for a particular group of assets. This is the type of thing which I thought might be available in the statement of procedures followed by the company.

767. I think that is clear. May we now look for a moment at accounting principles, because I think I am right in saying the American form of auditors' certificate does refer to the consistent use of recognised accounting principles?—I think there is something on those lines, yes.

768. It is a question, is it not, as to what are these basic accounting principles? Could I just put to you one or two to see whether you agree or not? I think at the beginning I put to you, in respect of the balance sheet, what you might call the historic cost principle, that is the principle of accounting on the basis of historical cost and not of valuation. You would not really wholly accept that principle, would you?—No, I do not think I was using "principle" in quite that sense; I was using it in the sense of a rule of valuation to be applied to a particular type of asset.

769. That I would call procedure—Perhaps procedure would have been a better term, then one can talk of procedure stated in more general terms and procedure stated in more detailed terms.

Professor Baxter: I think what we are trying to get at is more a statistical concept than one of right and wrong. We are entitled to assume I think that an overwhelming majority of accountants normally employ certain principles or procedures, not necessarily because they are right; and one would therefore in a particular case, unless something to the contrary were said, assume that the accounts had been drafted as so many other examples are; and if they had not, then one's attention should be drawn to the discrepancy.

770. I see that, but I would like to put to you a few of what might be regarded as the basic principles, because of course if there is agreement about the basic principles then the question arises as to how much flexibility should be permitted within those principles. But there is difference of opinion no doubt as to what the basic principles should be. You probably agree that one of the basic principles at present is that the balance sheet should be in terms of historical cost, it is an account of stewardship relating to the money which has been received and expended, and so on. That is a basic principle with which you do not wholly agree, and I think you have explained why

you do not wholly agree. Another basic principle, with which again I do not think you agree, is that you should account in terms of money. There are, as I have said earlier, three different types of profit: there is income tax profit, there is the money profit, and there is the real profit. You may say there should be complete flexibility, and any one of those three should be allowed to be used in the annual accounts published under the Companies Act. Up to now I think the feeling of accountants has been that the basic principle should be that profits should be computed in money terms, because of the great difficulties which arise when you depart from money and account in terms of purchasing power units or in terms of the value of the particular goods you are making. I think you really do not accept that basic principle, do you? You do not think it should be the purpose of the accounts to show the money position?—Agreed.

771. The third main accounting principle I think would be this, that you should not take account of profits until they are realised. I do not think you quite agree with that either, because you favour the idea of incorporating the results of a revaluation of assets in a balance sheet, even though the values have not been realised. Am I right about that?—I think one must distinguish between a gain which is so sure and so liquid that it is available for dividends, and one which is not; in other words, I would say that appreciation—perhaps that is what I should call the unrealised gain—ought to be shown, but preferably in a form that does not suggest to the shareholder that there is a corresponding dividend coming to him.

772. You would agree with the principle to this extent, that you would not think it right to distribute as dividend surpluses arising from revaluation of assets?—Certainly not surplus due to inflation.

773. Would you think it right that that surplus should be used for issue of bonus shares?—I think that would be very sensible.

774. But you would not go as far as to say it should be paid as dividend?—That would be wholly inconsistent with the general conceptions of company law.

Mr. Edey: I think the point there would be that this really takes us into a separate field as to what should be the power of directors in distributing the assets of a company.

775. I think we should perhaps leave that particular point, which is a wider one altogether. We have had quite a bit of evidence about what should be done with these surpluses which arise, and it has been suggested to us from some witnesses that those surpluses should be available for dividend.—I would not like to be quite so definite, I think it depends on so many factors, but I would subscribe to the view that if they were distributed, and the law permitted it, it should be made very clear what the source of the distribution was, because this is a fundamental question from the shareholders' point of view. After all, gold mining companies do distribute in effect part of their capital in each dividend, because they do not provide for depreciation, and when the life of the mine is over the shareholder hopes he has had his capital back. I would have said that from the point of view of the investor, the question is, does he really fully and completely recognise what is happening.

776. I think you have gone a long way towards agreeing with the accounting principle that you should not take account of unrealised gains. You qualify it by saying it is quite reasonable to incorporate those unrealised gains in the capital, and there may be exceptional cases where they should be distributed and so on.—I think the rationale is that where the profit is not realised, the evidence for the value is much worse than when it is realised. It is a matter of evidence. When you have a thing in cash or a debt there is good evidence that it is worth the stated value, but when it is simply said that it is worth a certain amount that is just a personal opinion. So I would agree with that.

777. The fourth principle would I suppose be this, would it not, that you regard the life of the business as being indefinite and permanent, the purpose of that being of course that you provide for your depreciation or amortisation of assets in accordance with the life of the asset and without regard to the life of the business. There are exceptions to that, of

course—mining companies, and so on—but broadly that, I think, would be the accounting principle, would it not?—*Professor Baxter:* Yes.

778. I thought I would just put to you those four basic principles, because they are important to our discussion. What troubles me a little about your suggestion, Mr. Edey, is this: would it really be any help to shareholders to be told that generally accepted accounting principles had been used, assuming we could agree what generally accepted accounting principles were? If we could agree, would it be any help to tell them they had been used, unless there were a record somewhere, a statement clearly on record as to what those accounting principles were?—

Mr. Edey: I agree. In a certain sense the situation at present is that accounts are prepared on the basis of rules which are fairly generally accepted, but which vary. Shareholders have not got access to any particular source of information, unless of course they buy the publication of the Institute of Chartered Accountants. And I have wondered, since writing the memorandum, whether it would not be appropriate to have so to speak a standard set of rules (or perhaps it would be better to talk of some standard sets of rules, since there are variations, for example, in stock valuation methods) not in the sense of standards which were approved as being the right ones—the only ones which could be used—but in the sense of standards which were most commonly used, which were the ordinarily accepted standards; and that perhaps there might be something to be said for such standards being incorporated in a statutory instrument, or something of that kind, as a result of a recommendation of a committee. I have not thought about this very deeply, but I do agree fully with your general point that it would be of considerable advantage to shareholders to have easily available sets of rules which could be referred to in an auditors' report, and there would clearly have to be more than one set.

779. I think my point was really rather the narrower one, that it would not help shareholders very much if we merely adopted your suggestion of putting these words into the audited report unless at the same time there was some method of recording what those principles were. You

agree with that, do you not? The problem, of which you are well aware, has arisen in America where they do use these forms of words and it is causing them some anxiety.—I would agree with that and adopt your earlier suggestion of not using the word "principles" and speaking about "procedures".

780. It would be one of many different procedures?—Yes.

781. Consider the question of depreciation and leave aside the question of replacement or historical costs. Within the broad principle that depreciation should be provided over the life of the asset and not over the life of the business, there is the straight-line method and the reducing balance method of calculating depreciation. Your thought is that people should apply one or other of those anyway and not some arbitrary method of their own choosing?—I was not quite saying that. I would say that if they wanted to go outside that range they must make it clear beyond a peradventure that they had done so.

782. Some witnesses have gone further than that and said that companies should state which of those methods they had employed, and indeed should disclose the rates of depreciation of the principal assets.—I would accept that, that would be my view too, certainly, as to which methods have been used and if possible the rates; certainly if that is practicable I would agree with that.

783. Now may we turn to the subject of disclosure. You, Mr. Edey, say in your memorandum that if disclosure of any of this information incidentally assisted the competitors of a company, this would be a very good thing and in the public interest. But, presumably, in that case the disclosure might be against the interests of the company's present shareholders? Suppose, for example, that the shareholders of a company decided that disclosure of turnover and cost figures would assist actual or potential competitors and would, therefore, be against their interests. In your view the law should insist nevertheless on publication? In whose interest?—In the public interest.

784. You think in certain matters the public interest should override that of

the present shareholders?—Indeed. It is one of the features of our free market system that changes must take place in the system and some of these changes will be adverse to particular groups of people, particular bodies, and this is part of the price we pay for the system, so I would say this is an overriding consideration.

Professor Baxter: The shareholder is getting the great privilege of limited liability, and it is not unreasonable to ask him in return to give up a certain amount of feather-bedding.

785. I can see your point. I just wanted to get it clear. You are both strongly of the opinion that much more information ought to be made available in company accounts. Mr. Edey, you say that "the aim of company law should be to place shareholders as closely as is reasonably possible in the position of directors in the provision of information". You do not think that would be going rather far and make it difficult for the management if all this type of information was available to competitors?—*Mr. Edey:* That is why I put the word "reasonably" in. What I meant was that the nature of the information which is important for the shareholders to have is the same as that which management have. After all, in the last analysis the shareholders in some circumstances are the managers. You have owner-controlled companies where the shareholders and managers are the same. But I do agree that in the public company and, indeed, in any company, it would not be practicable to give the shareholders, as shareholders, all the information which the management would have. I think I would distinguish broadly between the plans of management for the future and what has happened in the past. I think, on the whole, I would be prepared to disclose most of what has happened in the past. There may be some things which one would not want to give away, the company's secret processes and so on, and if you gave the shareholders the budgets on which the management were planning this would put the management in an impossible situation—although, of course, this is just what the shareholder would like to have as an investor. I cannot, I am afraid, give a principle for distinguishing here. I think it is a matter

of good sense and going as far as one reasonably can without damaging the management's method of procedure.

786. I think I understand your view. I would now like to turn to a rather different aspect. The Cohen Committee noted—and I do not think matters have changed very much in this respect—that the average investor was not closely interested in the companies in which he invested. Have you any evidence that investors generally are anxious to have more information about companies or is it your case that the professional investment analyst and financial journalist generally lacks information which is essential to their task of advising the public?—It would be my view that it is the informed shareholder, the investment management of the financial institution and the financial commentator who need this information. I think the ordinary shareholder would like to have it, not as raw material, but after processing through the financial press.

787. Is that your view too?—*Professor Baxter*: Certainly. An investor does rely on, for example, stockbrokers' circulars to draw his attention to anything that is going wrong.

788. Professor Baxter, you suggest that the particular trading figures should be given showing the main revenue items and the main costs. Am I right in thinking that what you have in mind as regards expenditure—I think I am quite clear what you have in mind about revenue—is that figures should be given of wages, materials consumed, overhead expenses, that kind of thing, is that what you have in mind?—Yes.

789. You know, of course that many businesses, particularly large businesses, do not usually provide those kind of figures for their directors. They usually provide departmental results—results of different divisions of the business—and with modern accounting systems, the accounts show comparison of performance against standards rather than actual figures, and you end up with the profit and loss account which shows a statement of "variances". Do you think that figures of wages, materials consumed, and so on should be prepared specially for the shareholders if they are not in fact provided

for the management?—Yes. I am afraid this would be a slight extra cost.

790. What value do you think they would be to shareholders? Could you amplify your views on that?—It is easy to belittle the importance of any given figure, say that for wages. But if there were some dramatic change in it, then the analyst would start to ask what was happening and it might be that something of considerable interest to the shareholder would emerge. I feel no given set of figures can meet all the needs and be free from criticism, but I think that what I have in mind is probably the best compromise available. In support of this view I would appeal to American practice where these figures are considered by, I suppose, the world's most critical group of analysts as being useful and something they would not go without. One small point on your suggestion about the "statement of variances" form of revenue account. Would it not be true to say that the revenue account of a really big company is a consolidation of the accounts of all sorts of departments, and that the "variance" form of presentation must have already disappeared from the consolidated accounts that are put before the directors? You cannot just add together a lot of "standard cost" reports and get anything sensible. So in the case of the really big company the directors already receive cost figures of a kind suitable for shareholders.

791. I think you may have and I would not suggest that they are difficult to obtain. But I wonder whether they would have any great value to the shareholders if they have no particular value to the directors. I accept your point it is done in America and has been done for some time. I am not suggesting in any way that your suggestion is not a good one but I am trying only to inform my own mind as to what real advantage there is in it.—I think it gives a complete picture which is interesting at any rate and on occasion would draw attention to some change in trend that is taking place.

792. I would like now to consider Mr. Edey's suggestion about disclosure of the accounting procedure by way of filing a detailed statement of it. I think you were not quite in agreement with this, Professor Baxter. If you put it only on a file in

Bush House the shareholders all over the country cannot have access easily to that information. It is true that there are stockbrokers and professional advisers who would have access to it, but is it really right in principle that a great deal of information about the accounts of a company should be available to those who take the trouble or are able to go and examine the files of the Registrar which would not be available to the other shareholders?—*Mr. Edey*: My suggestion was really intended to deal with the problem that if there was a large amount of information to be given it might greatly overload the accounts. But on reflection I think perhaps such a statement of procedure might not generally be necessary. I think that probably in most cases one could give the information I am suggesting in the accounts. I think it would depend partly on how much detail was given. It seems to me that if attention were given to requiring companies to provide a good deal more information about their accounting procedures, you would probably have to have some kind of standard questionnaire in which companies would be asked to give the necessary information. For example, they would be asked whether they were following a stated standard accounting procedure and if they had departed from it in any particular. If the answers to this questionnaire were sufficiently short to go into the annual accounts it would certainly be far better than if they were filed at Bush House.

793. I think I have your views. It is quite an important matter that we have to consider, because if the view were taken that it would not be right to have a separate statement filed at Bush House which would not be available to all shareholders, and that all information should be in the annual accounts, that would affect the amount of information it would be practicable to insist on companies giving.—That is the point. You could ask for a lot more information if you only had to file it.

794. *Mrs. Naylor*: Would it not be practicable for shareholders to write for a copy of this statement of the procedures used in the same way as they can now request a copy of the shareholders' list?—I should have thought this was perfectly possible.

795. *Professor Gower*: It is also the case that there is now available on the company's register, information which may be of great relevance but which is not included in the accounts, and therefore the shareholder who goes to inspect the accounts gets information denied to one who does not.—*Professor Baxter*: The Securities Exchange Commission in the United States gets great quantities of information which is not given in shareholders reports. I do not think that is an ideal system.

796. *Mr. Lawson*: I have one or two more questions. Professor Baxter, you suggest that there should be less onerous requirements for small than for larger companies. You are referring particularly to progress reports, half yearly accounts, and so on?—Yes.

797. Would you think that that distinction between what a large public company should provide and what a small company might reasonably be expected to provide is valid over a wider field than just this particular aspect of quarterly or half yearly accounts? Would you accept the general principle that there should be less information from smaller companies than from large?—Yes, I think so. I take it that the form of annual accounts and so on would be identical in both cases. But I had in mind that once a year would probably be enough for the small company, and twice for the medium, and something extra in the case of a very big one.

798. I was wondering whether your suggestion went even further than that to the point of the kind of information we have recently been talking about. If one had this file of additional information and so on would you have rather more detailed requirements for a large company than for a small one? I know you do not deal with that in your paper. I was asking for your views about it. Perhaps you have not thought about it?—I have not thought about it.

Mr. Edey: I am concerned particularly with the public company where there has been a public issue of shares and there are very likely a large number of minority shareholders who are unable to get information except in so far as it is published annually or quarterly. With the private company one would expect a small

number of shareholders and no public issue; one would expect the shareholders to make more efforts on their own to get information before they became shareholders. I should have thought the case for statutory disclosure of more information applied much more strongly to public companies.

799. Another point that neither of you touched on; what do you think about exempt private companies? Do you think they should continue to enjoy their exemption from filing accounts or do you think, having the privilege of limited liability, that they should all file their accounts? —*Professor Baxter*: I suppose the answer is that one must for practical reasons draw the line somewhere. From the standpoint of the economist, it would be a good thing if every private person had to publish his profit and loss account; but there would be a lot of opposition to that and great difficulty. There is this extremely important extra reason for adopting a guiding line based on the public company: in this case, the investor is usually an absentee. He is detached from management and he should be given a lot of guidance; whereas one normally does not put any money into an exempt private company unless one knows those responsible and has personal contact with them. So I should think this would be quite a sensible dividing line.

800. Yes. Do you agree with that view? —*Mr. Edey*: I think so, yes. I would have thought that in the exempt private company one was not interested so much in shareholder protection as in creditor protection, and one should attack this from the point of view of the Official Receiver and the kind of things which have come up in liquidation proceedings and so on, on which I am not an expert so I would not like to give an opinion. I should have thought it should really depend on that kind of thing whether exempt private companies should be required to file accounts.

801. We have had evidence, mainly from that point of view, suggesting they should be forced to file accounts. Two more questions. Mr. Edey, you deal with the law relating to dividends and suggest that it should "be illegal for directors to

distribute dividends if thereby they endangered the solvency of the company in the short or longer run". At the time the decision is taken it will generally be a matter of judgment—not of fact—whether a particular distribution is likely to endanger the solvency of the company. Do you think it would be reasonable to make directors criminally liable for what might be bad judgment on their part?—I am not quite sure about it but I think there is some provision at the moment in the Companies Act which in certain circumstances would make the directors either criminally or civilly liable for distributing dividends even if there was a profit, if this meant that creditors would go unpaid. I am not sure about this, it is a legal point.

802. But it is that kind of thing you would like to see strengthened?—Yes. It seems to me that this is perhaps one of the things that seems to emerge when one reads the old audit cases. A good deal of emphasis was put on this issue in the judgments, that a fair amount of latitude should be allowed in the calculation of profit, but it was always wrong to distribute profits if it was not done *bona fide*. If the directors were distributing dividends one would expect them to do it *bona fide*. One would want evidence as to whether they had looked at the effect of the distribution on the position of the company and made their decision as one would expect a reasonable business man to make it. I imagine, though I am not a lawyer, that this is a difficult field in which to show that bad faith existed but I should have thought there were circumstances when the directors could be shown not to have acted prudently or acted so imprudently or quite clearly fraudulently as to be held liable. The kind of thing I had in mind, among others, was that a company might clearly be getting into severe difficulties and they might go on paying ordinary dividends to the detriment of debenture holders in the longer run. I think it is possible for this situation to arise and to be allowed if one applies merely the normal dividend distribution rules which have emerged from cases. Of course, these rules allow one to distribute profit on the face of it even after past losses, and in certain cases even if depreciation has not been provided. That was the kind of thing I had in mind. It may not be very important.

803. My final question, Professor Baxter. You touch on the situation which quite frequently arises in practice where capital or some part of it has been lost. You suggest that it should be made illegal for any dividend to be paid until the capital has been made good, but then you say that individual cases might merit some special loophole. Have you any particular loophole in mind?—*Professor Baxter*: I think my idea was this. I would not like a statute to be so firm that it would prevent a court from agreeing to some reconstruction that was approved by all the creditors, the shareholders, and so on.

804. *Professor Gower*: The case you have in mind is a scheme for capital reduction which would be approved under the existing law?—Yes.

805. You say you should not be allowed to pay a dividend in the circumstances we have been considering unless you get a formal reduction of capital?—I have said that would be a much more logical arrangement than the present one. Hardly anyone is happy about present concepts.

806. You drew a distinction between smaller and larger companies. Would you go so far as to say there should be one accounting schedule of the Act applying to the large public company and a different one applying to the private company? If so, would that not make for certain difficulties when the private company changed over to be a public company—presumably it is hoped it will?—I do not think I meant to suggest that there should be different regulations covering the full set of annual accounts. The difference should lie in whether or not you are required to produce them. Once you are, then I think the annual accounts should be the same, although you might perhaps allow a little leniency if, as I hope you will, you ask for more frequent information from some companies.

807. A number of people, apart from yourselves, have suggested that insurance values of fixed assets should be put in the accounts. This has some attraction because it is simple and straightforward and would not cause businesses a great deal of trouble. Mr. Lawson put one

objection to this, that it might encourage the directors grossly to inflate the figure at which they insured their fixed assets. Would you say that is a matter about which an auditor should have some responsibility? If an auditor realised on the face of it that the insured value was suddenly increased for no apparent reason, would it be his duty in your view to raise this point?—*Mr. Edey*: I do not see any reason in principle why an auditor should not apply his mind to it. Obviously the auditor is not capable, because he is not associated with the business, of deciding what is the right insurance value, any more than he can decide what is the right stock valuation. I suppose an auditor's procedure would be to satisfy himself by questioning and talking to people and looking at the written information that, on the face of it, the proper values had been adopted for insurance.

808. The other problem, of course, is the fixed assets which the company does not insure. Some companies carry their own insurance. What would you do about that?—Yes, this is a difficulty and if you required insurance values to be disclosed, it would be important to distinguish between those assets which were insured and those not insured. A small insurance figure might otherwise apply to a large block of assets, some of which were not insured. I would be prepared to say we will do without the information about uninsured assets because we are trying to improve the information available but we realise that there are certain things you cannot do.

809. But you would require the company to state that certain assets were not insured?—I think that would probably be best. Alternatively you could ask the directors to make a specific appraisal but that might cause difficulties.

· *Professor Baxter*: This is true if the Act says you must show the insurance value. But if it says you must give the best available value—perhaps one found with an index—then there is no question of the directors having to reveal the extent of the insurance, because they would simply substitute another acceptable value for the insurance value.

810. Some people have suggested that irrespective of the value shown in the

accounts you should in a note state the value for insurance purposes.—I think the Act should require something like "the value which in the opinion of the directors is the best available one".

811. You would not make an additional check?—*Mr. Edey*: I am a little worried about that suggestion because it does open the field out so much. One great thing about the insurance figure is that one would expect directors to apply their minds fairly carefully to it. It would normally be based on the replacement value which is the figure you would be trying to get at. This is one of the reasons for requiring a note of insurance values where they are available.

812. *Mr. Watson*: You advocate that companies should publish interim statements of profits and earnings. Should these be made available to the press or direct to shareholders?—*Professor Baxter*: They should be given the same publicity as the annual accounts.

813. Therefore the opportunity would be presented to the directors to make a comment on them?—I think that would be reasonable.

814. It perhaps would be desirable in cases where the half yearly or quarterly results had been exceptionally favourable or unfavourable?—Yes, indeed.

815. Thank you very much. I would like to ask a question about voteless shares which neither of you have touched upon. Have you any view about their desirability?—I think there is a general principle that one wants to encourage control by shareholders of their companies, and as the voteless share weakens that it is something that I am against.

Mr. Edey: My view would be a little more general because I have not directed my attention very closely to this. But my view would be that it would be undesirable that the control of companies should remain in the hands of small minorities. I think that the kind of arrangement—whether it is due to the fact that some shares have no votes or due to some other arrangement such as interlocking arrangements between companies—which effectively makes it impossible for the majority of the invested interests to control, is contrary to the general

principles on which our free market system works and is to be avoided. But I do not think on the face of it I would disagree with a certain number of voteless shares; it would really rest on this question of whether a very small interest could control the assets which are owned by a very large voteless interest.

816. *Mr. Scott*: Do you hold the view that, in preparing the accounts and balance sheet, directors and auditors have a duty to the public and not only to the shareholders to give the full information you have referred to, even though that information might, in fact, be to the detriment of the shareholders who, in effect, employ the directors?—I do not think that I hold the view the directors should offer information voluntarily which would be beneficial to the public though adverse to their shareholders (though there might be circumstances where they had to do this). My view is that the law should require certain things to be disclosed because it is in the public interest, even though this may be adverse in some degree to the company. So there is a distinction, I think, between putting a duty on directors to comply with the law and a duty to do things which are not required by the law which would be adverse to the company.

817. Do you think that your recommendation would impose somewhat severe burdens on the directors? I am referring particularly to the points you made about showing valuation of assets which I think we all agree can be an extremely difficult thing and can be arrived at on various alternative bases; and there might be repercussions which they had not contemplated if the directors were required to state such valuations?—You are referring to balance sheet valuations?

818. Yes.—I would have thought there were two answers to this. First of all, I have suggested that the insurance value should be taken in some cases and this does not seem to me to be anything which should be adverse to the directors. It is a definite figure which is available, one presumes. Where assets were valued by outside valuers I would have thought that this would not throw any burden on directors. I do not think I suggested a valuation on the balance sheet other than

those two types of valuation. But if directors took it on themselves (although the Act did not require this) to value assets which were required to be valued, instead of going to valuers, I suppose you might say there was a certain burden thrown upon them. But directors supervising many companies have revalued their assets and I would not have thought that this had an adverse effect in any case that I can think of.

Professor Baxter: It is just unfortunate, I think, that inflation has imposed this extra task. I am fairly satisfied that, once one got the arrangements established, a five-year overhaul of this sort would not involve much trouble or difficulty and, indeed, that the figures are such that the directors should consider them occasionally in any event.

819. I am sure we have all been most interested in your suggestions for the improvement of the balance sheet and accounts and in particular the additional information which you think should be given. Is it your thought that these ideas should be made compulsory under a new Companies Act so that it should lay down, in fact, a standard method of accounting which must necessarily apply to all companies, whether they are manufacturing companies, merchanting companies, retail stores, insurance companies, investment companies, all carrying on widely different businesses and therefore probably confronted with very differing problems; or is it your thought that accountancy is not a fixed science but is constantly changing its techniques and that it is perhaps undesirable to attempt to legislate because that would codify in great detail how accounts should be prepared, and that might be out of date fairly soon afterwards?—Yes, I think the Act should require periodic disclosure of asset values but should not specify the accounting or the valuation procedures. I think that the question of whether the revenue account should be expressed in historical or real figures should be left optional; and I agree entirely it is most undesirable to lay down specific details of how the information should be given.

Mr. Edey: Perhaps I could add to that—this arises out of something I said to Mr. Lawson. I think there might be

something to be said for having a kind of "Table A" in the Act which did give various types of accounting procedure, one of which one would normally expect to be adopted and to which the company could itself refer in its reports, or even the auditor might refer to in the auditor's report. If the company went outside that Table A then it would be required to give special information about just what it had done. But I would agree with Professor Baxter, you should not put company directors in a straitjacket.

820. Would you not be in the same difficulty if you had it in the form of Table A because Table A would have to be pretty specific?—I would have thought that, although the range of companies is very great, the range of problems in interpretation of balance sheets tends to be concentrated on particular points such as stock valuation, depreciation and valuation of hire purchase debt, and I should have thought it would have been possible—and after all, the Institute of Chartered Accountants really has gone some way to doing this—to draft alternative standard types of valuation procedure in some detail.

821. It is easier for the Institute of Chartered Accountants to amend and change their principles from time to time than it is perhaps to alter some compulsory part of an Act.—I would not make it compulsory. The essence of Table A is that it is not compulsory (and it might be better to incorporate a set of such rules in a Statutory Instrument which could more easily be changed). But the essential thing is that these should not be compulsory but should be the most common standard procedures. You could refer to these if you adopted one or the other, but you would not be bound to adopt any of them if you had sufficiently strong reasons. If directors wanted to go outside them they could, provided they said that they had not adopted one of the standard systems, and gave details of what they had done, either in the accounts or in some filed document.

822. *Mrs. Naylor:* Mr. Edey, I would like to refer you back to the problem of valuing fixed assets of a concern where the assets are extremely specific, such as a steel works. Did you say that you felt

that the importance to shareholders of information about the value of such assets, however calculated, was less important than in a concern where the assets were much less specific?—I think that in a sense what you say is correct, that where the assets are very specific, except so far as scrap value is relevant, one cannot put any particular significance on a valuation. I think it would, however, be useful, as I said earlier, to have an indication of the kind of outlay which would be necessary now to reproduce the plant they have got, not because that in itself is directly relevant, but because it is the next best thing perhaps to having what you would most like to have, an estimate of the cost of reproducing the plant in the best possible way now. So that it would be helpful, I think, to take your original cost and then adjust it by using a specific price index to arrive at a current value, and by applying depreciation to it, to get the net figure. I did not expressly say I thought the company should be required to make this kind of index and calculation because there are difficulties in index calculations and putting into an Act just what ought to be done. I think if you required the insurance value to be disclosed this might in many cases deal with the situation. I think it would be desirable for companies also to do an index number calculation, but I think this should be left to them.

823. Is your approach different when the assets are specific than when they are not specific?—What you are trying to get at in the case of very specific assets is what would another efficient management pay for them. The alternative use, if they are very specific, is not by some other industry but by another firm in the same industry. I do not think in principle you can get this very precise figure here without referring to profit itself. But I think it is of some value to re-adjust your original cost to bring it up to modern price levels, even if the original directors may have made a mistake in putting up the wrong kind of plant so in effect it is much more costly than it should have been.

Professor Baxter: One advantage of having some form of revaluation, even in the case of specific assets, would be to

let one see whether or not the depreciation figures were adequate.

Mrs. Naylor: Yes.

824. *Mr. Lumsden:* Is there not a danger in the case of specific assets, if the insurance or replacement value is shown, which will almost certainly be far higher than the company would get if the company were liquidated, that the shareholders might be misled?—*Mr. Edey:* I agree there is a danger it might mislead some shareholders and I think it is a danger inherent in publishing accounts which one has to accept. I think almost any accounting figure can be misused and can be misunderstood and I think again this comes back to the question of a free enterprise economy. I believe very strongly in the philosophy of a free enterprise economy that one must accept that some people will make mistakes but one hopes that the spread of knowledge will deal with this. I accept your point.

825. You have been suggesting a number of ways in which additional information should be given, the main purpose being that the financial analyst should be able to use the information to advise the shareholders. But is not there a real danger that the ordinary shareholder, who likes to receive a report and accounts and a reasonably concise statement of what is going on, is going to be completely confused by this enormous volume of information? It seems to me it is happening already and what you suggest will increase that danger.—Of course it is true that he might find it difficult to find his way through the trees but there would be nothing to stop directors from preparing a summary and this, I think, is done by quite a number of companies nowadays. Shareholders who did not want to read further could stop at the summary. Any shareholder who wants all the information in three or four figures is asking for the impossible because business is a complex activity and it just cannot be put into three or four figures, even though, if you know what you are doing you may be able to use three or four figures to good effect quite often. If you are going to be a shareholder in a company you must accept that you are buying something which is rather complex. But it is open to directors to simplify reports in addition to providing full information,

Professor Baxter: I think this is an argument for flexibility rather than concealment. We expect the accountant to experiment with ways of giving exactly what different readers want—something that is very simple on page one and schedules at the back for the man who wants to dig deeper.

826. Following on that and Mr. Scott's question I think you have agreed that most of the points you have made are really a matter for accounting practice which would be built up by the professional institutes rather than by specific legislation?—Yes.

Mr. Edey: Except in so far as our suggestions have been for greater disclosure of what accounting practice is being followed, and such points as the disclosure of insurance values.

827. Could I just ask on the question of private companies, I was not quite clear whether you wanted full information of re-valuation of assets and all such things to be given in the case of private companies or whether your recommendations were really limited to those companies which were seeking money from the public in one way or another?—*Professor Baxter:* There I think the distinction is whether you are doing it for investors or for creditors. From the standpoint of the investor, I do not think it is necessary to give all this information, except in the case of the public company. But I do not know the extent of the loss to creditors in the case of the rather unsavoury or unwise small private company. If you receive a substantial volume of evidence which suggests that things are worse there, or could become much worse in the case of depression, then I think the suggestions we have been making would be useful for the creditor, and perhaps legislation should have a wider ambit than we have suggested.

828. On the question of disclosure you did state, Professor Baxter, that the public interest should override the interests of the shareholders so as to require disclosure of certain things even where it was thought it was not in the interests of that particular company. I just wondered how far you would go with public interest—what you meant by it? It does seem to me possible that such a requirement could compel a

company in this country to make disclosures which would not be to the public interest here but would benefit a competitor, shall we say, in Japan. Would that be in the public interest?—Unless there is some question of national defence, I think so. As a consumer, I think I would be better off if a Japanese company stepped in.

829. *Mr. Brown:* Is not legislation necessarily concerned with those who might not act in good faith? Such people might use the flexibility which you have advocated not to give a fair presentation of the situation but to paint the particular picture they wanted to paint at the time?

—Yes. This is a question where one can state the principle easily but its implementation really depends on clever draftsmanship. I think we probably all agree that we want to lay down a certain minimum requirement, but leave people free to build on that and give more when the occasion arises. The great difficulty in drafting here is to lay down a minimum that does not also become a maximum. All I can say is that draftsmen in the past have been extremely successful in this respect and I think we can rely on them still.

830. My particular point is the more flexibility is introduced the greater is the risk that it may be misused.—*Mr. Edey:* I think that is true. However, one should take some risk in the interests of improvement. Moreover there are the auditors to confirm that the accounts present a fair picture so that I think this danger is probably not very great.

831. *Mr. Althaus:* I think you were in favour of giving more information about the age of assets: Mr. Edey mentioned the shipping industry which was one in which it could be easily done. However, in the case of companies with complex and widely spread interests such as Imperial Chemical Industries, where processes are being changed all the time, the provision of such information would surely impose the maximum burden on the directors and would give the minimum assistance to shareholders and commentators?—I think we would agree very much. As a matter of fact this suggestion about the age of assets did not come from us. The age of assets in certain cases would give

useful information but I quite agree that it would not, in the type of company which you have cited, be practicable to provide it.

Professor Baxter: One of the great advantages of revaluation is that it does automatically give you enough information in a nutshell about age. If, as in the case of I.C.I., you have a five-yearly revaluation, then it would probably be superfluous to publish long lists of assets by date.

832. *Chairman:* Section 149 lays on the company, or its directors, the duty of producing a balance sheet giving a true and fair view of the state of affairs of the company at the end of the financial year and it lays on them a corresponding duty about the profit and loss account. Then certain further requirements are laid down and each of the provisions of this section is made an offence punishable by fine or imprisonment. Would you not agree that this penal section must be regarded as imposing a minimum rather than as requiring directors to conform with whatever may be the best standards of accounting according to one or other school of thought in the field at the moment?—Yes.

833. So that what one wants is a method of accounting which complies with the requirements of the section and is so framed that it is possible to say if a prosecution arises that the director concerned has or has not complied with the Act?—Yes.

834. And for the rest it is a matter of pious hope that companies and their accountants and auditors will study to improve and gradually make their accounts more useful and more informative, and that no man should be put in peril by an ambiguity?—*Mr. Edey:* I think the primary point which I would like to put forward is that we should like more information of what has been done—what calculations have been made in preparing the accounts. The calculations that have been made in preparing the accounts are not an ambiguity. They are things which are actually written down on paper and can be checked by audit. I would say that anything which required any disclosure of how accounts had been prepared was not a thing which would put anyone in peril from ambiguity.

835. Supposing it was decided to prosecute someone for not complying with the accounting provisions of the Act would he not enlist the aid of the best accountant he could find to show that he had done everything that was proper and would not the prosecutor enlist the aid of another eminent accountant to show what he did was wholly wrong and these two gentlemen would give their evidence and at the end of it all supposing the court held that the method advocated by the prosecution was the better, what then? Has the man committed an offence?—That was not the situation I was envisaging. It was as follows. Suppose that the stock had been valued by the directors on the basis of current market values but that in the accounts, having been required to disclose how they had valued them, they had said that the stock had been valued on the basis of original cost. Let us further suppose that market values had risen since they were bought by, say, 30 per cent. Then the accounts would show the stocks valued at a figure 30 per cent. higher than they would have shown if the valuation had been done on the basis stated by the directors. This would be susceptible, I would have thought, of proof.

Professor Baxter: To take the case of stock again, there could be no doubt that if the company in question had a stock but did not show any stock at all, that would be clearly illegal. Secondly, if it shows a stock but does not reveal the method by which it has valued the stock, then that is an obvious offence; similarly if it lies about the valuation method used, that is clear enough. Then you come to the case in which it reveals its method but puts in a figure which is doubtful. It seems to me that here you are in the same position as when prosecuting a man for reckless driving. It does become a question of opinion about whether the figures are reasonable or not.

836. Have not the directors really done all that can be expected of them by way of compliance with the Act if they have adopted a method of some kind, which a reasonable accountant applying his mind properly to the question would consider was, by and large, an adequate method of doing it?—Yes, if they have explained what they have done and stuck to it, I think that is true.

837. Then I would like to consider a practical aspect of this matter. I think of a boot and shoe manufacturer. His function is to produce as many boots and shoes as he can at competitive prices and, if possible, to pay a dividend. In the case of that manufacturer you would agree he must have accounts of a sort to show whether the business is paying or not and he must have accounts to show the shareholders what they are going to get out of it, and he must have accounts to show the degree of credit worthiness *vis-à-vis* his creditors, must he not? Is it right to divert more than is really necessary of the time of the directors from the positive and useful function of producing good boots and shoes at competitive prices to deal with a mass of paper which may or may not give useful information to economists, statisticians and investment analysts and his own competitors?—Yes. You have to compromise. But if the man has got reasonable accounting methods and a reasonably good accountant, I do not think the extra work in anything we suggest is going to be very big. May I say that the provision of boots and shoes is a matter covering not just the mechanics of making boots and shoes, but also the attraction of investment into that industry or not. So the publication of reasonably clear accounts is only one step in the process of physical production, and a certain amount of time and energy spent on this would not be waste.

Mr. Edey: May I make a comment on that. The country at any time has only a limited quantity of capital resources and some system has to exist by which these resources are diverted to one end rather than another. For example, in a country beyond the Iron Curtain the decision would be made by the Central Planning Board. They would say that such and such an industry is to receive so much of the resources this year. It is the principle of a free enterprise economy of the type we have that a large part, not all, of the decisions of this type should be taken not by Government planners but by individual investors, by investment managers of institutions, by everyone who has available funds to dispose of. If information is not available which tells them where the greatest profitability lies (and the greatest profitability implies that

the public are being most satisfied, provided you have a competitive economy, since if the public is not satisfied they do not buy your goods and it is not profitable), there is a serious danger that the resources of the country will be directed into directions where they will not most satisfy the needs of the people of the country. So I would suggest that the good accounting system which provides information about where costs are lowest and sales higher (and therefore profitability is greatest) is one of the essential mechanisms of a free enterprise country and of enormous importance from this point of view.

838. Would it not be better to collect such information as you have in mind by means of an economic census of the country as a whole. Then everybody without distinction would be required to answer certain particulars about his business and so forth; would not that be better than leaving it to more and more detail in balance sheets?—I think in a certain respect the proposals which we are making come almost to the same thing because we are suggesting information should be made available of a type which I think would be collected in such a census.

839. Then would it not be right that everyone should have to give the information, otherwise are you not penalising the more conscientious company who tries to carry out your recommendations as compared with the less conscientious one?—I think it is true that it would be very difficult to provide in company law for furnishing of information from every company without reducing the quality of the information, since you must level down to the lowest. So I think there is imperfection in this method of getting information but it is the best we can do.

840. Yes. I am wondering whether it is within the scope of the Companies Act. It seems to go rather wider.—*Professor Baxter:* The kind of person who will feel the effect of any new legislation is in the company that is asking the public to subscribe to its share capital. It seems reasonable that it should be compelled to give information on the lines we suggest, so that the public will have adequate guidance before they invest.

841. The shareholder's right to information is not unlimited. He is not merely tied to the directors, he may be getting it from fellow shareholders. He can put on his hat and go down the road and tell another company what he has found out. He is not like a partner who is bound by the just and faithful clause. There is that difficulty, do you not agree?—Yes, but I think that in general the more economic information there is the more prosperous we shall be. I do not object to competitors getting to know about information of this kind. The only objectionable thing, I think, would be if for some reason Competitor A could limit the knowledge available to Competitors B and C; we are saying the thing should be published to the whole world.

842. Yes, thank you. But the point I was trying to make in a general way was that the collection of this type of information, if considered desirable, ought to be carried out by some form of legislation directing disclosure generally from everybody such as the Statistics of Trade Act.—*Mr. Edey*: I think it is a field in which the interest of the shareholder and the public interest lie together to a very large extent and where they lie together I take it there would not be any dispute since the interest of a shareholder is one of the main objects of the accounting provisions. But I would say about the public interest that the institution of limited liability is a very great privilege granted by the State to business people, and that it is reasonable to expect in return for the granting of this privilege the provision of information which will be to the public benefit.

843. Is not the prime advantage of limited liability that it brings money in and that there would be no financing of industry without it as things stand?—Yes, and the primary object of bringing the money in is to make the country prosperous.

844. Yes. I do not know that we can pursue that point much further.—

Professor Baxter: I take it, in Board of Trade statistics, that you have a statement about the boot and shoe industry as a whole. Total turnover is X and the total capital is Y and so forth. But it is very important, from the standpoint alike of individual investors and of the country, that the individual company should be well run, and that its directors should be compelled to tell the shareholders and the Press how their affairs are going. I am not belittling the importance of the kind of statistics you have in mind, but I do not think such general statements are enough. One must have information about individual enterprises.

Chairman: I see. Thank you very much.

845. *Professor Gower*: Am I right in saying that in the main your suggestions about disclosure are directed to the interests of the shareholders in the particular company? Although in this one respect you would decide in favour of disclosure, even if it were detrimental to the company because it was in the public interest, that should not be taken to imply that all your suggestions are based on public interest rather than shareholder/investor interest?—*Mr. Edey*: No, your proposition is right. It would only be in relatively small areas where there might be a conflict of interest between public interest and shareholders' interest and we are primarily concerned with the latter.

Professor Baxter: Of course, one is apt to think of competition in connection with the prosperous company; here the shareholder objects to publicity. But publicity can work the other way when the company is not doing well, because it lessens the attraction for further competitors to come in, and protects the shareholder.

Chairman: I think we have asked you all the questions we had in mind to ask and we are very much obliged to you both. You have been very helpful, thank you very much.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

MR. O. B. MILLER and MR. S. A. WETHERFIELD called and examined.

846. *Chairman:* Mr. Miller, I understand that you are the Chairman of John Lewis Partnership Ltd., and that Mr. Wetherfield is a director of the same company?—*Mr. Miller:* Yes.

847. I would like to say we are very much obliged to you both for the memorandum you have submitted to us and also for coming here to help us today. Generally I gather from your memorandum that, apart from your criticisms of section 27 of the 1948 Act in relation to your profit sharing scheme, you have little fault to find with the existing law so far as it goes and such alterations as you suggest, which if I may say so are very clearly put, will be borne in mind by the Committee. In these circumstances I need not trouble you with many questions. Does that fairly represent your view, that subject to various points bearing chiefly on your profit sharing scheme you have little fault to find with the provisions of the Companies Act as it stands?—Yes, Sir. If I may elaborate the words "fault to find" I would agree to this extent, that we find it perfectly practicable to operate our scheme under existing company law but, as a matter of our belief in the principles on which companies ought to operate, we feel that company law should adapt itself to a different set of circumstances from those in which it was originally drafted, and to that extent we do find fault with it in relation to our own particular organisation.

848. Assuming the Companies Act will be preserved in substance in its present form, your main criticism of it, as I understand it from your memorandum, is that it makes no sufficient provision for profit sharing schemes such as yours?—For profit sharing and worker participation, if I may use an ugly phrase. It does not recognise sufficiently the status that the worker seems to us to have in a company.

849. The way you seek to achieve that now, as I understand it, is the way which other people have adopted in varying forms, that is, to give the workers participation by allotments of shares in the company to them?—No, Sir, that is not really the basis of participation in our

organisation. The real basis of participation in the John Lewis Partnership is by means of a trust which holds all the ordinary shares; that is to say, we have had to exercise the control of ordinary shares through a trust in order to secure the rights and position of the workers in our organisation to the extent that we feel desirable.

850. It is in the nature of a paternal arrangement, is it?—It is, yes, a paternal arrangement whereby the rights of the workers are derived from their being able to exercise the powers of ordinary shareholders.

851. There are various points you touch on in your memorandum which perhaps I might usefully refer to. Heading 4 is the matter of donations by companies to charitable and political, and for this purpose I think one should perhaps add benevolent, objects. I understand you take a broad view as to the powers of directors in such matters. You would leave it to the absolute discretion of the board, would you?—Yes Sir, I would, and perhaps I need hardly emphasise that is not a feature of our belief in profit sharing or worker participation. That is a separate issue.

852. What might be called the conventional view, which I think has probably held the field generally speaking up to now, is that such donations are really only warranted in so far as they are likely directly or indirectly to benefit the company or its employees?—Yes.

853. But you would go further than that, and allow contributions to any deserving or useful object irrespective of any benefit the company may derive therefrom?—No Sir, what I am saying is that the directors should have complete discretion in deciding whether any contribution of that sort should be made, and should be free to decide whether it was in the interests of the company to make it, and that it should not be incumbent upon them to be able to demonstrate that there was some direct advantage to the company. That springs from a belief that companies have a duty to the community as well as to their shareholders.

854. What would you say of the suggestion that the annual amounts of the donations made under these varying headings should be disclosed in the accounts or the directors' report?—I think it would be quite desirable that they should; I see no reason why they should not.

855. You see no reason why they should not, but do you think they should be compelled to do so, or would you leave it to their discretion again?—I would leave it to their discretion subject to the demand of shareholders; that is to say, if the shareholders in annual meeting asked for disclosure it should be disclosed.

856. Of course if there was no disclosure they would not know whether there was anything to disclose or not.—No Sir, I agree. I have not considered this question of compulsory disclosure, but on the spur of the moment I can think of no reason why one should be opposed to it.

857. Then under heading 5(a), which deals with fundamental changes in a company's activities, you refer to the case where you formed subsidiary companies, one of which held the freehold or leasehold premises used for the purposes of a retail business and the other company carried on the retail business as a separate concern. That, if I may say so, appears to me to be a perfectly innocuous arrangement which I think has been adopted by many companies, and in your particular case I suppose it was really a matter of organisation within the group, was it not?—Yes, it was. It was to some extent affected by the nature of our group and its particular need for financing in that, as we issue no equity capital outside, all our financing has to be by fixed interest or fixed dividend securities, and because of that this particular grouping was very desirable. But in general it seems to us that, regardless of the particular nature of a company, a company should be free to dispose its operations among its subsidiary companies in this kind of way.

858. We might perhaps come back to that in a moment. You observe in connection with this matter of fundamental changes that a company needs a free hand to change the activities of its wholly owned subsidiary. Clearly that must be so

I suppose as between the company and the subsidiary, because the company holds all the shares in the subsidiary and can cause it to do what it likes?—Yes.

859. But of course that leaves open the question whether some changes of that kind may not be of such major importance to make it desirable that they should be referred to the company in general meeting for approval. To give a crude example, you have a holding company with a wholly owned subsidiary. The directors think it would be a good idea to convert the business of the wholly owned subsidiary into something radically different from anything that it has done before. In that kind of case would you consider that the shareholders of the holding company ought to have an opportunity of approving the proposal before the directors carry it out, or would you leave the directors an absolutely free hand in all cases to make whatever changes they liked?—I would leave the directors a free hand on the ground that if the directors were making such a change in a sector of the company that was not a subsidiary company no question would seem to arise, and the mere fact that it was changing the operation of a subsidiary company rather than a sector of the total operations that was not a subsidiary company would not at first sight seem to me to require any reference to the shareholders in the holding company.

860. Suppose, for example, leaving out the question of the wholly owned subsidiary, a company which has always carried on business as hotel keepers in England sold all the assets and set up business as gold miners in South Africa. That is, of course, an extreme example, but would you think the shareholders ought to be consulted?—I would say yes. I was hesitating to try and find in my mind some way of differentiating between cases in which consultation was desirable or not. I should have thought that was a matter on which responsible directors would wish to consult their shareholders. But on the general question I can see there are cases in which there should be consultation, I can see many cases in which it should not be necessary, and I cannot divide the two.

861. Other witnesses have found that the question resolves itself into one of

degree, and that the difficulty is to draw the line between cases where the directors should go ahead on their own and cases in which they should consult the shareholders.—Certainly, yes, that is my position now.

862. If it were possible to define a substantial change or an exceptionally important change, or whatever expression one may use, you would favour the view that then the directors should consult the shareholders?—Yes, I would.

863. So that the difficulty is really one of definition?—Yes.

864. Then under the heading of directors' interests you suggest an amplification of the information required by section 195, which is a section of the Companies Act about the register of directors' shareholdings. The particular point you make there is to the effect that any circular issued by the directors containing proposals relating to any shares or debentures of the company ought to contain an extract from the register of the directors' shareholdings. Can you state in greater detail or more specifically the kind of proposals you have in mind?—*Mr. Wetherfield*: It was in our minds that if conversion offers are made or rights offers or anything of that sort the shareholders should have an opportunity of seeing whether possibly the directors have taken advantage of the fact that they knew the offer was going to be made and have bought in a lot of shares, or something of that sort.

865. Broadly one might say you would include any arrangements altering the rights of classes of shares in which the directors were interested, or altering the rights in respect of debentures in which they were interested?—Yes, and not merely requiring them to state in putting forward the arrangement what is their present interest, but whether they have increased or reduced their interest before putting forward the arrangement.

866. Of course the directors cannot say "this is an excellent plan" without telling the shareholders that they have some interest on one side of the fence or the other.—Yes, that is provided already, generally speaking, but they are not required to say when they acquired that interest.

867. I think I follow the point. Then returning to carrying on business through subsidiaries, which is a practice you consider perfectly proper, would you agree that the company concerned should disclose the identity and activities of such subsidiary companies and the extent of the company's interest in them?—*Mr. Miller*: No; requiring such disclosure could be a considerable handicap in trading operations of any complexity.

868. I am rather thinking of the balance sheet and the accounts laid before the company. If you have a holding company carrying on business through one or more subsidiary companies, I am asking whether it is your view that the holding company, in submitting its accounts, should include somewhere details of the subsidiary companies, giving their names and the kind of business they carry on and the extent of the holding company's interest in them?—No, it is our view they should not be required to do that, and that such requirement would seriously hinder trading operations. Certainly that would be true in our own case: our activities extend into certain fields and knowledge of the fact that one is interested in those fields might react adversely on one's trading operations in other fields.

869. You mean, for instance, supposing a holding company has a subsidiary which is manufacturing a perfectly useful but not first grade article, then it is to your advantage that its connection with another subsidiary of the same holding company making a very expensive and de-luxe article should not be made known?—I think the example of manufacturing is a good one in connection with a business engaged, for example, in retail distribution. It could easily be that the knowledge that you were manufacturing something for yourself could handicap your buying operations in the field of that merchandise as a retail trader.

870. That kind of objection has been put to us, and I think I appreciate the force of it. Then one comes back to your profit sharing scheme. You complain, as I understand it, that section 27 gives rise to certain expense. "A body corporate cannot be a member of a company which is its holding company"—that is the prohibition in section 27. Does your

scheme necessarily involve infringement of that prohibition?—Not necessarily, no, but in the operation of our scheme there is complication and difficulty of the kind set out in our reply under heading 20, which is perhaps peculiar to an organisation which distributes profits in the form of shares.

871. The holding company for this purpose is John Lewis Partnership Ltd.?—Yes.

872. That is the holding company, and the very thriving family of subsidiaries is headed by John Lewis & Co., Ltd.?—Yes, Sir.

873. The employees that you seek to benefit are employed I suppose by all these operating companies in John Lewis & Co. Ltd.'s family, is that right?—Yes, they are.

874. And the shares by which the services of all those employees are rewarded are shares of which company?—John Lewis Partnership Ltd.

875. Does the scheme involve lodging all subsidiary companies' shares in John Lewis Partnership Ltd.? Is that the difficulty? I am anxious to understand it because it may be that this part of the legislation might need looking at.—The allotment of the shares is not to the subsidiary companies but it is direct to the employees.

876. That cannot infringe section 27, can it?—No, it does not.

877. I rather gathered from your memorandum that the undesirable result was that there were a lot of small parcels of shares held by a very considerable number of employees, and that when one of these employees wanted to dispose of his shares it was sometimes not so easy to find a purchaser for such a small parcel.—It is, Sir, and in general schemes of this kind can be more easily operated—and this may apply more strongly in other schemes than ours—if the company concerned can purchase its own shares from the workers and distribute those to others.

878. As I said, I think it is quite likely that in the course of our investigation we shall have to consider this question and might decide that some amendment was needed in section 27 and, I think I should

add, section 54, which is another relevant section. But I doubt if we can usefully pursue the matter in detail now because it is obviously very complicated and one would have to have I think a further more detailed explanation. We are anxious to help you about this so far as we can, and possibly you might like to submit a further memorandum setting out the scheme in detail and the difficulties which attend it under the existing law. Would that be possible?—Yes, I would be very glad to do that, Sir.*

879. Then the committee could study that and perhaps we could leave it in that way. Then there is the question of revaluations of fixed assets—heading 21, Accounts. Your suggestion under that head is that there should be obligatory revaluation of the fixed assets of the company whenever an offer is circulated for the shares of the company.—Yes.

880. Could you say on whom the obligation would rest? The take-over bidder puts his offer round, circularises all the shareholders of the offeree company; clearly at that stage no-one has had an opportunity of valuing the assets for the purposes of that offer.—*Mr. Wetherfield:* What we had in mind was that some take-over bids seemed to have been hurried through without the shareholders of the taken-over company being aware of the real value of the assets that they were selling.

881. Then it would be the duty of the directors of the offeree company at some stage to produce a valuation of the fixed assets?—To say whether they had had them revalued or not.

882. Under most proposed schemes for take-over bids I think it is put on the directors of the offeree company to tell their shareholders whether they approve the offer or not. Your proposition is that those directors in making any such communication to the shareholders should either give them a recent valuation of fixed assets or state that they have not been revalued; would that put your point?—Yes.

883. The question of expense comes into that. If the offer came to nothing someone would have to pay the cost of the

* See supplementary note to Appendix IX page 208.

valuation that might have been made?—Yes.

884. And there is the question of the basis of valuation, on which in another connection we have had considerable discussion this morning, which shows it is not a matter as easy as it looks. But, subject to practical considerations, it is what you would like to see, is it, a re-valuation?—Yes. The point is put very broadly here of course that the shareholders to whom an offer is made should know what secret reserves really exist.

885. I follow. Then going back to take-over bids, head 16, you raise a point about the position of employees. I fully sympathise with your submission under that head regarding the provision of adequate compensation for employees losing their employment, but what troubles me is this. Once you depart from contractual rights how do you suggest the amount should be ascertained for the purpose of any statutory obligation in this respect which you think should be imposed? I have in mind, for example, a company which employs chiefly weekly wage-earners. Presumably the full extent of their claim, subject to special rights under some provident scheme or something of that sort, would be one week's notice or wages in lieu of notice, some derisory sum from the point of view of an old servant. How do you suggest compensation should be quantified so that it could be enacted in an Act of Parliament that on a take-over the employees if they lost their employment should be compensated by a payment of £x?—*Mr. Miller*: I think, Sir, our answer to that would be that it would be a real advance to put the obligation of compensation clearly upon the table, as it were, to put it in the minds of the directors of both companies concerned. But I would say that it was impossible, at least very difficult—I cannot see any way in which it could be done—to prescribe it quantitatively in any formula. It would seem to us that merely to require that this question of compensation for the workers was considered would secure something. It would prevent companies completing operations of this kind without consideration of that problem.

886. You would not make it compulsory?—I do not see how one can

make any quantitative compulsion, because the circumstances in each case will differ so much. It could perhaps be compulsory that the directors of every offeree company should state what was proposed in respect of compensation to the workers, or something of that kind, on the general ground, as I say, of compelling boards to consider this question, whereas at the moment it largely goes by default.

887. You would make it legitimate for the directors of the offeree company to negotiate on the footing that part of the price shall be applied in compensating employees, or something of that sort?—Yes, that in fact has been a practice of our own in acquiring businesses.

888. It is in some respects a wicked world, and one knows by experience of cases where employees are looked after by an agreement to keep them on in the reorganised concern, but this does not come to much in the end because there is nothing to prevent the take-over man employing them for a week or a fortnight and then getting rid of them.—Certainly.

889. So I think any settlement of their interests, to be effective, would have to be a cash payment probably, would it not?—Generally, yes.

890. Then there is another point, quite a different one, about the voting by trustees of pension funds in respect of the voting rights attached to the shares held by the fund. You say that the trustees should be free to vote. I do not suggest of course anything of the kind would happen in your case, but what would you say, as a matter of principle, of the position in which directors were to avail themselves of the votes attached to shares held by trustees of pension funds for the purpose of gaining or maintaining control?—It is a very complex problem on which I am not sure I am competent to offer an opinion. It would seem to me that provided there is ample disclosure so that it is perfectly plain to other shareholders in the company that perhaps a controlling interest in the company is held by trustees of a pension fund, I can see no sufficient ground for limiting the right of trustees to exercise the voting powers as

they could if the shares were held by individuals.

891. You might get a position—and it has been suggested to us that the position has arisen—where a board of directors by its influence over the trustees of a pension fund have used, or put themselves in a position to use, the votes attaching to the pension fund shares to maintain themselves in control of the company.—As a theoretical situation it does not seem to me to be wrong, assuming that the trustees in fact act properly as trustees, in which case presumably they are required to use their voting power in respect of those shares in what they conceive to be the interests of the beneficiaries. That, I take it, is the position of trustees exercising voting rights. If they do that properly then in theory there is nothing wrong in their supporting the directors, it being assumed they are doing so because they believe that to be in the best interests of the beneficiaries.

892. You do not think there would be anything wrong in the directors constituting themselves trustees of the provident fund and proceeding to use the votes attaching to those shares for the purpose of maintaining themselves in office?—No, as a situation I see nothing wrong in that, subject to the use they made of their powers.

Chairman: Thank you very much. Other members of the committee may want to ask you some questions.

893. *Professor Gower:* I understand that you would like the law amended so as to make it easier to operate the sort of partnership scheme that you do. What I am not quite sure about is this. Do you go further, as some witnesses have, and say the law should be altered so as to make it compulsory for directors to pay greater attention to the interests of employees, or is all you are asking that, if they want to, it should be easier for them to do so?—The latter of the two alternatives. We do not think it is really possible, even if it were desirable, that progress in this field should be under compulsion. Our submission here is that there may be scope for amending company law to make it easier for developments of this kind to be undertaken as it were within the scope of the Companies Act instead of, as in our own case, largely

outside it; that is to say, by the device of trusts and so on using the powers of ordinary shareholders. But our view is that there should be enabling powers, not compulsion. We do not think compulsion desirable or, if it were, that it would be practicable in any case.

894. Presumably the only way of securing that employees who were dismissed did get adequate compensation would be to lay down some rule, which should be laid down as a matter of law, that every employee was entitled to, say, one month's salary for every year of service. I am not sure that this is a matter of company law, but would you favour such a rule?—Yes, we would favour such a rule very strongly. We have in fact rules of our own, again entirely outside the company system, to that end, and I think in that and in similar ways we should be wholly in favour of action to secure pension rights and things like that for workers so far as they can be secured by law.

895. To that extent you would be in favour of an amendment of the law in the interests of employees?—An amendment of the law, yes, although the question was primarily addressed to company law, which does not seem to me really to deal with a matter of that kind because redundancy obviously extends beyond particular companies to sole employers, and so on.

Professor Gower: I agree.

896. *Mr. Watson:* My question really relates to the question you were asked concerning the use of voting power by pension fund trustees where they happened to be directors of the company. If as directors they think a certain kind of action is desirable it is very likely that as trustees they will hold that view. Do you think that the difficulties that that situation poses could be overcome in any way? Let me put it this way: do you approve of the company owning its own shares in its pension fund as a matter of principle?—Yes, as a matter of principle I do.

897. And yet there might be something to be said for the wisdom of spreading the investment in other fields, might there not?—Certainly. Again my views are coloured by the character of our own particular organisation, and a pension

fund holding shares in its own company is clearly one way in which employees can get some control in their company. For example, I believe the Sears Roebuck organisation in America secures worker control of the organisation in that way. It is from that standpoint that I should be opposed to anything which limited possibilities in that respect.

898. That would be taking into account the duty of a trustee of a pension fund to invest the fund to the best advantage in the interests of the beneficiaries?—Yes.

899. That implies he probably thinks the investment in his own company's shares is the best he can make?—Yes, I should have thought you might make a good case for that. You have much more control over what happens to your investments, much earlier knowledge of what is happening, and certainly in our own case all our pension funds are invested in our own business. We feel we can get a better return on it and look after it better than by investing outside.

900. *Mr. Scott*: Following up that question, is the thought that it is better for the pension fund to remain in the business where the employees have earned their money, that it should be a sort of continuing remuneration from that company, rather than a separate fund invested, for example, in trustee securities? Is the idea to preserve continuity of the pensioner with the company as much as anything?—No, the idea is to protect to the best advantage the pension liabilities of the fund. I should have thought it was demonstrably beyond any argument that in our own case our pension beneficiaries were far better off as the result of what we have done than they would have been if we had invested in gilt-edged securities when we started the fund twenty years ago.

901. Yes, but there could be other equities where they might have done as well.—Again I come back to my point that if you gamble with equities at least you gamble with those that you can control if you invest the pension funds in the shares of your own company.

902. In the last paragraph of your memorandum you are dealing with take-over bids and you suggest that a director appointed by the employees might have

power to veto any transaction the result of which would be to transfer the control to somebody else. Are you suggesting that that might be made a compulsory provision, or just that it is a good idea that some companies could adopt if they liked?—I am suggesting it is a good idea that companies could adopt if they liked, and that it is desirable, as part of the general climate of encouraging worker participation, that that should be done inside company law. At the present moment in our own case we have a provision of that kind in a constitution which is wholly outside the company—part of a separate trust—under which our workers do elect directors and under which their concurrence is necessary for either additions to or subtractions from the assets of more than 5 per cent. of the total. Our submission is that it should be possible to incorporate something on those lines, within the Companies Act, within the Articles of Association; that membership should extend beyond shareholders, that employees should be able to become members of the company whether or not they were shareholders.

903. You would like such a measure written into the Companies Act, to make it possible if it is not already possible, but not to make it compulsory for all companies?—No Sir, we have in mind an extension on these lines of Table A of the Companies Act, that sort of solution.

904. *Mr. Lumsden*: My first question is about the last paragraph of your memorandum. I can understand how this works in your particular organisation where the equity shares are really privately held, but in an ordinary public company where the equity shares are held by the public is it your suggestion that it would be possible, in a case like that, that employees who were not necessarily shareholders, through a representative on the board, would have absolute power to veto any take-over bid for the shares of that company?—Would have power, not necessarily absolute power. It could be qualified. It could be defined in the Articles of Association. Our submission is there should be power of that kind; it might only be a delaying power. I have no predetermined views on the extent of the power, but it should be possible for a company in its Articles of Association to give its workers

representation on the board and to give those representatives some power in decisions on matters that are likely to affect the worker particularly, such as parting with a large section of the company's business, or something of that kind. In that way workers would be given some right of action in the courts, if necessary, in the same way as shareholders have a right of action in the courts. It seems to me that this would be feasible and desirable.

905. It might be very difficult to define?—I can well believe that, and of course companies would presumably define the thing in the way they wanted it. Each company tailors its Articles of Association to its particular needs. But if I am right a company, at the present time, cannot give rights of membership under the Companies Act to someone who is not a shareholder.

906. May I ask an entirely different question. It has been suggested by various people that it should be obligatory for companies to disclose their turnover in their accounts; would you be in favour of that?—I have no views on that. We always disclose ours, and I can never see any reason why people should not disclose it. I think I should be in favour of making it obligatory.

907. You have no objection that it benefits your competitors, or anything like that?—I do not see how it can. As I say, our own practice has been to disclose it, for twenty years or more, and in general terms we favour maximum disclosure of all kinds.

908. *Mr. Brown*: May I just revert to a small point on the question of the investment of the pension funds in the company. I think, in your case, the whole of the funds have been invested in the company. That has worked out very well in the case of your company which has been successful, but there is on record a case of a shipping company which got into financial difficulties, and not only did the staff lose their jobs but they lost their pensions as well. Is that not an argument against the pension being invested in the same organisation?—Sir, I think I would suggest that the converse could also happen; that is to say, it would seem to me perfectly feasible for a business to continue

reasonably successfully and for its pension fund to diminish very substantially through unwise investment of the pension fund. I think the lack of business efficiency or whatever it is that causes a business to lose a pension fund if it is invested in a business could also have the same effect on funds invested outside. If you can make mistakes by investing the money in the business so you can also make mistakes by investing it outside.

909. My point was of course that the staff's whole interests, job and pension, were lost at the same time. If it is invested outside it is not likely to be invested in one concern that failed totally. On the point of the opinion you expressed that you would not like it to be obligatory for the names and activities of a company's subsidiary companies to be disclosed, there are cases where, say, a store company has started some subsidiary for manufacturing products which have been so successful that they have sold outside the parent's store, and it has become a major part of the parent company's activities. You do suggest that the shareholders have no right to know that in fact that company does things other than running the store, which may be a major part of its activities and which may be quite different?—It may well be against their interests to know. That seems to pose a conflict between rights and interests. I do not think I can on the spur of the moment express any views on that. I can certainly think, within my own small span of experience, of cases in which it would be disadvantageous to the company to have compulsory disclosure. I know of many cases where that would be true. I know of none in which I could conceive there would be any real benefit from compulsory disclosure.

910. As a matter of your practical experience might that be answered by a question of degree? If it were a major interest the shareholder should know, and if it were not major then it need not be disclosed?—Yes, I would agree I think on those lines one might arrive at some settlement; two different sets of considerations.

911. *Mr. Althaus*: Arising out of the question asked by Mr. Brown, it is true I understand that the great part of your pension fund is in fact invested in the

shares of your own company. It is clear in your case that has been a very happy and successful experience.—Yes.

912. But would it be right to say that there are two objects as far as you are concerned, one of which is to secure a profitable investment and the other of which is, in the broadest sense viewing what you regard as the interests of your employees, to secure continuity of employment. In fact, if I may put it that way, can you conceive of any situation in which the trustees of your pension fund would ever vote in any sense to deprive your workers of their employment or to expose them to that hazard?—No, I cannot conceive of that. Our view has always been that the real security for workers' pensions is the prosperity of the company. The fund is merely an outward demonstration of that, and certainly we should take the view that if our fund were invested in equities and the equities themselves lost value substantially it would be for the company to make that good in the form of *ex gratia* pensions outside the fund. In fact a considerable element of our existing pension arrangements is outside the fund to make good the change in the value of money, and so on. So I think it follows from that that I cannot conceive of the trustees of the pension fund voting in any other way than to secure the prosperity and strength of the business.

913. They are therefore only in a limited sense independent trustees?—Independent of what?

914. They have no independence of choice in the manner in which they would cast their vote in major matters such as would affect the continuity of employment of the beneficiaries?—Only in the sense that they have no freedom to vote in ways that would harm the company.

915. I have two minor points. The first one is with regard to your interest in Glyndebourne, for which I am sure many of us are grateful to you. It has been represented to us that contributions by companies should be confined to things which can be demonstrably in the interests of the workpeople, and this appears to be in rather a broad sense in that interest, although it is obviously desirable in the conditions of today in

which taxation and other factors have made it more difficult for private individuals to function in these matters. Would you wish if it were possible for that freedom to be more clearly expressed, or are you happy that you have that full freedom at present?—We have that freedom, but I would nevertheless wish for directors generally to have that freedom; that is to say that it should be recognised by shareholders that directors should be free to exercise their judgment in matters of that kind. Most of the things we do, including our contributions to Glyndebourne, have in fact been done for the benefit of our staff initially—we always sent large numbers of our people to Glyndebourne. But I think, on the general point, that directors should not have to justify to their shareholders any direct benefit of expense of that kind to the company. Directors clearly have to act as directors, with all the obligations that devolve on them in exercising their judgment in relation to the company, but I should have thought that the general requirement was sufficient in matters of this kind. Shareholders can ask questions, but the decision ought to be with the directors.

916. Just one final point; you said where a subsidiary company contemplated a radical change of its functions you thought that should be a matter for reference to the shareholders. Would you distinguish there between an internal subsidiary, something which you have created *ad hoc* on your own behalf in the conduct of your own affairs, and a company which you had acquired, possibly with a certain amount of public limelight, which exercised one kind of function, and which, having acquired it, you then proceeded to change to another use?—No, I would not distinguish between those two. In the case of an acquisition which was of 100 per cent. of the equity capital I would think there was no distinction that arose there at all. If I understood you correctly, in suggesting that there should be this disclosure in the case of a radical alteration in a subsidiary's activities, I understood from the Chairman's questions that you were suggesting that the disclosure should be where the scale of change in relation to the total affairs of the group, not of the affairs of the particular subsidiary, was large. If a

subsidiary, that was only a small fraction of a group's activities, changed, for example, from selling insurance to selling hot dogs I should not regard disclosure to be required. I would think disclosure should be made if the activities of the subsidiary in question were important to the whole group. Is that what you said to me?

917. *Chairman*: Yes, you would have to look at the whole and decide whether 20 per cent., 30 per cent., or whatever it

might be, was sufficiently important.—Yes.

918. And that is where the difficulty comes in.—Yes.

919. I think that is all we need to trouble you with this afternoon. Thank you very much for coming here to help us. You will let us have that memorandum about the Partnership?—I will, Sir. We would like to consult our lawyers about that and make it as comprehensive as possible.

(The witnesses withdrew)

PROFESSOR B. TEW called and examined.

920. *Chairman*: Professor Tew, you are the Professor of Economics in the University of Nottingham and the contribution you have made to our investigation was actually a joint paper done with Dr. R. F. Henderson, who is an economist at Cambridge, but who is unable to be here because he is in Australia?—That is so.

Chairman: As your evidence is directed mainly to accounts, I will ask Mr. Lawson to put the questions at the outset.

921. *Mr. Lawson*: Professor Tew, what would you say is the purpose of annual accounts? Should they be prepared solely for the guidance of the shareholders, creditors and others who are interested in the company concerned, or should they also take into account the requirements of economists and others who require statistical information for one purpose or another?—I think they should perform both of these functions. We compiled our memorandum of evidence essentially from the point of view of the shareholder, taking no account of the economist's needs, even though as economists we have spent a lot of our time trying to make use of accounts. We had it in mind to submit a second document saying what economists wanted, but then we decided that economists wanted what shareholders wanted, so that there was no need for a further submission. I say this subject to one reservation only. We think as economists that the net of exemption is rather too wide, and that the large private

company which at present enjoys exemption should not be exempt, i.e. there should be some such rule as that no private company whose assets exceed a certain amount should be exempt. This would I think affect a small number of companies, but ones whose accounts would be of interest to economists. If he is looking at shipbuilding or glass-making the economist misses one or two very big companies because at present they are exempt private companies. That is the only difference we wish to make.

922. So if your recommendations are accepted as regards annual accounts, that would really give you the information which you need as an economist?—We have also recommended that rather more simplified accounts should be published more frequently than annually in the interests of the shareholders. In this respect too I think they want exactly the same thing as economists.

923. You say that it is undesirable that the value of shares should diverge substantially from the real value of the underlying company. You would probably agree, would you not, that the price of the shares on the Stock Exchange is subject to the laws of supply and demand and that the real value of the shares of the company at any particular moment is what they would fetch in the market?—Yes, indeed.

924. Do you seek to distinguish this from what you describe as 'the value of

the underlying company'? I am not clear what you mean by 'the value of the underlying company'.—I agree that the price of the shares on the Stock Exchange is determined by supply and demand. The demanders of shares are however investors who are demanding on the basis of what they know about the company. If their information is inadequate or misleading their demand will not be the same as it would be if they were correctly informed. I think, therefore, that if shareholders knew more about the companies of which they were shareholders the market value of the shares, although determined by supply and demand, would more closely correspond to the value of the assets of the company.

925. I see. May I ask you a few questions under each of the subjects you mention in the summary on the last page of your memorandum, leaving the question of replacement values of assets until the end? You refer to the problem of stock appreciation and depreciation. You say if stocks held at 31st December, 1958, were valued at £1,200,000 and those stocks at prices ruling at 31st December, 1959, were worth £1,320,000, stock appreciation in 1959 amounted to £120,000. From this you draw two conclusions; firstly, that the cost of maintaining the same physical quantity of stocks has increased by £120,000. There can be no argument about that; you need more finance to carry that higher figure. Then you go on to say that a note should be made in the published accounts so that an appropriate adjustment to the figures of profits can be made by those who wish to do so. I would be grateful for some further amplification as to how you would make that calculation. The difficulty is this, that the amount of profit derived from the appreciation of stock will depend upon the company's policy as regards price fixing. If you fix your prices in relation to the historical cost of stock you may never realise that appreciation at all. The benefit will have been passed on in low prices to the public, who will benefit in having their stock cheap, so that you cannot put a note in the Profit and Loss Account and say this is a profit of £120,000 on appreciation of stock because the company might never have made that profit at all. Could you deal with that?—I think if the company has been sell-

ing its products on the basis of historical costs, irrespective of the conditions prevailing on the market, so that it has been selling more cheaply than the market would bear and has in consequence been making a loss on its transactions, the shareholders should know. Suppose, calculating the profits in the orthodox way, that the company has made, let us say, £100,000 profit, but then a footnote has to be added saying that from this might be deducted £120,000 worth of stock appreciation; then taking this into account the business is being conducted at a loss and the shareholders should know that. If I were a shareholder I would take the view that the management had been remiss in selling its products so cheaply.

926. I think that is a very difficult point, because at some periods of time it has been the Government policy that prices should not be increased. If one puts into the Companies Act anything of that kind one might get into serious problems.—If it embarrasses the Government I would be pleased, for I think the Government, in fixing prices, should take account of the current market situation and not force companies to resell at a fixed profit margin goods they bought cheaply when prices were lower. In any case I think shareholders should know what is going on. If the Chairman has to say, "Although compiling our Profit and Loss account in the orthodox way we have made a profit, in fact if we take into account stock appreciation we have made a loss and this is not our fault because the Government forced us to sell at this price", then the shareholders are simply getting information they are fully entitled to.

927. Now you are getting into a field of difference between the viewpoint of the economist and the viewpoint of the accountant. An accountant would not say you had lost £120,000 under those conditions. He might say that if you had had a different pricing policy, you would have made £120,000 more profit. He would not regard that as a loss.—I am trying to look at it not as an economist but as a shareholder. I would have thought the shareholders would take the view that the company had in fact conducted its business at a loss in those circumstances.

928. Taking shareholders today, very many of them are quite unsophisticated in the matter of accounts. Supposing the man in the street had a motor-car which cost £500, and the new price of the car went up to £700 and he then sold his car for £600; would he say that he had made a loss?—I do not know, but I think he should think that. If he is misguided he should be re-educated. In this field he has got his professional educators. He normally will not try to interpret company accounts himself but will rely on the "Financial Times" or some such journal. We need not assume he is a fool, or if we do assume he is a fool, he is at any rate under the guidance of more able men than he is.

929. I suppose I am regarded as being in your category of expert advisers, but I am bound to say it would not occur to me in the example I gave you that I had made a loss of £100 on my motor-car; perhaps I ought to.—Are we not playing with words? There would be a figure shown in the Profit and Loss Account calculated as heretofore, but there would be a footnote to the account saying that the prescribed calculation had been made and that the result of the calculation was so many thousand pounds. The words "profit", "corrected profit" or "real profit" would not be introduced. I need not join issue with you as to the use of the word "profit", whose meaning could remain completely unchanged. What is at issue is whether this additional information should be divulged, and I think it should.

930. The difficulty is the calculation, and that is what I come back to. In the ordinary way what happens is not that a man fixes his prices either upon historical costs or replacement costs. In a very large number of cases it depends upon the particular moment of time when the selling price was altered, so that it is from an accountant's point of view difficult to sort out and say that a particular part of the profit was due to the rise in prices. You can get somewhere near that by valuing stocks by the LIFO (Last In, First Out) method; that in a sort of rough and ready way may bring up the kind of results you are talking about. Have you any views about LIFO?—The reform we are asking for does not concern the

Balance Sheet. We have no recommendation about that. We would be happy if the method of valuation for Balance Sheet purposes remained unchanged. It is only a correction to the Profit and Loss Account we are concerned with, and here we want it merely as a footnote. I do not think LIFO meets this need at all. It seems to me the best way to calculate the figure we want to be calculated is to take the actual value of the stocks at the beginning of the year, valued on any reasonable method—either FIFO (First In, First Out) or LIFO and compare that value with the hypothetical value that the same stocks would have had at the level of prices prevailing twelve months later. In order to get at the figure we want you have to compare the actual value with a hypothetical value.

931. But you say that the Balance Sheet might well remain as at present with the conventional method of stock valuation?—We are not making any recommendation on that.

932. Supposing the whole of this increase in stock value of £120,000 which you refer to had occurred in the last week of the year; then the Balance Sheet according to the convention would not include that at all; very little stock would be sold at that price. Correspondingly your Profit and Loss Account would not include it either; in that case this £120,000 would not be in your accounts?—I agree.

933. I think I have got your views on that. Then you refer to the need for more information in the accounts, particularly as regards turnover figures. We have got a lot of evidence on that point; quite a number of people have put suggestions to us that turnover figures should be produced. What are your particular reasons for it—for the purposes of economists or because you think the shareholders should know?—I think the shareholders should know. The typical shareholder does not so much decide "Shall I invest in this company or keep my money idle?" He is deciding whether to invest in company A or B. Therefore, typically he is always making comparisons between one company and another. One helpful way of making such comparisons is to use accounting ratios which usually involve either in the denominator or in the

numerator the figure of turnover, and if you look at what an American stockbroker sends to his clients you will see a lot of his advice takes this form. He will produce accounting ratios for the two companies in which his client is interested and draw broad conclusions.

934. Then you go on to say that figures should also be given of wages, materials consumed, overhead expenses, etc. You know of course that in many businesses, particularly large businesses, this type of statement is not prepared for the directors. The directors would normally get departmental accounts, accounts of different sections of the business, and they would get comparisons between actual costs and standard costs and all that type of information which they need to assist them in running the business. Very often they will not have the type of information which you suggest should be published. Two points arise on that; firstly, whether you think it would be worth putting the company to the trouble to get all that information together, and secondly, what use is it likely to be to the shareholders if it is not really of any particular use to the directors themselves?—These figures we have asked for, as distinct from turnover, I think we would regard as the least important of our recommendations. Where companies in fact divulge their turnover they usually give the figures which enable you to reconcile the turnover figure with the Profit and Loss Account; they usually give figures for wages, raw materials, and similar broad headings. We thought that, if companies were required to divulge their turnover, the further step of giving under very broad headings the explanation of the gap between the turnover figure and the profit figure would not meet with much objection, but we would not want to press it if there were objection. We would agree that these figures of wages, etc., are not so important. The important thing is the figure of turnover.

935. Do you think there could be any circumstances in which it is desirable in the interests of shareholders that the connection between the parent company and its subsidiaries should remain secret, or do you think it should always be disclosed?—I cannot think of any case where it should remain secret, but I would

not like to say. I should have thought that if our recommendation were adopted there ought to be some loophole so that the information could remain secret with the permission of, say, the Board of Trade.

936. That is the sort of question we could ask our business witnesses, so I will not press you further on it, nor on your other suggestion about the disclosure of income from overseas companies. These are questions in which we shall have to consider whether any damage would be done to a particular company or to the economy of the country if that type of information were disclosed. I think we can pass on from that. Now you make a suggestion about the statement of the sources and the uses of capital funds. That again has come from other people. What you have in mind, I assume, is the sort of statement which the Americans call the cash flow—on the one side, the amount of cash coming into the business, from issues of capital, from profits retained and from depreciation, and, on the other side, capital expenditure, etc. With very complex accounts it is the sort of simple statement which is useful.—Yes.

937. You would like to see us make that compulsory?—Yes. We think also in so doing little additional information would have to be disclosed. We think a competent accountant with time to spare can readily draw up such a statement from the existing form of accounts, but if the accountant of a company were made to draw it up on the shareholders' behalf he would be performing a very useful service.

938. I think there would not be any difference of opinion, firstly, that that type of statement can be readily prepared and, secondly, that it is a very useful thing to do. The question is whether it is the sort of thing the Act ought to provide for. Now you suggest that the estimation of the written down replacement values of fixed assets should be provided annually and that assets should be valued at the end of every five years. What exactly do you mean by replacement values in this sense? Have you in mind a straight calculation based upon a price index, or should some account be taken of offsetting reductions in replacement costs due to technological improvements?—I feel this is a technical matter on which I prefer not to give an

answer, but many companies have revalued their assets and I should have thought, if the Committee are prepared to consider this recommendation at all, then the kind of people who, say, have revalued the assets of I.C.I., should be asked to explain what exactly they did. I think this is a practical problem where a man who has not actually done it can be of little help.

939. You think something should be done but do not want to express an opinion as to the details?—That is right.

940. The practical difficulties are very great, you appreciate that?—Yes.

941. Do you think that the present under-valuation, particularly of land and buildings in Balance Sheets, to which you refer, is due solely to the very exceptional amount of inflation in the last twenty years, or is that a continuing problem?—I should have thought the problem has been greatly aggravated by the war and the immediate post-war years, but the problem will always be with us, particularly in urban site values. Some towns will continue to grow and urban site values will rise even though the general price level is not rising, and if some company owns properties in such desirable sites the shareholders should know of the appreciation of the property.

942. You immediately get into this problem of valuation there. Urban site values depend on what planning permission can be obtained and what the demand is for that type of property and whether the business now being operated at that property can be conveniently removed somewhere else. You get into a very difficult field of assessment there. It is not so much theoretical as practical.—I would like to say this. It seems to me the purpose of the accounts is not to provide the shareholders with all the answers as to whether the company is well managed or not, but to ensure that be can ask sensible questions. I imagine a good chairman will anticipate the questions that will suggest themselves to the shareholders and will explain in his speech why some apparent anomaly is not really an anomaly. In other words, I should have thought the one main way in which these better accounts would be

valuable is that the chairman would be forced to give more informative reports to the shareholders.

943. If you were to envisage stable prices instead of the inflation which we have had for such a long time, would you agree, generally speaking, that the trend of building costs would be downwards because of the technical improvements which are being developed all the time?—I do not see that technical improvements would be any faster in building than in other industries.

944. Not faster, but in all industries there would be technical improvements.—If there were technical improvements in all industries, are you suggesting that all prices would go down, or just building costs?

945. I was thinking particularly in terms of capital goods at the moment. If you have stable prices the tendency would be, I should have thought, for the price of capital goods, the price of replacement of equivalent productive capacity, would tend to be lower than the historical cost. What would you do there? Should the Balance Sheet write those assets down?—We do not suggest any change in the Balance Sheet. We suggest the Balance Sheet should be published as at present, but that further information should be given in the form of a note.

946. But the trouble about a note is that, however you word the note, some shareholder will play around with the figures and incorporate them in the Balance Sheet. That is the danger.—I think that is a danger, but it seems to me that increasingly shareholders are coming to rely on professional advisers who would interpret the information in an expert way. In protecting the shareholder from his incompetence, by keeping him in ignorance, you are at the same time starving the competent financial adviser of information which could be useful for him to digest so as to give better advice to his clients.

947. I see your point. You then make a suggestion, which we have had from others as well, that the Balance Sheet should disclose the amount for which assets are insured. There are many

technical difficulties about that, but quite apart from technical difficulties, is there not a certain danger that a man who wanted to present the picture in a pretty favourable light would perhaps rather over-insure his assets and therefore state a higher figure?—We would not attach a great deal of weight to this particular recommendation. We wanted to bring it before the Committee, but we would not press it.

948. Do you think that depreciation allowances should always be calculated on the basis of replacement costs, or should it be additional?—We think it should be additional.

949. You would have your normal depreciation on the basis of historical cost and then make any addition considered necessary because of price changes?—The addition should be disclosed in some form of note.

950. Do you think that, if the effect of charging depreciation on the basis of replacement cost was to turn a profit into a loss, the directors would be justified in passing their dividend, and even a dividend upon the preference shares?—They might be, but I have no views on this.

951. All you want is the information disclosed?—That is right.

952. Have you any views as regards this additional depreciation when a very high proportion of the assets are financed by loan capital?—No. I realise there is a problem there, but I am afraid I have no considered view on it.

953. Would you agree that it is now unusual for assets to be replaced by precisely similar assets? In some cases of course there may not be replacement at all. One of our witnesses has said that to estimate the cost of replacing something which nobody wants to replace is a very academic notion. Would you share that view?—No. This problem must have been very much to the fore in the I.C.I. revaluation because their industry is one where technical progress is very fast. Yet they thought it worthwhile, so I think this must be a practical possibility.

954. It has been suggested that for practical purposes one should limit revaluations to assets such as land and

buildings which have an indefinite or a very long life, and that the complexity of doing the same thing for relatively short-lived assets would make it not worth while. Have you any views on that?—I should have thought it would be sensible to have some rule that assets whose expected life was less than so many years should not be revalued. What that life should be I do not know, but, speaking offhand without having considered it, I would say five years.

955. Yes, on the principle that with short-life assets depreciation catches up quickly anyway and the advantage of any special depreciation is not very great and the amount of work involved is very much greater than it is in connection with land and buildings?—Yes; I have in mind things that would be worn out very quickly.

956. As regards specific assets, you would probably agree that the value of that type of asset depends upon its earning capacity?—Yes.

957. Therefore if the accounts show a fair statement of the profit, is there any advantage to anybody in showing a valuation of such specific assets?—We are not asking that this footnote should disclose the market value of the assets as a going concern, as it were. We are not asking for a view to be taken as to the future profits of the company and a calculation made as to the present value of the expected future stream of profits. We are asking that the replacement cost of the assets should be estimated and an appropriate deduction made for depreciation.

958. The difficulty is that because of technical improvements the replacement cost may be no more than the original cost.—I agree the difficulty, but since so many companies have in fact revalued their assets I should have thought the Committee should not decide the difficulties are insurmountable before asking for evidence from someone whose job it is to do such revaluations.

959. Is there any real evidence, in the case of highly specific assets such as plant, of any advantage in revaluing them?—Our argument depends on the shareholder being able to judge in some very rough-and-ready manner whether his money is

being put to good purpose. Supposing a company's profits are very low and the market value of its assets is very low but the replacement cost of these assets is very high; a possible implication is that the company has used its shareholders' capital to buy expensive assets whose pay-off in profits has been very low. There may be some perfectly good reason which the directors should then be able to explain. But *prima facie* there is a case to be answered; why has the management of the company invested this money in plant when the profits are so low?

960. You have still got quite a long way to go, because if you go to replacement costs you have got to have some sort of agreement that you must have a fairly uniform price index for revaluation.—I do not know that we should. I do not want to be drawn into methods of revaluation. It seems to me the men who do it for the big companies should be asked how they do it. They must have some way, and I wonder whether they do have recourse to some general index. They may in fact look at the present cost price of equipment equivalent to that already owned by the company.

961. One of the difficulties about this problem is that the people who do this use a variety of different methods. One company may do it by one method and one by another. You yourself have said that you really do not know the answer to the problem of loan capital, but if you are going to make this kind of calculation, that is an essential thing to which the answer must be found. At the present time one company is doing one thing and one another.—On the question of loan capital I am quite clear, companies with large loan capital should still do this calculation and put a note saying that their assets, revalued in this way, amount to so much. The only question is whether some further information ought to be required of such companies. That is the difficulty as I see it.

962. Then you would get the situation that with property companies or other agencies financed largely by loan capital, you would either have to make the most exorbitant charges to tenants or else the company would show large losses due to charging large sums for additional depreciation. It would be extremely difficult

to adapt your system to that type of case.—It seems to me if you calculate depreciation it should be on the replacement cost of the asset, not on the market value. Take the case of a brewery which owns a lot of public houses on sites that are appreciating in value. It seems to me that for calculating depreciation the right method of calculation here is the replacement cost of the buildings with the right percentage applied; in other words, the depreciation provision should not be inflated by the fact that the site value is appreciating year by year. When it comes to showing under the Balance Sheet an alternative valuation of the assets, then I think it would be right to say that the site values are higher than they were last year and amount to such and such. I think, however, that in some companies, particularly those whose assets comprise sites, the note about depreciation I would like to see under the Profit and Loss Account would not be exactly geared to the note as to the value of fixed assets that would appear under the Balance Sheet.

963. It would be a different thing?—Yes, in so far as the assets consisted of sites, then there would certainly be a difference. If they were replaceable assets—buildings and machines—I should have thought that the normal method of revaluation would be at replacement cost, and in that case the depreciation provision would be geared thereto.

964. There is one final question. The Committee have a definition of a Balance Sheet contained in paragraph 98 of the Cohen Committee's report. I will read it:—

“The function of a balance sheet may be stated briefly to be an endeavour to show the share capital, reserves (distinguishing those which are available for distribution as dividends from those not regarded as so available) and liabilities of a company at the date as at which it is prepared, and the manner in which the total moneys representing them are distributed over the several types of assets. A balance sheet is thus an historical document and does not as a general rule purport to show the net worth of an undertaking at any particular date or the present realisable value of such items as goodwill, land,

buildings, plant and machinery, nor, except in cases where the realisable value is less than cost, does it normally show the realisable value of stock in trade."

Do you agree with that definition of a balance sheet, or would you feel that since the Cohen Committee reported changes have taken place which make it necessary to review that?—I am quite happy about that.

965. What you really want is to get fuller accounts?—That is so.

966. *Mr. Mackinnon*: I have one question. Generally you have said you want turnover disclosed. I would like to know how far you want to carry that in the case of a composite business with perhaps six different branches. Would you want the turnover to be broken down between the six different and perhaps unrelated branches of the business?—My answer is that I would like to encourage companies to do so where it was possible, but it seems to me that it would often not be possible, and therefore it would be difficult to embody such a requirement in a law and require that it should always be done.

967. Have you considered the position where there is an associated company whose shares stand in the books of the parent company and where, for instance, the profits of the associated company may have been put to its reserves for many years so that the value shown in the accounts of the parent company is small; would you feel that that is a problem which should be attacked in some way so that the shareholders of the company might be informed about the real position of that associated company, which just falls short of being a subsidiary?—The only recommendation we make on that score is that we think in such a case the undistributed profits of the partly-owned company belonging to the parent company should be shown in the parent company's accounts. That would not unearth the past history but it would disclose to the shareholders in the parent company what was going on currently.

968. You would get the profits but you would not get the asset position or the relation of the profits to the asset position. But you would accept that as going far enough to deal with that problem?—I

would not accept it, but I would say we did not feel competent in making any further recommendations.

969. *Mr. Watson*: On what you said about the valuation of stocks, I can see your proposals might have considerable merit if you are visualising a situation where the value of commodities is likely constantly to rise; but that is not true, is it, over the raw material field?—I cannot predict the future, but in the light of the recent past it seems to me that falls in prices are quite likely.

970. So that there might be a situation like this with, for example, a commodity like wool. A company produces a Balance Sheet and shows a profit on stock of the size you instance, but by the time the accounts are published that profit may have vanished; is it not possible that that may lead to greater mistakes in the valuation of shares than the absence of that information?—I do not think so. I think you get a very good example of how bad the present disclosure is by going back to the period of the Korean War, and considering industries like the paper industry and the textile industries, whose materials went up very greatly in price and then fell. In such cases you might get two adjacent years when in the first year profits, as disclosed in the Profit and Loss Account, were very high because the price of (say) wool had risen so much; in the following year there were very low profits or even losses. I should have thought the shareholder would get a much better idea of the value of his investment if the correction we are now suggesting had been made. It would iron out such temporary fluctuations in profit due to variations in material prices. I should have thought this information is as much use when prices are falling as when they are rising, and even more useful when prices are fluctuating. What we must always expect is that prices of raw materials will fluctuate violently; they always have in the past. It is a question of the reasonable interpretation of the profitability of companies who own large amounts of such materials.

971. Would you agree it is normal for a company not to have a large stock but merely to cover its requirements say for a period of six months?—I would not agree; some do and some do not.

972. You stick to your opinion that this valuation of stocks should appear in a note on the Balance Sheet?—No, not on the Balance Sheet. The stock appreciation or depreciation during the course of the year should be put as a note under the Profit and Loss Account.

973. In order that this should form a basis for the calculation of future profit or not?—I think that the past is never an infallible guide to the future. It is up to the shareholder or his advisers to decide how much reliance they should place on the past as a guide to the future. We are recommending that the record of the past should be more clearly put before the shareholder and his advisers.

974. It is not of any great value as far as the future is concerned?—That is a different matter. It seems to me that in all matters of prediction to a greater or less extent we rely on what we know of the past, and I suppose it is one of the skills of a stockbroker or an investment adviser to know how much the past is a guide to the future in a particular company. He would probably assume the past can be a guide to the future unless he has some reason to think to the contrary.

975. *Mr. Scott*: Your recommendation is, I think, that estimates of stock appreciation or depreciation should appear every year?—That is right.

976. Would you extend that to your suggestion that companies should produce accounts every six months or even quarterly?—No, I should have thought not—I should have thought that rather less information would be given in the six-monthly accounts and still less in the quarterly. Certainly the calculation of stock appreciation should not be compulsory in the six-monthly accounts. Quarterly accounts could be even more rudimentary; figures of cash, debtors, creditors, stocks: those would perhaps be the main things. When I talk to people who are in the investment business it does seem that when they have an interest in an operating company they get the annual accounts and they frequently get half-yearly or quarterly or monthly

accounts. The monthly accounts provide less information, and it seems to me just as a City house would want this information more frequently in order that it can see how its investments are going on, so the ordinary shareholders should get this information. I think the information most frequently demanded at short intervals is a summary of the stock position, debtors, creditors and cash.

977. The stock position is just a figure for stock, no details as to how the value has changed as compared with the last accounts?—That is right, yes. If I may presume to make a suggestion to the Committee, it does seem that if the Committee are going to consider accounts covering shorter periods than a year, compiled on a less comprehensive basis than the annual accounts, the advice of City houses who have investments in operating companies would be very valuable indeed. It seems there is a great deal of skill embodied in the experience of the City as to what can be conveniently provided on a quarterly basis.

978. *Mrs. Naylor*: To go back to the point about the value of shares, you say that it should not diverge substantially from the real value of the underlying company. In the value of the underlying company do you include the value of the management's estimated earning power. I was thinking of Woolworths where the assets' value is a great deal less than the market value of the shares. I was wondering whether the value of the shares is not more closely related to the estimated earning power rather than to the value of the assets.—Yes. I would not defend what we said in this respect. In the case of a well-managed company it is clearly appropriate that the shareholders should value their investment more highly than the assets of the company itself.

Chairman: Professor Tew, that appears to exhaust our questions, so we will not trouble you any further. I would like to say we are all very much obliged to you and to Dr. Henderson for the memorandum and to you for coming here today to help us.

(The witness withdrew)

APPENDIX VII

Memorandum by W. T. Baxter, Professor of Accounting, University of London

Shares of No Par Value

1. The case for these shares is at least as strong now as it was when the Gedge Committee reported. A new Act should in my view permit the issue of no par shares.

2. The market value of preference shares can in some cases (e.g., if dividends are in arrear) differ greatly from par value. Thus the arguments for issuing ordinary shares of no par value do in fact apply with considerable force to preference shares also. There seem good grounds for including preference shares within new regulations.

Accounts

Need for full information

3. The case for full disclosure is well-known, but will perhaps bear repetition.

4. In a free economy, resources are guided to their most fruitful uses (in the main) by the decisions of individuals. If the economy is to work efficiently, these decisions must be based on adequate information. Investors should have available the fullest and clearest data on the working of the various sectors. Guided by such data, they will put new resources into the sectors where likely returns are highest—thus helping to give the consumer what he wants, and to reduce abnormally high profit rates to the competitive level. The society that fails to provide itself with the best available information is wasting resources, and keeping its income needlessly low; when applied to such a society, the main economic argument for freedom becomes hollow, since most people concerned would probably be better off in material things if they abandoned private enterprise, and entrusted new investment to state planners with dictatorial powers to extract information.

5. This is the main argument for disclosure, and it seems to me to be very strong. But there are others; perhaps the most important is the desirability of showing up managerial incompetence.

6. I do not as a rule like to see public intrusion into areas that have so far been treated as private. But the benefits from full disclosure seem amply to justify some compulsion; if the economy is stimulated as a result, the intrusion may in the end strengthen the rights of the individual, since we shall probably not want to overthrow a free-enterprise system that is plainly making us prosperous.

7. Though the case for full disclosure is powerful, it is not likely to commend itself to company officials. The evidence submitted to you may therefore stress the economic and social benefits less than the technical difficulties of reform. The latter deserve careful thought. But the very full experience of the United States in these matters shows that the fear of publicity is somewhat ill-founded; American companies flourish despite candid accounts, and public confidence in business is probably far greater now than when secrecy was common. Though some aspects of the American regulations may be unfortunate, in general we must surely deplore our quarter-of-a-century lag behind United States practice.

The dangers of rigid accounting standards

8. It is highly desirable that the law should lay down minimum requirements for accounts, but in no way cramp experiment, innovation, and the development of new concepts. In the past, our Companies Acts have been very successful in this respect. I hope that the draftsmen of any new regulations will be at great pains to continue this happy tradition. No reform at all would be far better than regulations that start as a floor but end as a ceiling.

9. Here the experience of the S.E.C. shows the danger of carrying a good idea too far. For instance, U.S. Steel was forced by the S.E.C.—in the interests of uniformity and “generally accepted accounting principles”—to abandon a revised system of measuring depreciation under rising prices. Accounting innovation of this type, clearly explained to readers of the reports, is something entirely different from failure to give minimum information. If accounting is not to be ossified, regulations must not act as a strait-jacket.

Revenue account

10. The chief fault in the reports of British companies is of course the lack of trading figures. The main revenues and costs should be published.

11. This reform seems far more important than any other accounting change that can be suggested.

12. Full trading figures would doubtless not give a perfect picture of some companies' operations (e.g., consolidated data for different departments might cover over conflicting trends). But figures that are imperfect in this sense are normally more useful than no figures.

Interim accounts

13. The investor would be helped by the more frequent publication of company results. Such interim reports need not amount to full audited accounts; but enough should be published to show important trends, and thus prevent severe shocks when the year's results appear.

14. Possibly half-yearly statements would be adequate for smaller public companies. The giants (most conveniently defined in terms of number of investors?) should publish quarterly figures.

Inflation and asset valuation

15. The rise in general prices has had a considerable impact on company finance. Accounting methods have so far failed signally to keep pace with this development. Though I strongly favour changes of method, and hope that any new Act will leave the door wide open for experiment, I hardly feel these should at present be made compulsory—except where asset values are concerned.

16. It is clear that balance sheet values of many assets have drifted far away from current values. Published figures no longer fulfill the purpose of the Act. The stories of many take-overs suggest that shareholders—and possibly directors—have in consequence not realised the potential earning power of the assets. In fairness to such shareholders, and as a check on management inertia, some reform appears to be needed.

17. Therefore, though detailed rules on how to revalue are undesirable in a statute, I think that a new Act should indicate a bias in favour of balance sheet revaluation at suitable intervals. Where a company does revalue, the basis should be stated; and any surplus resulting from changes in the general price level should not be treated as profit. Where directors do not see fit to alter the balance sheet, they should be required to explain their reasons, and to append a note showing—in broad terms—the current replacement value of the main fixed assets; the amount of insurance cover, or historical cost adjusted with the aid of a price index, would in many cases be sufficient.

Money rights versus non-money rights

18. Inflation has emphasized the fundamental difference between rights defined in terms of money and rights whose money value can move freely. The investor should be able to see how far a company's assets consist of money rights, and how far of non-money rights; the nature of claims against the company should also be clear.

19. In general, existing practice makes this distinction for most balance sheet items of normal companies. But one occasionally comes across cases where the distinction is not made; for example “Investments in Associated Companies” may mean either equities or money assets such as debentures. Clear distinction should be obligatory.

20. The balance sheets of insurance companies fail badly to distinguish between money and non-money items—and indeed to show basic figures that inflation has invested with special importance. No note is given of market values of securities owned (a specially grave defect in the case of ordinary shares); and the life insurance fund combines both without-profit and with-profit policies. Accordingly the potential life policy-holder lacks the information needed for intelligent choice between offices. This gap in the regulations seems an indefensible anachronism. Particularly in view of the great volume of saving done *via* life insurance, the government should be strongly persuaded to bring insurance practice into line with good commercial practice.

Share premium account

21. Amounts received as premiums are in logic indistinguishable from other payments for shares. All such sums should be given uniform treatment where repayment is at issue.

Pre-acquisition profits of subsidiaries

22. Like dividends accumulated at the date of a share purchase, pre-acquisition profits do not satisfy the tests of income. Accounts ought therefore to distinguish such amounts clearly, and not merge them with income; further, such amounts are no more divisible to the majority shareholders than the subsidiary's capital.

Reserves

23. Today there is some feeling against the multiplication of reserves, and even against the use of the word "reserve". This trend should be encouraged. Reserve accounts are highly artificial, and therefore any attempt to define or explain the sums at stake will usually run into grave difficulties.

24. The present Act's definition of "capital reserves" is unsatisfactory. The phrase plainly covers sums whose distribution is forbidden by law (and these ought indeed to be well labelled). It also covers other sums; but the boundary between these and revenue reserves in some cases appears arbitrary. The splitting up of revenue reserves under several heads must be confusing to many readers, and seldom seems to serve any good purpose; shareholders might well be spared such pomposities, which introduce pointless complexity into both balance sheet and appropriation account.

25. Even to some skilled users of balance sheets (for instance, bankers), the primary meaning of "reserve" is "liquid asset"; and this meaning must seem the natural one to the majority of shareholders. Its attachment in accounts to credit items, instead of debits, is sadly out of harmony with normal usage.

26. The drafters of a new Act should accordingly avoid the word "reserve". They should stipulate that the equity section of a balance sheet should contain descriptive phrases explaining the nature, and the reason for, the various sub-divisions, and should in particular show (besides share capital) the following:

- (a) Sums whose distribution is forbidden by law.
- (b) Sums whose distribution would seem to impinge on real capital (e.g. allowances made during inflation to raise historical charges for "cost of goods sold" and depreciation).
- (c) Balancing figures arising from the technical difficulties of consolidation, etc.
- (d) Retained earnings.

One or two other heads may in some cases be unavoidable. In general, however, the fewer heads the better.

Definition of profits

(a) Inflation

27. Inflation causes profits (as measured by conventional accounting methods) to be shown at figures above real profit—chiefly because "cost of goods sold" and depreciation are understated when based on historical cost. The practical results of this error may be very considerable; for instance, it alters the relative tax burden on

different kinds of company, and may well cause great social harm by contributing to the excesses of booms and slumps. However (to repeat what is said in paragraph 15) I hesitate to suggest that reform should be made compulsory, and merely hope that a new Act will clearly permit experiment with better techniques. If the Government wishes to go further than this, its best way would probably be to let firms opt for income tax assessment on reformed profit figures, provided their ordinary revenue accounts are correspondingly reformed.

(b) Losses and dividends

28. Where a company has made losses, the case law governing its dividend payments is far from clear.

29. If we wish to restore some measure of logic and consistency (and one does not hear many complaints about their absence from this area), I suspect that we must move right back to the views held before the *Lee v. Neuchatel Asphalt Co.* decision: no dividend must be paid if the accounting value of the (net) assets falls below capital.

30. A rigid rule of this sort might not suit shareholders in a company that has lost substantial assets but is now earning steadily at the reduced level. Possibly this case would merit some special loophole.

Exemption of banks, etc.

31. I am sceptical of the need for secrecy in these special cases.

32. Unless the institutions in question are now able to plead for continued privilege with new arguments of overwhelming persuasiveness, I suggest that the exemption should be modified or abolished.

33. In paragraph 20, I have already mentioned the desirability of tightening up the rules governing the balance sheets of insurance companies.

21 May, 1960.

APPENDIX VIII

Memorandum by Harold C. Edey, Reader in Accounting, University of London

General

It is generally accepted that investors should be given every reasonable opportunity to select, for the investment of their money, the securities of those companies which are economically most efficient and which for that reason are, in a competitive economy, likely to be the most profitable. This is one of the major reasons for requiring companies to provide periodic accounting reports and financial statements in prospectuses. The 1948 Companies Act effected great improvements in the quantity and quality of financial information thus provided for shareholders. Certain deficiencies, however, remain and are the more apparent for the improvements of 1948. My submission is directed towards this aspect of company accounts. It will relate to annual accounting reports, but the comments will apply, *mutatis mutandis*, to prospectus statements.

It is sometimes said, when suggestions are made to increase the information available for shareholders, that particular measures of disclosure are undesirable because the information so disclosed is open to misinterpretation, and may therefore "mislead" the public. It is also sometimes said that provision of fuller information would make accounts too complicated for shareholders to understand. These arguments are, I believe, inappropriate in a free society. In my opinion the legislation should be based on the fundamental assumption that the public should receive as much information as is reasonably possible and should be allowed to make their own minds up on the basis of this information. Apart altogether from undesirable philosophical implications, such arguments also ignore the fact that expert advice can be sought from professional advisers or from the financial press, who are certainly unlikely to be misled if the accounts are sensibly prepared. Business is, after all, a complicated process. It is not always possible in financial reports to remove all the complications without seriously distorting the picture. Furthermore, directors can always supplement accounting information by more or less detailed explanatory notes if they think that the accounts are likely otherwise to mislead. It is also sometimes objected in relation to the disclosure of accounting information that competitors will be helped. Two points arise here. Firstly, competitors probably know much more about one another before accounts are published than this argument implies. Secondly, it is in any case in the public interest, making for smoother working of the pricing system, that competitors should become aware of exceptionally profitable opportunities in particular fields, and the like.

A Statement of Accounting Procedures

It is undoubtedly true that statutory accounting reports may be substantial documents. The addition of further requirements will certainly not reduce their size. I think that the Act might well include a requirement that each company, or at least each public company, should file annually with the Registrar a "Statement of Accounting Procedures" at the time of publication of its annual accounts. Such a statement could be designed to explain the bases and assumptions on which the less certain of the figures in the accounts had been calculated.

Explanations in such a statement could, because they were filed, be much more detailed than would be possible in the published accounts; and the Act's requirements could be correspondingly more comprehensive. Another advantage that could well accrue would be an increased flexibility in the use and development of accounting conventions. At present it is difficult for a company to depart from generally accepted accounting principles because, if it does, its auditors are likely, not unreasonably, to qualify their report. Yet there is room for improvement in some of these conventions. And in any case I take it as axiomatic that freedom to experiment is desirable. The procedures currently followed for financial accounts are not always convenient for internal management accounting purposes. But because it may be too expensive to

duplicate internal accounting arrangements and prepare accounts on two different bases, companies may have to continue to prepare figures they do not really want because this happens to be in accordance with "normal procedures".

For example, a manufacturing company might wish to change its internal accounting arrangements in order to value its raw material stocks at current market prices. This would be a departure from the more normal "cost or lower market value" rule: the auditors might feel they had to qualify their report if the company were to use this basis for its annual financial accounts. If my suggestion were adopted the company would state in its "Statement of Accounting Procedures" that this particular method of valuation had been followed, explaining the procedure used; and reference could be made to the "Statement of Accounting Procedures" in the auditors' report, thus drawing the attention of shareholders to the need to study this statement.

I shall give other examples later of the type of figure with respect to which I believe that a statement of this kind would be particularly valuable.

If this suggestion were adopted it could be implemented by requiring the Board of Trade to embody in a Statutory Instrument and appropriate form of words and instructions. A standing committee could be appointed to advise the Board; this could draw on the services of practising and industrial accountants, economists and financial journalists.

I think that the importance of not allowing rigid rules of financial accounting to strangle at birth improvements in management accounting practices cannot be over-emphasized. It is not easy to obtain evidence of the extent to which this has happened. My own view, however, is that financial accounting rules, together with income tax considerations, have had a considerable effect in limiting experiment.

Form of the Auditors' Report

This raises the question of the auditors' report.

I think it is unfortunate that the words "true and fair" are at present used in this report (and in the body of the Act). These words constitute, it is true, a term of art; but even so they are an unhappy choice. I believe that an appropriate form of words, incorporating a reference to the "Statement of Accounting Procedures" suggested above, would be:

"In our opinion the balance sheet and profit and loss account present a fair view of the company's affairs in the light of generally accepted accounting principles and the company's statement of accounting procedures filed under Section . . . [and of the following modifications to generally accepted principles, explanations of which are contained in the said statement, namely . . .]."

The section in square brackets would be deleted where not appropriate.

It may be argued that to leave directors free to vary accounting methods would be to allow a latitude that could be abused. I do not think this is a convincing argument, firstly because even within the present body of accounting practice quite wide variations are possible in certain respects; and secondly because it would still remain in the hands of the auditors whether they should qualify the above form of words if it seemed to them that a departure from normal accounting principles did not arise from a *bona fide* motive, or if it seemed to them that the departure from the usual conventions was so radical as to make the accounts seriously misleading. (The effect of any change in the basis of accounting on the financial results of the year of the change must be disclosed under the existing legislation. This important provision would no doubt remain in force in any amended Act.)

Profit

It is unfortunately true that the concept of profit is not one that lends itself to a general definition that can be applied precisely in practice. Profit is customarily defined in accounting texts as "that which remains after provision has been made for maintaining capital intact". But this definition does not convey a clear meaning until the word "capital" has been defined.

(*) Insert here a short description of the modifications (e.g., "the stock-in-trade has been valued on the basis of current market prices").

The "maintenance of capital" could mean the maintenance of the saleable value of the company's undertaking as a whole; the maintenance of the current level of profit or of some other defined level of profit; the maintenance of the current level of dividends or some defined level of dividends; or the maintenance of the break-up value of the undertaking. It cannot be said that any one of these definitions would be freely accepted as the definition implied in practice. Yet it would be difficult to find any other general definition which would be accepted. Probably the first of these definitions comes the nearest to what is generally considered to be the idea of maintaining capital intact. Quite apart from this, there is the question of whether the quantum that is to be maintained intact should be stated in terms of current money values or in terms of a constant level of prices, i.e. after adjustment for changing price levels.

The problem is solved in practice by applying a number of accounting precepts that have developed over a period of many years. These precepts are capable of fairly wide variation in application, however, and in a given company, in a particular year, the profit figure could vary quite widely depending upon the bases of calculation adopted and the assumptions made. This is one of the reasons why I think that these bases and assumptions should be stated, more precisely than has hitherto been the case, in a "Statement of Accounting Procedures" to be filed with the Registrar, as I have suggested above.

By reading such a statement in conjunction with the accounts the individual shareholder or his advisor would have a clearer picture of what was in the minds of the directors when profit was calculated, and would be able to make such adjustments to the figures as he thought appropriate if he did not wholly agree with the directors' approach. This is not a new departure in company accounting. The idea of showing depreciation separately in the profit and loss account, and in the balance sheet the original cost (or subsequent valuation) of a fixed asset before the deduction of depreciation, established by the 1948 Act, has the same kind of reasoning behind it. The shareholder can see how much depreciation has been provided in relation to original cost. He can make his own assessment of the situation and make such adjustments as he thinks appropriate. The suggestions made here merely take this approach a stage further with the object of making the information available more precise and therefore more useful.

I should like to draw a parallel here between the shareholder and the director. A director necessarily has access to a great deal of financial information. In particular he receives accounting reports drawn up in much greater detail than is usual for shareholders. He is thus able to supplement the relatively limited amount of information conveyed by the net profit figure—which he knows is dependent upon a number of calculations and assumptions in which the order of magnitude of possible differences of opinion is very high—by examining critically the component figures of the profit shown in the account given to him. Moreover, the director can supplement his information by asking searching questions with the reasonable certainty of getting satisfactory answers. But unless the accounts are presented to him in sufficient detail to show the component figures that, taken together, make up the profit, and unless the bases and assumptions on which these figures have been drafted are available, he will be handicapped in pursuing his enquiries. In the ultimate analysis the shareholder is interested in the same kind of financial information as the director, who is, after all, the shareholder's servant, and presumably has the same broad aims. In the limiting case of a controlling shareholder, indeed, it may become difficult to distinguish between the part played in control by the shareholder himself and that played by the board of directors. The aim of the company accountant, and the company law, should be, in my opinion, to place shareholders as closely as is reasonably possible to the position of directors, bearing in mind that they have less facility for intelligent questioning than the directors. It is, of course, out of the question to provide as much detailed information to the minority shareholder in a large company as is available for the directors. But I believe the accounts should deliberately go as far in this direction as is practicable. The attitude of mind of the financial accountant when preparing accounts for shareholders should be similar to that when he prepares accounts for directors and managers. In this sense, I believe that all accounts should be regarded as "management accounts". The company law should, I think, be based on the same philosophy.

This question bears on such matters as a calculation of depreciation provisions in periods of changing price levels. There has been a good deal of controversy on the question of whether "profit" is to be correctly interpreted as a figure before, or after, adjustments for changing price levels have been made. Official pronouncements on the interpretation of the existing legislation have tended to suggest that the word "profit" should always mean a figure *before* a price level adjustment has been made. This has not been universally accepted by company accountants, but it has, I think, tended to make some accountants and directors refrain from introducing procedures which many people would have regarded as valuable. It is in my view undesirable that in such matters, company legislation should be capable of an interpretation likely to prevent accountants from presenting information which the weight of economic and financial opinion would regard as important to the investor.

I believe that the correct approach is to leave directors, advised by their accountants, to calculate the profit in accordance with the view that seems to be most appropriate and—most important—to make it clear to shareholders beyond a peradventure how they have made those calculations. I think that a general statement to this effect in the Act, or in the 8th Schedule, is desirable. This means that all calculations which lie within the area where opinion may differ, both with respect to the general method and the particular calculation or estimate, should be fully explained, e.g. in a "Statement of Accounting Procedures".

In the following paragraphs I shall make some comments on particular items as they are affected by this general view.

Depreciation

My first comment relates to depreciation. In my view the provisions of the 8th Schedule of the Companies Act in effect already allow directors to show profit net of depreciation on the basis of current price levels, since they may make provision for *replacement*, even if they have not first revalued the assets. (There is no disagreement where assets have been revalued.) Nevertheless there seems to be uncertainty on this point and I think the position should be made more explicit. I suggest that an amended 8th Schedule should be so drafted as to make it clear that there is no prohibition of the calculation of depreciation on the basis of current price levels if the directors think fit. Coupled with this I think that a fuller explanation of the method of depreciation should be supplied than has hitherto been the case, preferably in the "Statement of Accounting Procedures" suggested above. This explanation should cover (a) the question of the price level adjustment, i.e., whether such an adjustment has been made, and if so how it has been calculated; (b) the commercial life with the company that has been assumed for different classes of assets for the purpose of calculation of depreciation; and (c) the method of spreading depreciation over the commercial life of the asset, i.e., whether straight-line, reducing balance, etc. This explanation should relate to each class of fixed assets. Where more than one method is used in relation to a particular class of assets, the balance sheet value of the assets appertaining to each method of calculation should be stated.

It will be noticed that this suggestion refers not only to the problem of price level adjustment, but also calls for additional information than is now customarily provided with respect to depreciation calculated on the normal basis. One of the major difficulties of present practice with respect to fixed assets is that the shareholder is left very much in the dark about the approach the directors are taking in relation to the spreading of depreciation charges over time. This is particularly important, for example, where a heavy capital expenditure programme is undertaken and is then amortised over a short period: in the absence of explanation such a procedure may give for a time an unduly pessimistic view of the longer-term profitability of the company.

Expenditure on Research, Development, etc.

There are certain types of expenditure which are of particular significance for the longer-term prospects of the company. Expenditure on scientific research, on development, on advertising, fall into this category. Where such expenditure is charged to revenue the present legislation does not call for any accounting disclosure. Yet in some companies the failure to carry out heavy annual expenditure under one or

other of these heads, or the failure to maintain a certain level of such expenditure, may be of great significance to the shareholder. I believe revenue expenditure under each of these heads should so far as possible be separately disclosed in companies' published profit and loss accounts. I am aware that this raises practical difficulties: it is not always easy to categorise expenditure of this type. It would, I think, therefore, be necessary to provide that this information should only be required to the extent that it was available in the company's books. This would not be a perfect solution but it would place more information of a particularly important type in the hands of many shareholders. It would be open to directors to add explanations if they thought the figures thus disclosed would be misleading in the absence of such explanations. It would also be interesting for shareholders to know whether their directors had in fact arranged for such expenditure to be separately analysed.

Stock Valuation

I think it unsatisfactory that the method of stock valuation, which may affect the profit figure a good deal, should not be stated in the annual accounts. I should like the suggested "Statement of Accounting Procedures" to show in some detail the method of stock valuation used, e.g., whether "cost and lower market value" has been used, and if so whether the formula has been applied overall or to individual stock items; and whether "lower market value" means estimated net selling price or estimated replacement value. An example of a situation where this information would be particularly important is that of a company carrying a large quantity of raw material at a time when prices had fallen heavily.

Profit on Hire-purchase Transactions

Companies carrying on hire-purchase or deferred payment business do not always disclose the precise way in which profit is allocated between accounting periods. The formula on which this allocation is made should, I believe, be included in the "Statement of Accounting Procedures". Differences in formulae may make substantial differences in the figure of profit reported in particular years.

Sales Turnover

It is becoming increasingly accepted that the sales turnover figure is an element of the profit and loss calculation that is of particular significance when trends are under examination, and should be disclosed in the published information. This is now the accepted practice in America and is a growing practice in this country. I believe it should be required by the legislation.

A large company with many activities may make profits on some and losses on others. It is of significance to the shareholder to know when ground is being gained or lost on one particular activity. It is probably impracticable to call for separate profit and loss statements for different activities, but I see no reason why companies should not be asked to disclose the sales turnover figures for different major divisions of their business. This is not an easy matter to legislate on, since the definition of a separate activity is not easily arrived at. I suggest that for public companies whose shares are quoted a statement of the sales figures for distinct trading activities of the company should be required where these amounted to more than 20 per cent. of the total sales turnover. A "distinct trading activity" might perhaps be defined as one for which separate figures of sales are recorded by the directors for their own information. Here too there is no reason why the directors should not add explanations if they thought the figures would tend to mislead in the absence of such explanations.

Interest on Finance

The present legislation requires the disclosure of interest on debentures. But a substantial part of the finance of a company may consist of an overdraft or other non-permanent finance. It is of considerable investment interest to know the total burden on a company of its financing. I suggest that the profit and loss account should be required to disclose all interest paid, whether on debentures or on other loans and advances.

Reserves

The general balance sheet headings "revenue reserves" and "capital reserves" may each cover a long list of separate reserve balances. There is however a tendency

in well-drafted balance sheets for this practice to be discontinued. Such balance sheets contain only a single item under the heading of "revenue reserves" and no more items under the heading of "capital reserves" than are necessary to comply with the existing legislation (which requires the share premium account and the capital redemption reserve fund, if any, to be stated separately).

Sub-divisions in the reserves have little economic or financial significance. I cannot see that any information is conveyed by such sub-divisions that could not be better conveyed by a short note, or a comment in the directors' report. I think that the proliferation of reserve balances is confusing to people who are not familiar with accounting figures. In my view there would be a considerable gain in clarity if all revenue reserves, including the profit and loss balance itself, were shown under a single head in the balance sheet with no sub-division.

I also think that the distinction between (a) items entering into the composition of profit and (b) appropriations to reserves tends to be fogged by the absence in the published accounts of a clear break between the profit and loss account proper and the appropriation account. This often applies even where the otherwise useful "narrative" form of account is used. I should like to see transfers shown in the annual profit and loss statement to (or from) revenue reserves, other than tax reserves, limited to a single net figure, representing the transfer of the balance of profit (or loss), after deduction of tax, to (or from) a separate account, to be called, say, the "Retained Profit Account". The latter, following Canadian and American practice, would be presented as a distinct account, or in an entirely separate narrative statement. In this separate account or statement would be reconciled: (a) the opening balance of the retained profit from the previous year; (b) the profit for the year in question, net of all expenses and taxes; (c) the dividends paid or to be paid for the year in question; (d) any transfer to or from the capital reserve account or to nominal capital in respect of capitalised profit; and (e) the retained profit to be shown in the closing balance sheet. The latter figure would be the only revenue reserve balance in the balance sheet. The sharper distinction thus made between (a) the calculation and (b) the distribution of profit would I think make the profit and loss statement easier to understand, and the balance sheet would also be clearer.

Tax reserves are a rather special case. I suggest that the debit for tax on the profit of the current year should be shown in the profit and loss account "proper". The fact that tax is from some points of view an "appropriation" of profit is not, I think, relevant in this context. From a shareholder's point of view his dividend must come out of what is left after payment of all tax.

The credit balance shown in the balance sheet for "future tax" should I think be treated as a separate item, *sui generis*. It would be appropriate I think to describe this balance as a deferred liability, but the exact name is not so important as making its significance clear. I shall refer in greater detail to the question of tax in a later section.

There is much to be said for getting rid altogether of the term "reserve" in connection with undistributed surplus. In certain contexts "reserve" means cash or investments, and many members of the public find it difficult to understand that "reserves" are not synonymous with "cash". For this reason I have suggested the term "retained profit" for the revenue reserves. The term "capital surplus" is a possible substitute for capital reserves.

Capital Reserves

As regards the capital reserves, it would be simpler if the share premium account and capital redemption reserve fund could be amalgamated with the other capital reserves, but under the existing law relating to distribution of profits this would raise certain difficulties. Under the present legislation directors may transfer to capital reserve amounts which they "regard" as not free for distribution to the shareholders. If, however, they later stop regarding these amounts as not available for distribution they can, it seems, re-transfer them to revenue reserves.

One reason for transfers to capital reserve is presumably to sterilise certain so-called "capital profits", which may be thought, having regard to judicial precedents, not to be available for dividend. A suggestion I shall make later with respect to the definition of divisible profits would, if adopted, make these precedents no longer relevant. If,

however, the law remains as it appears to be now, it would seem more rational to regard the act of transfer of such items to capital reserve as *ipso facto* causing the amounts so transferred to become "capital" in the same sense as the share premium amount, that is, subject to reduction only by due legal process.

There is also a case for allowing, with the consent of shareholders in general meeting, a "voluntary" irrevocable capitalisation by simple transfer to capital reserve, of amounts that would otherwise have been free for distribution. The usefulness of formal capitalisation of distributable profits arises from the fact that it may improve the credit standing of the company: once profits have been formally capitalised, the amount by which the company's assets can be run down at any time by the declaration of a dividend is reduced *pro tanto*. This improves the security of creditors. At present the only method of irrevocable capitalisation available is the formal procedure of paying-up nominal capital which is then issued *pro rata* to existing ordinary shareholders, as bonus shares or otherwise. This involves expense and administrative trouble.

I can see no useful reasons for transfers to capital reserve account which can later be revoked by re-transfer to revenue reserve. I suggest therefore that directors should be allowed to transfer to capital reserve (or "surplus") such amounts as they think fit, subject in the case of all amounts that would otherwise have been legally available for dividend to the approval of the shareholders in general meeting, the amounts thereby ceasing to be available for distribution and becoming subject to the requirements relating to reduction of capital. The share premium account and the capital redemption reserve fund, where they existed, would then not need to be kept separate, and any capital reserve in the balance sheet would consist of a single, undistributable total, available for no purpose except the payment-up of nominal capital. (I shall suggest below that the existing law with respect to the use of share premium and capital redemption reserve accounts be amended.)

No Par Value Shares

The case for no par value shares has been well put in recent years and I do not see any point in adding my own pleading to what is undoubtedly already in the possession of the Committee. It seems to me that the case in favour of this type of equity share is so overwhelming that there is nothing more to be said.

I should like, however, to make a brief comment on no par value shares. It has been suggested that no par value, while suitable for equity shares, is not a suitable device for preference shares. I do not agree. The idea of a par or nominal value seems to me unnecessary and indeed misleading, whether it be related to an equity share or preference share. It is quite possible for a preference share to be issued above par; to be quoted throughout its life at prices other than par; and to be repaid in liquidation or otherwise at a price other than par. It is unnecessary to have a par value in order to describe the dividend rate. It is just as easy to describe a preference share as a "1s. per annum preference share" as to call it a "5 per cent. preference share of £1". The concept of par or nominal value in relation to share capital seems to me wholly redundant.

Exactly the same principle applies to debentures, though here it is not so much a matter of legislation as of company practice. It is not the par value of a debenture which is relevant but the annual amount payable in interest per transferable unit, and the ultimate capital value repayable on redemption for the same unit.

Share Premiums

It seems now to be accepted that all amounts received on the issue of shares should be treated as not available for profit. Indeed it may be said that the acceptance of the non-distribution of the share premium was the final step in making the concept of nominal capital, as the minimum amount available for creditors when paid-up, finally obsolete. (A share premium account is, of course, only necessary when there is par value capital. If all capital is of no par value the total amount of the receipts from the issue of shares can be credited directly to the issued capital account.)

Once it is accepted that share premiums should not be distributed there seems to be no point in allowing the share premium account to be reduced for any purpose whatsoever except (a) the formal payment-up of shares, i.e. capitalisation by incorporation in the formal nominal capital; and (b) the formal process of reduction

with the consent of the court. The present provisions whereby preliminary expenses, underwriting commission or discount on shares or debentures, or premiums on redemption of redeemable preference shares or debentures, can be debited to the share premium account seem to be an inconsistency. Preliminary expenses and underwriting commission represent either a valuable asset or a loss. If they are a valuable asset they should be left in the balance sheet. If they are a loss they should be debited to the profit and loss account, since otherwise capital is in effect reduced: i.e. debiting them to share premium account is no more and no less consistent than debiting them to share capital account. Debenture discount, and premiums on repayment of preference shares and debentures, represent a special way of paying interest. If, for example, a debenture is issued below its agreed repayment value, or a preference share is repaid above its issue price, the annual interest or dividend is correspondingly reduced. Annual interest and dividends are unequivocally a debit to profit, and cannot legally be debited to the share capital account or to the share premium account. There seems to be no justification for doing the same thing in an indirect way by paying annual dividends or interest and debiting the corresponding premium or discount to a share premium account. To do so is tantamount to distributing as profit part of the share premium account.

The same general argument applies to a capital redemption reserve fund set up on the repayment of redeemable preference shares other than out of the proceeds of a new issue of shares.

Pre-acquisition Profits of Subsidiary Companies

It is well known that when two companies merge, both of which have accumulated distributable profits, one or both of the companies, depending upon the manner of merger, may lose the right to distribute these profits. This is because when the shares of a company are bought the value of these is assumed to include the accrued profits of that company. If the acquiring company distributes these profits to its shareholders after the acquisition the actual value of the assets acquired is reduced *pro tanto*. Unless the balance sheet value of those assets is written down by a debit to the acquiring company's profit and loss account the balance sheet value would stand above the cost of the shares by the amount of the dividend. This violates a normal principle of accounting.

It would always be open to the acquiring company to obtain a formal reduction of capital, which would allow the distribution of this profit to take place. This does, however, involve the trouble and cost of a legal process. There does, therefore, seem to be a case for allowing profits which would have been distributable, had the merger not taken place, to remain distributable in the hands of the acquiring company, provided that the consideration for the shares acquired has been entirely in the form of share capital and there has been no cash payment or issue of fixed interest securities in consideration for the assets acquired.

Where the transactions are entirely in the form of an exchange of share capital between the acquiring company and the shareholders of the acquired company it is difficult to see that the interest of the creditors of the acquiring company can in any way be damaged by allowing a distribution of profits that would have been distributable in the absence of the merger. If, however, assets are parted with, or liabilities are incurred, by the acquiring company, it is open to argument that the subsequent distribution of pre-acquisition profits may in some sense represent a reduction in the assets available for creditors.

Perhaps an example will explain this more clearly. Let us suppose that Company "A" acquires all the issued share capital of Company "B" by paying the shareholders of Company "B" the amount which they think their shares are worth. It is a reasonable presumption that this cash payment is not less than the market value of "B". "A" will therefore have parted with cash equal in amount to the value of the net assets, including goodwill, acquired. If now "B" pays a dividend to "A" out of pre-acquisition profits (i.e. in effect out of assets bought and paid for by "A") and then "A" distributes this to its own shareholders, it can be said that "A" has parted with cash equivalent to the dividend twice, first to the original owners of "B" and secondly to its own shareholders. The value of "B" to "A" will have been reduced by the amount of the dividend and should, given the usual accounting conventions, be written down in its books. This writing down, equal in

amount to the dividend distributed by "A", must be debited to the profit and loss account of "A". This has the same effect as if the dividend had been distributed out of "A's" own existing profit fund and not out of the pre-acquisition profit of "B", since an amount equal to the dividend will have been held back in "A's" books as the result of the writing down. If on the other hand "A" had merely issued its own shares in order to pay for the shares of "B" there would have been only one outgoing of cash, namely the payment of the dividend to the shareholders of "A".

Dividend Law

The foregoing assumes that the convention whereby the value of a fixed asset is regarded, for dividend purposes, as no greater than its cost, is applied. If the cash price paid by an acquiring company is in fact a good bargain—the interest acquired is clearly worth more than the cash paid—there is evidently a case for allowing distribution of the difference. This raises the general question of how far recorded profits created by revaluing assets in an upward direction should be distributable, if at all.

My own view is that there is a case for allowing such profits to be distributed, provided the revaluation is *bona fide*, is carried out by a reputable person who is independent of the directors and shareholders, and the facts are clearly indicated in the annual accounts and in a statement accompanying the dividend. Indeed, such a procedure would, I believe, be within the law as it now stands.

The present dividend law is, and has been for a long time, inconsistent, in that in certain cases dividends may in principle be paid (however unlikely this may be in practice) even though the value (on any reasonable basis) of the net assets is clearly below the stated issued capital plus the share premium and capital redemption reserve accounts, if any. This is because the judicial cases relating to dividends established long ago that certain types of loss, for example the depreciation of wasting assets, and losses arising in earlier years, need not be taken into account in assessing the profit fund. This is not probably a very great problem under present day conditions, at any rate so far as public companies are concerned. How far it is relevant for private companies I have no way of knowing. I would suggest, however, that it would be more consistent if the law made it clear that it was illegal for directors to distribute dividends: (a) if thereby they endangered the solvency of the company in the short or longer run; and (b) if thereby they reduced the value of the net assets below an amount equal to the figure of issued capital plus the share premium and capital redemption reserve accounts, if any, or the share capital plus capital reserves if my suggestions above were adopted. The value of the net assets in this context would be defined as the value in the opinion of the directors of the assets of the company less the liabilities thereof, either on sale in the market or to the company in the ordinary course of business, whichever was the greater.

A saving proviso would no doubt be necessary in the case of mining and similar companies which had formally declared their intention not to provide for depreciation of their wasting assets.

One advantage of such a declaration of the law would be to make it plain that, subject to the above proviso, depreciation of fixed assets must be provided in the calculation of divisible profit, a point that is at present moot with respect to manufacturing companies.

Such a declaration would also remove the present anomalous distinction for dividend purposes between "capital profits"—which are in practice difficult to categorise—and other profits.

Balance Sheet Values

It has long been recognised that the market values of current assets, and the amounts of current liabilities, are of special significance. The size of the inward and outward cash flows in the near future—and therefore the company's liquidity—is determined in part by these. It has, however, been fairly widely assumed that the balance sheet values of the fixed assets are of substantially less importance.

The flow of take-over bids in recent years has provided ample demonstration, however, that the balance sheet values of fixed assets may be of great significance. Broadly speaking, conditions are favourable for a take-over bid when dividends

distributed are relatively low in relation to the saleable value of a company's assets as a whole, net of liabilities, whether this be due to a deliberate policy of distributing only a small proportion of earned profits, or the inability or unwillingness of the directors to earn a competitive rate of profit on the assets under their control. The existence of either of these conditions may be hidden from the shareholders if the balance sheet substantially understates the current market values of the fixed assets. There is, of course, a range of uncertainty in any valuation; but the discrepancy between balance sheet and current market values may be sufficiently large to make this unimportant. In this kind of situation the shareholders may be unaware of a situation that may be known to a shrewd bidder.

It cannot be said that this state of affairs is satisfactory from a shareholder's point of view. He may part with his shares on false assumptions about the company's position. Nor is it satisfactory from a national point of view that the earning of sub-normal rates of profit on the current market value of assets should be hidden. The saleable value of assets reflects the price that other people are prepared to pay for those assets. In the ultimate analysis this price reflects the degree of usefulness that the community attaches to the assets, as reflected in the "voting power" of the money that people can spend. The competitive rate of return which can be obtained in the market on securities similarly reflects the usefulness attached by the community to capital resources. If directors fail to earn something approaching this market rate of return on figures approximating to the market value of the resources they control they are in effect reducing the level of the national income below what the market in general thinks it could be. Such a situation should be made apparent, so that shareholders may exercise such rights as they possess in full knowledge of the situation.

It is true that the assessment of the market values of many assets raises difficult problems. As suggested above, however, the question is not that of making fine calculations. It is rather a matter of showing up situations where gross discrepancies exist. The problem varies in difficulty according to the type of asset. Where assets are fairly non-specific it is usually fairly easy to arrive at an approximate valuation, since in this case the market is likely to be relatively wide. Freehold properties in a large town are often good examples of such assets. Where the assets are very specific they may be of little value (except as scrap) to anyone other than a direct competitor of the company, and this makes the assessment of the highest market value obtainable more difficult. However, the fact that assessment is not easy should not prevent an attempt being made to give better information if, as I believe to be the case, this can be done without undue difficulty. Nearly all assets, other than freehold land, are insured. The basis of insurance is the replacement value. I suggest that companies should be required to state in their accounts, by way of note, the insured values of each class of fixed assets. It would be necessary no doubt in some cases for such figures to be accompanied by some explanatory notes in order to prevent them from being misleading to shareholders. This seems to me no great disadvantage. On the contrary, such an explanation is likely to provide useful information from an investment point of view.

It is worth noting in this connection that the current market values of some fixed assets at least may have significance for the liquidity position of the company: the assets may be available as security for loans, or for "sale and re-lease transactions".

Over-Valuation of Fixed Assets

The foregoing relates mainly to the undervaluation of fixed assets. I think it can be argued from the existing legal precedents, and from the Act, that it is illegal to show in the balance sheet any fixed asset at a figure above the value which it is considered to be worth to the company. I am doubtful, however, whether in fact close attention is always given to this matter. In my view it should be made explicit that no asset may be carried in the balance sheet at a figure above the value at which (a) it is believed to be saleable in the market or (b) it is considered to be worth to the company in the ordinary course of business, whichever is the higher. (This already applies to current assets.) I agree that what an asset is worth in the ordinary course of business is not susceptible of precise measurement. Here too, however, we are not concerned with fine calculations, but with the avoidance of gross discrepancies. I think that the attention of directors and auditors should be expressly drawn to this point.

Revaluation of Fixed Assets

This raises the question of the revaluation of fixed assets. The present Act allows this to take place and it seems entirely desirable that this should be so. As valuations are always matters of opinion, however, I think it is desirable that when an asset is revalued the following additional information should be provided, either in the accounts of the year in question, or in the "Statement of Accounting Procedures" which I have suggested should be filed annually with the Registrar. The relevant information would be: (a) the manner and process of revaluation; (b) the name of the person who carried out the revaluation; and (c) the date or dates on which the revaluation was carried out.

It is I think generally accepted that unrealised appreciation of assets written into the books of a company may be used for the purpose of formal capitalisation, provided the valuation is *bona fide*. I think, however, that there is something to be said for making this clear by a declaratory provision in the amended Act.

Stock

I think the present information available with respect to the valuation of stocks of all kinds is insufficient to allow shareholders to make a full appreciation of their company's position. I think it desirable that stocks should be separately classified in the balance sheet under the heads of raw material and components, work-in-progress, finished goods, and other appropriate headings. Changes in the value of stocks held under each of these headings have their own particular significance. No doubt, however, it would be necessary to provide that such information would only be required if it were available in the company's books.

Balance Sheets: Miscellaneous

Under the present accounting requirements of the 8th Schedule it is not always possible to reconcile the opening and closing balances of any given class of fixed assets with (a) the amounts of any disposals; (b) the profit and loss debit for depreciation on that class of asset; (c) any profit or loss on disposal; and (d) the amount of any revaluation. It think it desirable that a reconciliation be provided for each class of fixed asset so that the logical continuity from one balance sheet to the next may be complete.

I think a similar reconciliation is desirable in respect of tax reserves and provisions (however named), deferred income (such as unearned interest on hire-purchase contracts) and long-term liabilities.

I think it is desirable that the balance sheet should give information about credit facilities, such as the right to overdraft facilities, which have been granted but have not yet been used. Such facilities form an important factor in assessing the liquidity position of a company. (It would no doubt be necessary to exclude from such a requirement trading credit likely to be available in the ordinary course of business; it would not be reasonable to require the assessment of this to be estimated.)

I think it is desirable that the statement relating to capital expenditure planned but not yet entered in the accounts should refer not only to contracts made, but to all capital expenditure which the board of directors has decided to incur, whether or not it has not been made the subject of a formal contract. This is important in relation to the company's liquidity position and its prospects generally.

The 1948 Act did not define current liabilities and current assets. I think this was probably a wise decision. It is difficult to find satisfactory definitions which are both useful and generally applicable. The present arrangements work quite well on the whole. However, there is, I think, one exception. A practice has developed of classifying investments separately from both fixed and current assets. I see no particular reason why this should be necessary. The Act allows trade investments to be valued on different bases from others and the directors have therefore to make up their minds which investments are trade investments and which are not. Once this decision has been made I see no reason why trade investments should not be included under fixed assets and other investments under current assets. This is, perhaps, not a very important point. If, however, a category of current assets is to be distinguished it seems reasonable to include in it such investments as are held as a temporary repository for liquidity. Investments in subsidiaries perhaps represent a special case.

There is something to be said for classifying the whole interest in a subsidiary under one head, even though this may include both permanent shareholdings and temporary advances.

Taxation

It is hardly necessary to point out that tax represents a very important outlay from the point of view of the shareholder, accounting at present for something of the order of 50 per cent. of net profit. For this reason alone it seems important that shareholders should be able to see as clearly as possible the impact of taxation upon their company, including the way in which it is distributed over different kinds of taxes, e.g., income tax, profits tax, and overseas tax.

There is another important point, however. The tax payable by a company provides perhaps a more objective check on the profit calculation than any other. A person who is reasonably expert in the field of income tax and profits tax can judge from the accounts of a company, provided the information relating to tax is sufficiently detailed and precise, how far the tax assessment is likely to have differed from the reported profit of the company. This provides additional information in the interpretation of the accounting results, e.g., with respect to the conservatism of the board of directors in their depreciation calculations, and so on. It is, of course, true that there are pitfalls in these comparisons, but it cannot, I think, be denied that the provision of precise figures relating to income tax and other taxes payable by the company will give the expert shareholder (or the shareholder provided with expert advice) information that is likely to improve his general understanding of the company's financial position. Indeed, it can be argued that companies should be required to disclose the quantum of the estimated income tax assessment on the profits of the year for which the accounts have been prepared, together with the agreed assessments relating to earlier years. I think that as a minimum the profit and loss account should show, under separate headings, all debits and credits in respect of United Kingdom income tax, United Kingdom profits tax, and overseas tax, if any, each classified by years of assessment. Where any items in the profit and loss account are recorded net of tax, or are not subject to tax, this should be stated. Where relief has been allowed from United Kingdom income tax in respect of overseas tax I think the accounts should show the net United Kingdom tax payable, if necessary with a note of the amount of the relief. Where initial allowances have been granted the accounts should indicate the net tax payable. No doubt the present practice of some companies of showing the United Kingdom tax that would have been payable if overseas tax relief had not been granted, or the United Kingdom tax that would have been payable had there been no initial allowances, is a useful addition to the information available to the shareholder. But I believe that the net tax payable under each head should also be disclosed. The amount of overseas relief granted, and the amount of relief from initial allowances, are both of interest to the shareholder and I see no reason why the information relating to these should be withheld.

In my view the practice of debiting in the profit and loss account tax that would have been payable had initial allowances not existed, and then showing this in the balance sheet under the heading of future tax reserves or some similar title, is unnecessarily complicated. I believe it is much simpler to charge each year the tax that is actually payable, or that will become payable in the following tax year as a result of the profit for the current year, and to leave the hypothetical question of the impact of current initial allowances on the tax in later years to an explanatory note.

I appreciate that the present approach of many accountants to this problem is to show a "normal" income tax or profits tax charge in relation to the profit of a particular year. But I think the effect of the methods described above is to make the accounts harder to unravel, even to accountants. Such information is better given, I believe, by way of note.

Similarly I think it is misleading to increase depreciation allowances (which in principle should be calculated independently of tax law) because certain initial or investment allowances have been obtained.

Investment allowances represent, in effect, reductions in tax. I think the net tax charge should be shown, the amount of relief from investment allowances being disclosed by way of note.

The foregoing relates to the profit and loss figures. I think the balance sheet should also, in the interests of clarity, show the amounts payable or estimated to be payable under each class of tax in respect of each year of assessment.

Subsidiary Companies: Names and Interests

It would, I think, be advantageous if holding companies were required to state, preferably in the "Statement of Accounting Procedures" or in conjunction with such a statement, the name of each of their subsidiary companies and the holdings in each of these by types of shares.

Modification of Accounting Requirements

At present it is open to the Board of Trade to modify, on the application of a company, under SS.149 (4) or 152 (3), the accounting requirements of the Act, to meet the circumstances of particular companies. I think it is desirable that the nature of all modifications of this type should be published annually in some detail, so that the question of whether all such modifications are in the interests of the investing public may be open to public discussion.

Special Exemptions to Banks and other Companies

In my view the present exemption which is granted to banks, insurance companies, and certain other companies, whereby they do not have to disclose accounting information required from other companies, is unjustified. It is argued that the special position of banks and insurance companies makes it particularly important that creditors should have faith in these institutions. For these reasons, it is argued, it is desirable to hide from shareholders and creditors information which, the law has decided, should be disclosed in general for other companies. This argument amounts to saying that one will have more faith in a company when one does not know what is happening to its profits and assets than when one knows that there will be full disclosure of any adverse event. Furthermore, the argument rests on the assumption that the public is essentially not to be trusted with information. I do not regard this as appropriate in a society such as ours.

Arrangement of the Accounting Provisions

I do not think the present arrangement of the accounting provisions in the Act and in the 8th Schedule can be regarded as the most convenient layout achievable. In this connection I should like to invite the attention of the Committee to the general approach to this problem in the (amended) Draft Report of the Commission of Enquiry into the Working and Administration of the present Company Law of Ghana. I had the privilege of being associated to some extent with Professor L. C. B. Gower when he was working on the report in question and it seemed to me that the presentation of the accounting provisions in the 3rd Schedule of that Report, though these are hased, broadly speaking, on the 8th Schedule of the English Act, is nevertheless more systematic and is easier to follow.

The same report incorporates certain of the suggestions which I have made in this memorandum and should the Committee see merit in them they may feel that the Report would be useful from a drafting point of view.

14th May, 1960.

APPENDIX IX

Memorandum by John Lewis Partnership Limited

General

This evidence is in the main limited to matters which concern this Company (which is referred to throughout as "the Partnership") because—

- (1) It is the holding company of a complex group;
- (2) all the directors of all the companies in the group are working directors and none of them draws any director's fees;
- (3) the Partnership has been a pioneer in giving full information to its shareholders and workers ("Partners") in its annual reports etc.;
- (4) all the equity capital employed by the Partnership is held in trust for the benefit of the Partners among whom or for whose benefit the equity profits are divided (in proportion to their pay) or used. The total capital employed is—

		£
Subscribed by the public	Debenture Stocks ..	5,400,000
	Preference and Preferred Ordinary Stocks ..	8,100,000
Subscribed and about to be subscribed by Partners (out of profits divided among them) ..	Preferred Ordinary Stocks	2,150,000
	Held in trust	612,000
		16,262,000

Heads of Evidence

Head 4. Donations.—Directors need the power to make donations if the motive is improvement of profits or the welfare of the company's employees. In theory donations for other motives ought perhaps to require shareholders' approval; in practice it would be impossible, by legislation, to define motives. Corporations are taking the place of individuals as supporters of religious and charitable causes and patrons of the Arts—the Partnership itself, for instance, played a considerable part in the resuscitation of Glyndebourne—and it would do more harm than good to attempt to check or reverse this process.

Head 5(a). Change of Activities.—The Partnership acquired, a few years ago, a company engaged in the retail trade. Its retailing activities were transferred to another Partnership company, and the company itself became a property owning company only. There ought not to be any such changes of the law as would prohibit or impede a change of activity made with such proper motives of efficiency as existed in that case, which was probably not an unusual one. Certainly a holding company needs a free hand to change the activities of its wholly owned subsidiaries.

Head 6. Directors' Duties. *Sub-heads (a) Should their duties be stricter and more clearly defined, and if so, in what respects?, and (b) Are Directors generally aware of the legal duties arising from their fiduciary position?*—As mentioned in sub-paragraph 2 of the first paragraph of this evidence, all the directors of the Partnership companies are working directors. In theory it might be supposed that the independence of such directors in expressing their opinions or casting their votes would be affected by fear of losing not only their directorships but also their seniority or even their posts; in practice there has been little effect of that kind.

Sub-heads (c) Directors' and officers' dealings in their own companies' shares, and (d) Disclosure of directors' interests.—It is considered that Section 195 of Companies

Act, 1948, needs to be amplified. The register referred to in that section ought to be open before and produced at every meeting, not at the annual general meeting only; and reference to the fact that it is open and will be produced ought to be made in the notice of every meeting. Any circular issued by the directors containing proposals relating to any shares or debentures of the company, ought to contain an extract from the register of all particulars of the directors' holdings of and transactions in such shares or debentures.

Sub-head (e) Should bodies corporate be allowed to be directors?—There ought to be no restriction on the appointment of a corporate trustee (particularly a corporate trustee of employees' shares) as a director.

Head 7. Voting Rights.—For the reasons indicated in the first paragraph of this evidence the Partnership is concerned only with the voting rights of holders of fixed dividend or fixed interest shares or stocks, and it considers, with regard to such shares or stocks, that no legislation should go further than to entitle the holders of them to votes on matters directly affecting their interest and/or at times when interest or dividends are in arrears.

Head 12. Share Transfer Procedure.—The Partnership would welcome any change of law or practice facilitating the transfer of shares (particularly employees' shares) by endorsement (signed wherever practicable, by the transferor only) of the share certificate.

Head 13. Multiplicity of Directorships.—It has been the practice of the Partnership to appoint to directorships of a large number of its companies a single Partner of some seniority chosen partly for his experience of dealing with such matters (contracts, leases, etc.) as require the company's seal, and partly for his knowledge of past history and precedents. No changes of the law ought to restrict the freedom of a holding company to make arrangements of this kind.

Head 14. Carrying on Business through Subsidiary Companies.—The Partnership has found it convenient to carry on in subsidiary companies special kinds of business (e.g. manufacturing, export, property ownership, etc.) the accountancy and administration of which may with advantage be separated from the main stream of its retail trading. Again no changes of the law ought to impede such arrangements.

Head 15. Loan Capital.—As indicated in sub-paragraph 4 of the first paragraph of this evidence the Partnership has considerable experience of debenture stock. It has not found any difficulty in complying with existing law; and considers that existing law adequately protects debenture stockholders.

Head 16. Take-over bids.—The Partnership's recent experience is limited to its taking over two companies the shareholders of which, though the companies were fairly large, were unanimous in their acceptance of the price offered for their shares.

Because of its special principles the Partnership concerned itself in those two cases, and would concern itself in any others, with the adequacy of the compensation given to employees of the companies taken over who might lose their employment and expectations (of pensions, etc.) as a result of the take over. The Partnership would welcome any legislation tending to make the payment of compensation obligatory in such cases.

As to sub-head 16 (e) (*finance of take-over transactions*) though the Partnership has no definite proof its impression is that such transactions are not infrequently financed to a considerable extent by the use of the assets of the taken-over company. The actual liquid funds of that company may be used. More often the funds may be raised by selling or charging the fixed assets of the company. This appears to be contrary to Section 54 of the Companies Act, 1948, but that section is not sufficiently precise as it stands to achieve its objects.

As to sub-head 16 (f) (*disclosure of Directors' interests*) please see the Partnership's evidence on sub-heads (c) and (d) of Head 6. Any circular relating to a take-over bid for shares ought no doubt to disclose the directors' recent transactions in the shares.

As to sub-heads (b) *Securing disclosure of information on which shareholders can form an opinion*, and (g) *Compulsory acquisition of shares of dissenting minority* please see the Partnership's evidence under Head 21.

Head 17. Prospectuses.—The Partnership finds no fault with the existing law: it is not onerous to provide the information required by the law and that information is sufficient for an intelligent investor.

Head 20. Purchase by a company of its own shares.—The provisions of Section 27 of Companies Act 1948 have caused considerable difficulty to the Partnership. As shown in sub-paragraph 4 of the first paragraph of this evidence over two million pounds of the Partnership's preferred ordinary capital has been subscribed by Partners and much of it is held in small individual holdings. Stock Exchange transactions in shares so held are relatively expensive and are unpopular among stockbrokers, and the Partnership has therefore frequently found it necessary itself to deal in the shares in order to assist Partners having a genuine need to sell, and to prevent a fall of Stock Exchange quotations. The special procedure for these dealings has not infringed the Section but the need to adopt it has caused appreciable inconvenience. Accordingly the Partnership strongly urges that the Board of Trade should be empowered, in the case of profit-sharing companies, to exempt them from the provisions of Section 27, and from the general rule that a company may not hold its own shares, to any extent necessary for the purposes of the profit-sharing scheme.

Head 21. Accounts.—In general the Partnership considers that the existing law requires little amendment: its provisions are neither onerous nor inadequate. In particular there ought not to be any such changes of the law as to make revaluations of fixed assets obligatory in normal circumstances. However it is suggested that whenever an offer is circulated for the shares of a company it ought to be obligatory to state in the circular whether there has been such a revaluation and, if so, what surplus or deficit has resulted. The absence of a revaluation ought to be *prima facie* evidence for the grant of an application by a dissenting shareholder made under Section 209 (j) of Companies Act, 1948. (See also sub-heads (b) and (g) of Head 16.)

Head 23. Returns.—As indicated in sub-paragraph 4 of the first paragraph of this evidence the Partnership divides its profits yearly among the Partners as a "Partnership Bonus". The Partners, by consent, use their shares of this Bonus to subscribe for Preferred Ordinary Shares. This results in the allotment of shares to as many as 9,000 allottees each year. The return of these allotments yearly in accordance with Section 52, Companies Act, 1948, is an onerous and unnecessary requirement. There ought to be an exception from the requirements of that Section in favour of profit-sharing schemes, the definition of which could be as in paragraph 10 of the Control of Borrowing Order, 1947.

Head 26. Internal Management and Administration.—Trustee shareholders of the kind instanced in sub-head (d) (*Trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company*) ought to have no lesser voting rights than any other holders of shares of the same class.

Head 29. Other matters.—In the Partnership's opinion the 1948 Act and company law in general are based upon a conception which is no longer really valid, namely that a company belongs, and ought to belong, to its shareholders. Neither of these things are really true today and there is need for company law to be adjusted to the responsibilities that a company should have to its workers and to the community.

The Partnership accordingly advocates amendment of the company law to recognise this. For example, the provisions of Section 27 of the Companies Act, 1948, which have caused the particular conditions that the Partnership has mentioned under Head 20 above, also prevent a company from recognising the interest of its workers by

earmarking some part of its own shareholding for their benefit. In particular, it would welcome any legislation which would give advantages to companies whose employees participate in its management and ownership. The advantages might be such exemptions, etc., as are suggested under Heads 12, 20 and 23 above and might well extend further to reductions of stamp duty on issues and transfers of employees' shares, even (though this is recognised to be debatable) to reduction of taxation.

The fullest advantages might well be reserved to companies whose employees have the right to elect one or more directors to the Board. Particularly if such elected directors had (as they have in the Partnership) the power to veto any transaction the result of which would be to transfer the control of any substantial part of the company's business from one set of people to another, that would be for work-people a safeguard against the worst consequences of take-over bids—loss of future employment and disappointment of legitimate expectations of benefits relating to past service.

Supplementary Memorandum by John Lewis Partnership Limited

Head 20. "Reduction of Capital and Purchase by a Company of its own Shares"

Section 27 of the Companies Act, 1948

The Partnership adheres to its previous written evidence but having in the meantime observed the written evidence submitted by the Institute of Chartered Accountants has this to add:—

The submission of the Institute (in paragraph 133 of its evidence) to the effect that shares held by a subsidiary in its holding company should be disposed of or cancelled within a specified period after the relationship arises would not meet the difficulties described in the Partnership's own evidence. In relation to profit sharing schemes in particular, it may well be desirable—subject to the safeguard of Board of Trade consent being requisite—that a subsidiary company should be able to hold shares in its holding company without any limit as to time.

Section 54 of the Act

The Partnership had previously submitted no written evidence on this Section relative to problems with which it was itself confronted. The Partnership is naturally concerned in particular with the application of the Section to the operation of profit sharing schemes and submits that proviso (b) to sub-section 1 is too narrow in that it limits the exemption to purchases or subscriptions by Trustees.

In the case of the Partnership the main employing company adds to the pay of the Partners (employees) in one particular week or month of the trading year a certain percentage of pay (in the last year 13 per cent.) requiring the Partners to apply that addition in subscription for new fully paid Preference Shares of John Lewis Partnership Limited, which is the holding company of the trading companies. If the Partners were to fail to comply with that requirement they would be disqualified for subsequent trading years from the benefit of such addition to their pay.

Although the Partnership Profit Sharing Scheme is founded upon a Trust Settlement and the procedure described above is designed to follow the spirit of that Trust Settlement without actually using it at the present time as the vehicle for the Scheme, there must be many cases in which profit sharing schemes involve the application of bonus in subscription for shares of the employing company or its holding company without the interposition of any Trustees. It is submitted that such schemes would fall within the spirit of the exemption contained in proviso (b) to sub-section 1 of the Section and that this should be recognised by the deletion of the words "by Trustees" in that proviso.

APPENDIX X

Memorandum by R. F. Henderson, Lecturer in Economics and Politics,
University of Cambridge, and Brian Tew, Professor of Economics,
University of Nottingham.

Section 21—Accounts

An analysis⁽¹⁾ of the accounts of three thousand quoted public companies for the five years 1949–53 inclusive at the National Institute of Economic and Social Research has led us to the conclusion that valuable though the 1948 Act was, much remains to be done to improve the standard of such accounts.

The Importance of Company Accounts

The published accounts of public companies are the most important material available to all who buy, sell or hold their shares. The accuracy and completeness of that material largely determines the accuracy with which share prices reflect the real value of the company in question. Now there are many reasons why it is undesirable that the value of shares should diverge substantially from the real value of the underlying company. Such a situation is inequitable; those who know the real value of the company can gain at the expense of those who do not; this may even lead to action by directors or their friends to make profits at the expense of some other shareholders; speculation is encouraged and opportunities for corruption emerge. But much the most important objection to such a situation is that it frustrates and distorts the critically important mechanism governing the flow of investible funds into real investment and the use of assets in the most efficient manner. For the essential principle of that mechanism is that those companies are able to obtain fresh investible funds for expansion which have shown that they have earned a satisfactory rate of profit on their existing capital; while those companies which have not earned a satisfactory rate of profit on their existing capital are not normally able easily to obtain fresh funds. The efficiency and productivity of industry and trade depends largely on the competitive pressure of the expansion of efficient firms at the expense of the less efficient.

Now to show how distortion can occur let us consider the case of a brewery company owning a number of public houses in an area at a time when urban land values have risen steeply. Let us suppose that this brewery company has not revalued its assets which stand in its balance sheet at £2,000,000 (total assets); its nominal capital is £1,000,000, all in ordinary shares, on which it pays a dividend of 10 per cent. each year out of earnings of 12 per cent. The shares are quoted at £2 each to give a dividend yield of 5 per cent. It appears to be doing all right; the price of its shares is high enough to enable it to attract fresh capital by a rights issue should the directors so desire. But now suppose that the current value of its properties is so much greater than their book value that its assets are really worth £8,000,000. The real position is that those assets are being used very inefficiently to yield a rate of return of only 1½ per cent. (£120,000 on £8,000,000). It is certainly not in the public interest that such inefficient use of resources should continue, or that such a management should be undisturbed and even able to raise fresh funds to continue such policies. This situation arises basically because the incomplete and misleading impression given by the accounts of the company both to its shareholders and to the general public has led to the establishment of a price for the shares right out of line with the real value of the assets of the company.

It may be objected that this is an extreme case not in any way typical of manufacturing companies in general. The bulk of the fixed assets of manufacturing companies are more specific; they consist largely of plant and machinery installed to produce a particular product or range of products; such plant and machinery can seldom be adapted to the efficient production of quite different products. But even in these cases

(¹) This is described in "Company Income and Finance 1949–53", National Institute of Economic and Social Research, December 1956, and "Studies in Company Finance". B. Tew and R. F. Henderson, Cambridge University Press, 1959.

where fixed assets are specific they may be used more or less efficiently. The records of the leading firms of management consultants and of the advisory service set up by the National Union of Manufacturers show that differences in efficiency are so great that increases of productivity of up to 35 per cent. can be achieved.⁽¹⁾ Now where it is possible to form a fair estimate of the value of assets—their replacement cost less a depreciation allowance for age, wear and tear and obsolescence—it is possible to compare the efficiency with which assets are being employed by different companies. Such comparisons are commonly made by New York investment analysts and though of course mistakes can be made, the best of them are justified by later events. When it becomes obvious that a company is using its assets inefficiently then there is a strong financial incentive for a radical change of policy either by the existing management or by the assumption of control by a new group. There are many examples of this in the United States in recent years; Montgomery Ward and Armour are two well-known cases, in retail distribution and meat packing respectively. In these cases the specific nature of the fixed assets does not prevent the operation of the competitive capitalist process. The process of course is in operation in Britain also but the inadequacy of published accounts has the effect of slowing it down and making it much jerkier. If inadequacy in rate of return earned on the real value of assets became apparent sooner there would be more opportunities for reform and regeneration of existing companies by pressure of shareholders on managements and fewer cases of matters drifting on until another company makes a take-over bid greatly in excess of the previous market value of the shares. That such situations lead to speculative abuses need not be laboured here. An economist may perhaps emphasise however that *prima facie* it is more likely to promote efficiency in the long run if companies can be reformed without losing their identity, than if they are bought up by a larger concern mainly engaged in some other industry. For in such cases there is no particular reason why the amalgamation should be technically or economically efficient. A sufficient reason for it is the opportunity to buy up a company at less than its true value as a going concern with efficient management. It might be much better if the efficient management could be achieved without the amalgamation. But that is what is so difficult so long as company accounts are so uninformative.

The Main Objectives of Reform

Balance sheets are often so uninformative that it is quite impossible to calculate the rate of return which most British public quoted companies are earning on their assets. To ensure the provision of this information should be the first major objective of company law reform. The second objective should be to enforce the publication of sales or turnover figures—as in the United States—in order that it may be possible both for managements and for the investing public to calculate such important ratios as profits to sales and stocks to sales and to compare these for companies in similar industries. Such comparisons are an important element in the assessment of competitive efficiency.

Before the passage of the 1948 Companies Act it was possible to put aside to reserve either in the company itself or in the accounts of subsidiary companies undisclosed amounts before arriving at the income shown in published accounts. There was a sense in which the income shown was a *minimum* figure (though even this was not true in all cases as sums might have been brought back from secret reserves to swell it in a bad year). By insisting on the disclosure of transfers to reserve and on consolidated accounts the 1948 Act has gone a long way towards the production of a fair figure for income. It did not however apply this principle to balance sheets. There understatement can and does continue. The net result is that in many cases a fair figure of income when combined with grossly understated balance sheet values of assets suggests that the company is earning a much higher rate of return on its assets than is in fact the case. What is now required is legislation to secure fair as well as minimum values for assets in balance sheets.

We appreciate that the difficulties in the way are considerable. We submit that the critical importance of the rate of return on assets employed in the process of distribution of investible funds as between alternative uses is sufficient to demand that those difficulties be tackled.

(1) Cf. "The Times Review of Industry", February 1957.

Major Reforms proposed in Balance Sheets

Two main types of assets are involved: fixed assets and stocks. From the point of view of the economist the ideal solution would be a revaluation of fixed assets each year. This, however, is impracticable. Some compromise for the sake of practicability must be accepted. Various suggestions can be made. An *estimate* of the current value of fixed assets might be made a compulsory footnote to balance sheets. This should normally be based on their replacement cost less a depreciation allowance for age, wear and tear and obsolescence. It might be made compulsory to disclose the value for which such assets are insured against fire or other disaster. In addition to these provisions it might be made compulsory to revalue fixed assets once every five years or once every ten years. The stricter requirement of once every five years might be insisted on by the Council of the Stock Exchange for those companies enjoying the privilege of a quotation for their shares, and once every ten years be made the legal minimum for all companies. Such provisions would not enable the rate of return on its capital for each company to be calculated accurately to two places of decimals. That is not the object. They would enable competent professional investment advisers and financial journalists to form a shrewd estimate of the right order of magnitude in the great majority of cases, and so to prevent the scandalous under-estimation of certain shares on the Stock Exchange revealed by some take-over bids in the last decade.

Major Reforms proposed in Income Accounts

Stocks are normally valued at "cost or market value whichever be the lower". Only when large fluctuations in prices of raw materials occur rapidly in trades where stocks form a large proportion of total assets, such as wholesaling, are balance sheet totals likely to be much altered by stock appreciation. But a considerable difference may be made to the published account of the income of a company by the inclusion of stock appreciation (or depreciation) in income. In order to assess the long-run profitability of a company, it is obviously important to distinguish between profits arising from stock appreciation and those arising from normal trading. Estimates of stock appreciation are already made and published in the National Accounts where they form an essential part of the data for the calculation of National Income⁽¹⁾. They are equally necessary for a true calculation of the income of an individual company. Stock appreciation should be estimated by revaluing stocks held at the beginning of the year at the prices obtaining for those goods at the end of the year. Thus if stocks held at 31st December, 1958, were valued at £1,200,000 and those stocks at prices ruling on 31st December, 1959, were worth £1,320,000, stock appreciation in 1958 amounted to £120,000 (£1,320,000 less £1,200,000). Such stock appreciation is the increased cost of maintaining the same physical quantity of stocks at higher prices.

Such an estimate of stock appreciation (or depreciation) during the year should be a compulsory footnote to published accounts so that an appropriate adjustment to the figures for profits can be made by those who wish to do so. In some cases calculations of stock appreciation may only be feasible for that part of total stocks comprised by goods in stock and awaiting processing. When this is so the proportion which these bear to total stocks should be shown.

In the income account the practice of the most enlightened companies should now be made general and the account should open with turn-over or sales figures. A trading account should follow in similar form to those used for the main headings of the census of production. We have found no evidence that publication of figures of sales or turn-over has damaged the companies which give this information in this country, or the corporations which are obliged to do so in the United States of America.

The disclosure of the amount of stock appreciation or depreciation as a footnote will enable those who wish to do so to calculate income net of stock appreciation. For many purposes this is much more significant than income as now shown.

Another cause of distortion in the published figures of profit arises from the conventional method of calculating depreciation. Since in many cases assets are undervalued, depreciation allowances based on these assets are inadequate for replacement purposes. It is impossible to judge the extent of this inadequacy and whether it is

(1) A detailed explanation of the procedure is given in "National Income Statistics Sources and Methods" H.M.S.O., pp. 309-313 and pp. 324-327.

made good by transfers to general or specific reserves. If assets have to be revalued every five years, as suggested above for quoted public companies, this will substantially reduce the element of uncertainty as to the adequacy of depreciation allowances. So would our other suggestions of publication of insurance valuations and of an estimate of the value of fixed assets each year.

It seems that sometimes modernisation and rationalisation expenses of a capital nature are charged against current revenue in published accounts. This causes serious distortion. Clearer and more uniform distinctions are required between maintenance and capital expenditure.

Payment of interest on short-term borrowing should be shown separately as well as interest on long-term debt. For shareholders should be informed of the extent of reliance on short-term borrowing; this is not always revealed by the amount of short-term debt outstanding on the balance sheet date.

Income from trade investments should also be shown as a separate item.

Consolidated accounts now include the income of subsidiary companies—that is those companies of which more than 50 per cent. of the capital is owned by the parent company. This principle should be extended to ensure that the undistributed profits of a partly owned company belonging to the parent company are revealed in its accounts. It is suggested that this be compulsory when either more than 25 per cent. of the capital of the partly owned company belongs to the parent company, or the income accruing to the parent company constitutes more than 10 per cent. of the total income of that parent company. These provisions are required because a number of important industrial enterprises are now being conducted jointly by two or more "parent" companies. It is quite contrary to the spirit, though not to the letter of present company law that the operations of a large company need not be disclosed because it is jointly owned by two "parent" companies, neither of which is obliged to consolidate the accounts of the offspring with its own nor to make them available to their shareholders. In certain other cases a medium-sized company may have such a large stake in a large underlying operating company without even holding as much as 25 per cent. of its share capital, that failure to disclose its share of the undistributed profits of the underlying Company seriously detracts from the value of the accounts of the parent.

A complete list of all subsidiary companies and those partly-owned companies to which the above provisions apply should be included in the accounts of all parent companies. This will enable those who wish to do so to study the accounts of such subsidiary companies in Bush House and to form an estimate of their relative importance. At present although the accounts are there, such a study cannot be undertaken in many cases for lack of knowledge as to which are the companies in which company X has a considerable interest.

Overseas Interests

Many large British companies now have substantial interests overseas and such "direct investment" is becoming increasingly important. Different risks are involved in different countries and shareholders should be told the main areas in which their company is operating. This might be achieved by providing that where 5 per cent. or more of the income of a company is earned in any one overseas country that fact be stated and that an estimate be given of the percentage of the total income of the company earned overseas.

Trade Credit

Trade credit is an important item in company finance of which little is known in quantitative terms. The Radcliffe Committee recently recommended⁽¹⁾ that further investigations be carried out on this subject. For this purpose it would be helpful if the present portmanteau item "trade and other credit" in published accounts were to be sub-divided and trade credit shown separately. Moreover, "creditors" should distinguish amounts owing on account of "current" items, such as raw materials, fuel and power, bought-out components and goods purchased for re-sale: "capital" items, particularly debts incurred through the acquisition of fixed assets, should be shown separately. Similarly "debtors" should provide a "clean" figure of debts

⁽¹⁾ Report of the Committee on the Working of the Monetary System. Cmd. 827 of 1959, paras. 310-311.

owed by customers whose purchases would be included in "turnover" (which is not normally taken to include sales of anything hitherto recorded among the fixed assets).

It is also desirable that progress payments should be treated in a uniform manner. In a study⁽¹⁾ of the accounts of building and contracting firms, Professor C. F. Carter found great diversity in the treatment of progress payments. "At least two companies put the entire work in progress less progress payments received, into the 'debtors' item. At the other extreme some companies fill 'work in progress' with a rag-bag collection of tail ends of substantially completed contracts and occasionally empty the contents into 'debtors'." We suggest, therefore, that four separate items should be shown:

- (1) Stocks;
- (2) Work in progress;
- (3) Progress payments;
- (4) Debtors.

Sources and Uses of Capital Funds Analysis

In order to portray the growth of a company over a period of years we have found that re-arrangement of items from the accounts in the form of a sources and uses of capital funds analysis is the best method. This shows the growth of various assets—fixed assets, stocks, trade debtors etc., and how this has been financed—the contributions made by retained profits, by new issues of shares and of loan capital, by bank loans, by borrowing from trade creditors; it also shows the effects on the liquid position of the company—whether its liquid assets have been increased, maintained or run down.⁽²⁾ Although we carried out this analysis for academic descriptive purposes we suggest that it is valuable also for those who control the flow of investible funds into securities. One or two companies already provide such an analysis in their published accounts. We suggest that this practice should be made compulsory. To do so would not demand the provision of any significant amount of extra information by the companies concerned but merely the re-arrangement of accounting data into a form which is particularly clear and helpful for the assessment of the growth and progress of the company in question.

It is particularly important that such a sources and uses of capital funds statement covering a five-year period be included in the prospectus of every company making its first issue and seeking a quotation for its shares on a stock exchange for the first time. Often at this stage in their growth companies are involved in amalgamations, changes of name and recapitalisation. This makes it most difficult for the reader of a prospectus to construct a sources and uses of funds analysis from the information provided, or in any other way to form a clear picture of how this company has grown and financed its growth in the past five years. Yet such information is important in the assessment of the value of the shares described in the prospectus.

Half-yearly and quarterly figures

Our suggestions so far aim at bringing the price of the shares of a company more nearly into line with its real value once a year—after the publication of its annual accounts—and on certain special occasions such as a new issue. Further action is required to keep them in line. The minimum necessary is compulsion to publish an abridged summary of accounts each half-year. This should include a balance sheet and income account and a statement describing any revaluation of assets carried out in that period.

Encouragement should be given to the publication of quarterly figures.

It will be objected (1) that this is troublesome to the companies concerned and (2) that the figures are liable to misinterpretation because of seasonal fluctuations and for other reasons. To these objections it may be replied (1) that all efficient public companies should have these figures to exercise effective control and (2) that all figures are liable to misinterpretation, but the experience of the past twenty years shows conclusively that fuller information reduces the risk of misinterpretation. The investors' statistical services, the financial press and professional investors are

⁽¹⁾ Quoted "Companies in the Building Industry", Tew and Henderson op. cit. pp. 188-190.

⁽²⁾ Brief sources and uses of funds tables are published in "Economic Trends", February 1958 and February 1959. Fuller tables and description are given in Tew and Henderson op. cit.

certainly competent in this country to interpret such figures for the benefit of the general public.

American Investment in Britain

A further reason for reform of company law is the desirability of encouraging American investment in Britain. That such encouragement is part of the policy of the Government was confirmed in the House of Commons on 9th February, 1960. There is no doubt that in the choice of foreign securities American investors attach great importance to the extent to which the standards of company accounts in the country in question fall short of those to which they are accustomed in the United States. Thus a leading American financier, as chairman of the New York Capital Fund of Canada, stated in the 1959 report of that company that one important reason for the investment of a large part of that investment trust's resources in Canada was that Canada imposes a "method of accounting practices and public disclosure of financial operations second only to those of the United States".

The process of acquisition of British shares by American investors—portfolio investment—enables Britain to provide more capital for the development of the overseas sterling area and other underdeveloped countries without too great a strain on the balance of payments. Moreover a climate favourable for portfolio investment will also encourage direct investment which is even more valuable. There is much evidence⁽¹⁾ now of the advantages which have accrued to Britain—and especially to Scotland—from investment by American corporations. This has provided a notable stimulus to technical progress in many fields, e.g. pharmaceutical and toilet preparations and office machinery. There is now a real danger that much of this American investment will go in the future to the countries of the Common Market instead of to Britain. Of course certain direct investment such as the establishment of a fully owned subsidiary company is not directly affected by the extent of disclosure insisted on by company law. But there is no doubt that different sorts of investment are inter-connected: the establishment of subsidiaries, the acquisition of shares in affiliated companies, exchanges of shares and of technical knowledge and portfolio investment. Further improvement of standards of publicity towards the pattern in the United States will have a significant effect in retaining American interest in Britain as a field of investment with favourable effects both on the British balance of payments and on technical progress in British industry.

Exemptions for Banks, Shipping Companies, etc.

The exemptions from full disclosure granted to banks, discount companies, insurance and shipping companies should be reviewed. We suggest that this provision has been on balance harmful. It has fostered inefficiency and wasteful use of assets in the shipping industry, because it has enabled directors to conceal from their shareholders the low rate of return which has been earned after proper provision for replacement of assets, and to obtain fresh funds in effect on false pretences. For support of this contention we would direct the attention of the Committee to the additional information which was made public at the time of the formation of the British and Commonwealth Shipping Company and to the affairs of the Union Castle Steamship Company. We do not believe that British banks, discount companies or insurance companies would suffer from a loss of public confidence if obliged to reveal their true reserves and earnings.

Summary of Main Recommendations

1. That estimates of written-down replacement value of fixed assets be provided annually and that assets be revalued every five years.
2. That estimates of stock appreciation be provided each year.
3. That sales or turnover figures and a trading account be published.
4. That a sources and uses of capital funds account be published.

⁽¹⁾ Cf. John N. Dunning, *American Investment in British Manufacturing Industry* (1958) *passim*.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
FOURTH DAY

Friday, 21st October, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

(Questions 979 to 1253 only)

MR. W. H. LAWSON, C.B.E., F.C.A.

MRS. M. NAYLOR

MR. C. H. SCOTT

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. R. E. BIRD, MR. G. LEE and MR. F. HIRSCH *called and examined*

979. *Chairman:* Mr. Bird, you are the Deputy Editor; and you, Mr. Lee and Mr. Hirsch, are members of the staff of *The Economist*?—Yes, Sir.

980. I need hardly say that we are very grateful to you for your interesting memorandum and for coming here to supplement it by your oral evidence. In your memorandum you say succinctly that incorporation is too easy and too cheap. Can you develop that?—*Mr. Bird:* We have indicated, I think, the way we would like incorporation to be made somewhat more difficult and expensive.

981. When you say incorporation is too easy and too cheap, you mean that it is so easy and so cheap that speculators and undesirable characters may avail themselves of limited liability when really they have not the resources to justify their being in business at all? Is that the kind of objection?—The objection I think is on rather broader grounds than that, Sir. It is that the provision of limited liability has become almost a "free good". It is so cheap and so easily available that there is no power of preventing anybody, for whatever reason, from setting up his own business as a company. This on the

whole is a reasonably good thing for enterprise, though in a number of cases it may not be so desirable; if so, some of those undesirable cases might well be weeded out if it were made more expensive. We do not suggest any kind of censorship or any kind of control on the incorporation of companies. We would like to make it more expensive.

982. Could I put it that in one class of case a man is getting an advantage for which he ought to pay a reasonable *quid pro quo*; and that there is another class of case where the promoter of the company should have some reasonably solid ground for the incorporation?—I am not clear how one could establish the solid ground for incorporation. There are many companies where assets are not so much in question as trading capacity and personal abilities. I am not sure that one could propose, for example, that you may not incorporate a company with less than, say, £100,000 issued capital. There is I think a good case for requiring a company to have a capital of at least, say, £100. But I would make the capital duty on that kind of company, and on all others, and the annual charges for registration work, a good deal heavier than they are now.

983. You would increase the fees payable, the capital duty and any annual charges there may be?—Yes, Sir.

984. Then you make the suggestion that exempt private companies might be made to file accounts, or at all events a certificate that properly audited accounts are being kept; the latter being certified by a qualified auditor.—That is right.

985. You say that you think on the whole it might be going too far to compel all exempt private companies to file properly audited accounts, that is to say that it might be going too far to deprive them of the statutory exemption that they enjoy under the 1948 Act.—I think our mind is a little unclear on this question, where to draw the line for exemption. We would in our heart of hearts prefer that all companies should file their accounts. We can see some qualifications to that general principle. But at any rate if we cannot secure that all companies, including those now exempt, should file their accounts, we think that certificates should be on the file for the protection of creditors.

986. What troubles me about that is that you may have accounts kept and the best auditor in the country audit them perfectly correctly, and yet they might show a deficit so that the certificate would not be any protection.—The certificate would only protect, I take it, those creditors who were curious enough to apply at Bush House to see the return, to see the file.

987. But the return, if you take the course of requiring a certificate certified by the auditor, would simply be a certificate that accounts have been kept and have been properly audited?—Yes, Sir, that is so.

988. You would glean nothing from the registry about the state of the company's affairs?—No, that is true.

989. While we are on the subject of exempt private companies, what is your view as to the privilege such a company now enjoys by way of exemption from the prohibition of making loans to its directors?—I have not considered that and I have no views about it.

990. Then, going back to the accounts, supposing the plan of having a certificate

from the auditor was adopted, then the accounts would *ex hypothesi* have to be properly made out and audited by a fully qualified auditor. All the work would have to be done before that certificate could properly be issued. If that is so, what hardship do you think there would be in requiring the exempt private company to take the further step of filing a copy of those accounts?—I would not think there would be any hardship in lodging copies of the accounts. I admit to seeing the argument, which might tip the balance in general discussion, that private companies are still entitled to some privacy about their accounts. But I would not put great emphasis on that and would much prefer that all companies should file accounts.

991. In the end the result might ensue that we might find we had abolished the private company altogether.—That is so. In which case some important consequences might follow—for example, about the control of transfers of shares.

992. Yes, I follow that. The view taken by the Cohen Committee on this point was that it would be a hardship on family companies of the smaller kind if they had to publish accounts, because that would help their competitors and possibly damage their business; and the Committee were particularly impressed, I think, by the potential use which might be made of these accounts by other small companies and by partnerships. What do you think of that?—I have never had any high regard for that argument, Sir.

993. Then we have already touched on the question of requiring a minimum paid up capital. You said it would be wrong to require paid up capital of £100,000, but I think you suggested that a reasonable figure of paid up capital, something not prohibitive but not derisory, might be required, say £100 instead of the present £2, or it might even be two shillings?—Yes, Sir. A minimum of £100 in these days could not be regarded as intolerable.

994. Then you express the view that it should be made possible for one man to form a company (at all events in the case of a private company); not, as at present, two, in the case of a private company, and seven in the case of a public company.—Yes, Sir.

995. Do you not see difficulties in that?—No special difficulties come to my mind, Sir.

996. I am thinking now of the individual who under the present dispensation gets his wife or his brother to take one share, takes the other himself and embarks on business as a limited company. You say with force that this is all mere form because there is one man really behind the company and a mere nominee obliging enough to take the other share; but would one not be losing a check of some kind by making it possible for one individual to form a company?—With respect, Sir, I would not have thought so.

997. Mr. XY simply signs his name to a memorandum of association in the presence of a witness and a company comes into being. I confess this has always troubled me, though many people seem to share your view that there is nothing in it. I was brought up on the theory that there are two kinds of corporation, the corporation sole and then the corporation aggregate, and I have always regarded Companies Act companies as falling within the latter description. The incorporation is founded under the law which has so far obtained, upon an agreement entered into by the intending incorporators. When they apply to form the company the memorandum which they sign says that "We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company, in pursuance of this Memorandum of Association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names." That shows what the legislature regarded as the basis of incorporation, does it not?—Yes, Sir. But the substance of an increasing number of these cases is that X is the single person interested in the company and Y is a nominee who is installed to assist with the legal form.

998. But of course in the eye of the law the nominee is the holder of the share, is he not, and the law will not, generally speaking, have regard to any trust?—No.

999. There it is. Your sole applicant would have to sign a document, not that he agreed with other signatories to be

formed into a company but that he, XY, by himself alone, agreed to form himself into a company. In fact there is no basis of agreement, one has to accept that?—Yes.

1000. Perhaps in these streamlined days it may have to be accepted, but I would put this to you: if there is a sole shareholder and no second shareholder holding as a nominee for him, will not complications arise where there is a death?—Yes indeed, Sir.

1001. Might there not be some advantage in having a second shareholder who would be there and could keep the company going, or take the necessary steps to wind it up?—But continuity, I take it, could be assured by legal representation of the sole shareholder; and in a great number of cases the sole shareholder would be in fact a corporation, not a person.

1002. That really comes at another stage I think. I am only suggesting to you, for your consideration, that to allow a single individual to form a company makes it that much easier to form one. He need not bring his wife into it, or brother or anyone else. He simply goes to the registry and forms as many companies as he chooses, with XY No. 1 Limited, XY No. 2 Limited and so on?—If I may say so, Sir, I wonder whether the presence of his wife would inhibit him from doing precisely that.

1003. It depends on what their relations were. But I must not take up any more time on that. I am just putting it to you that this need for at least two members does provide a check of a sort. You are disposed to doubt that?—In general I would be disposed to doubt it, Sir.

1004. What would you say of the suggestion that the requirement that a company ought to have two directors should be extended to private companies? A public company has to have two directors now, I think, but what would you say to making that necessary for all companies?—I should think that would be desirable as a matter of general business practice.

1005. A nominee shareholder can say "I am only a nominee shareholder, I am not responsible". But if he was made a

director as well it would not matter that he was merely a nominee shareholder. He would have his responsibilities as a director. Do you think that might be an advantage, if practicable?—I can see that the two things could go together there, the two shareholders and two directors.

1006. The difficulty I suppose might be that the persons interested in the company were so few in number they could not find a second director. I suppose that is the objection?—If the people interested in the company were so few in number, I would have thought they could easily decide to have, for example, their wife or sister to act as a director.

1007. Then you might keep some semblance of order in the proceedings? There would be two directors who could hold a meeting, and so on?—Yes.

1008. Pausing there, I would like to consider another aspect of this. You have mentioned the case where the sole shareholder is itself a corporation. It has been put to us that, by statutory definition, the wholly owned subsidiary company can only have one member, namely its holding company. But of course if you do not object to one individual getting himself incorporated, *a fortiori* I imagine you see no objection to the holding company being the sole shareholder of its wholly owned subsidiary?—No, Sir.

1009. Passing from that, we might perhaps deal with the question of the prohibition on large partnerships, that is to say limitation of partnerships to twenty members. I gather you are in favour of repealing this prohibition for any kind of partnership, that is to say a trading partnership as well as a professional partnership.—I am not sure, Sir, that we addressed our minds very closely to this particular question. I think there is no special relevance in the limitation of any kind of partnership to-day.

1010. The special ground for suggesting the repeal of this prohibition, I think, is the difficulty in which professional men find themselves. Rising costs have enormously increased the average size of partnerships—solicitors and accountants, I expect, as well as doctors. In cases of that kind an individual must act. Would you agree?—Yes, indeed.

1011. You cannot have a company coming to take your temperature. So it has been suggested that this maximum limit of twenty members should either be abolished altogether or extended by increasing the limit to fifty members, or something like that, for the special benefit of professional people.—Yes, Sir, we would support that view. I have some small knowledge of the predicament of an accounting firm in this matter. The limitation on partners and the confusion of separate deeds of partnership between a large number of people is a tiresome business for them.

1012. I do not want to close the door to the suggestion which has been made, I think, that the abolition of the limit of twenty members might extend to all kinds of partnership; but I think what brought it forward was the difficulty of professional men under existing conditions.—Yes.

1013. Do you, Mr. Lee, or you, Mr. Hirsch, wish to add anything on this question of the large partnership?—*Mr. Lee*: No, except to say that I think we had the professional men in mind when we were preparing our memorandum.

1014. Then you get into this difficulty—have you ever considered whether an optician carries on a professional business?—He may. On the trading side I should have thought the advantages of a company with limited liability were clear. We would not get in fact large trading partnerships anyway, so possibly the difficulty of definition might not then arise.

1015. But it is difficult to resolve. The optician, when he is testing your eyes and prescribing your spectacles, may be said to be exercising a profession, but when he sells you your spectacles it is difficult to say he is not trading; so difficulties of definition might arise and your view, Mr. Lee, is that that would not be very serious because it is more probable that concerns other than professional concerns would wish to avail themselves of limited liability.—Yes.

1016. Then as regards the general question of exercise of the company's powers by directors and control by the shareholders, what is your view about the difficulty in the way of improving the

position of shareholders, which shareholders themselves aggravate by refusing really to take any interest at all in the affairs of their companies until a dividend is passed, or something happens to show that things are going wrong? In our discussions this has often been raised. Some step is suggested for the benefit of the protection of shareholders. For instance, it is suggested, as you have suggested, that if more than a certain proportion of capital is issued, maybe for cash, the shareholders ought to be consulted. If the shareholders do not come to the meeting, do not apply their minds to the question at all, just leave it to the directors, nothing has been achieved by giving them the right to express their view at a general meeting.—*Mr. Bird:* They have had the opportunity to say no. If they have said nothing, then presumably they have consented by default. The dilemma is that we must deal with shareholders and company directors entirely as they are, even if they are stupid or fallible or take no notice of their own interests even when circumstances strongly urge them to do so. I do not see how we can change the quality of the average shareholder except by patient work over generations. All I would suggest is that the shareholder nowadays is a much more wide-awake person than he used to be twenty-five years ago when I came into the business of financial journalism.

1017. I am most interested to hear you say that, for I think two financial journalists giving evidence before you emphasized that this was an age of unsophisticated investors. It was put to us that money was so much more widely spread now and so many more savings were available for investment that many people who became shareholders in companies were less well equipped than in the past to assess the merits of a particular share or to understand the point of a particular article of association. What would you say to that? —I would agree with you as regards the fringe of new investors who, because of rising incomes, have lately come into the market. What I had in mind in my earlier answer was the rising knowledge and sophistication, not of the most recently attracted part of the public to the security markets, but of the general body of investors from institutions all the way

down. The newcomers are bound to be unsophisticated and some are foolish.

1018. They have to learn the hard way? —They cannot, I suggest, be guaranteed against their own folly.

1019. I suppose it would be true to say that one difficulty in the way of shareholders who want to restrain their directors, is the difficulty of organising the opposition and getting other shareholders to support it.—Yes, Sir. This will usually happen when a sufficiently important interest can rally support for opposition. It is a familiar enough process.

1020. And of course the institutional investors, the banks, insurance companies and others, whose business may include the buying and holding of shares, they can probably look after themselves in these respects?—Yes, Sir, and in looking after themselves do materially look after the general body.

1021. But of course in companies where there are not institutional investors—and although they cast their net fairly wide there are many companies they would not be concerned in—the ordinary private shareholder has to fend for himself?—Yes, Sir. Sometimes among the ordinary shareholders will be a wide-awake holder of sufficient interest in the company to create effective opposition if the directors are not doing their job.

1022. On this question of controlling directors, you are optimistic enough to think that shareholders will probably improve with experience as regards taking an interest in their company's affairs?—Yes, Sir.

1023. And therefore in this Committee you would say we should proceed on the assumption that use will be made by the shareholders of any legitimate additional protection that it may be thought fit to accord to them?—Certainly, yes, with the assistance of other institutions, not excluding the financial Press.

1024. Then one gets this position, that every measure taken to protect the shareholders in a way reduces the powers of the company. It reduces the power of the company to delegate to its directors. Supposing, for example, that it was thought fit to recommend a statutory

provision to the effect that, notwithstanding anything contained in the articles of association, the directors should not issue any shares without the consent of the shareholders in general meeting. Any recommendation on those lines would override the articles of association of the company and prevent the company *pro tanto* from delegating that power to the directors?—Yes.

1025. Then two views might be possible. Some members of the company might be in favour of such curtailment of the company's powers while others would say, let the company exercise an unfettered power of delegation?—This is a difficult point to balance. The general principle that we take must be that the shareholders have power to criticize and if necessary in the last resort power to change the directors and the policy of the company. Within that limitation the directors must have all proper discretion to deal as best they may on behalf of the company, and by extension for the benefit of the shareholders.

1026. Then as to possibilities of stimulating the interest of shareholders, I understand that in the United States they require a more substantial quorum at meetings than is customary with companies in the United Kingdom. Have you considered United States legislation on that matter?—No, Sir.

1027. So you cannot help as regards the United States. What would be your own view on the question of a quorum? I am thinking in terms of public companies.—It is very difficult to pluck the right number out of the air, so to say.

1028. It has been put to us that they manage these things better in the United States, and somehow or other they secure a more substantial quorum at their meetings than is found possible here.—Possibly because often enough shareholders in the United States manage their own affairs much better than the shareholders do here.

1029. Then you made an interesting reference to a feature of German Company Law, consisting in an advisory board representing shareholders and workers as well as the executive board of directors. I think you came to the conclusion

that that German practice might not be suitable for grafting upon English law?—I think this post-war German development is still in the stage where it is still to be proved whether it will work out in the long run. It would, I would have thought, be entirely premature to contemplate applying anything as formal as this to British practice today. But it did seem proper to us to draw the Committee's attention to this development, on the ground that it attempts to meet the demand for asserting general public and workers' control over companies which, according to the critics here, at present have almost complete independence apart from what their shareholders may be able to do to control them.

1030. Yes, I quite follow that. But then of course when one establishes supervisory bodies it raises the question *quis custodiet*. Who is going to look after them? And the same difficulty might apply, I take it, to the appointment of a kind of leader of the opposition to be the underdog's director and look after the interests of the minority.—I think that is so, Sir. In fact some critics of the German system have asserted that the trade union members of the supervisory body merely become the prisoners of the board of directors and are ineffective.

1031. Referring to the exercise of the powers of the company by directors, you deal in your memorandum with the acquisition of property, and I think your view as to that is that it should be left to the discretion of the directors?—Very broadly, yes, sir.

1032. And you also deal with the disposal of property, disposal of the company's undertaking or a substantial part thereof, which of course will have to be fixed at some figure. There you think the shareholders' consent should be obtained. Could you say why you think it should be necessary in the case of disposal but not in the case of acquisition, both being major operations, you understand?—Yes. The distinction I make between the two sides of this argument is that in the case of the acquisition the directors are expanding on the basis of their own company's activities into new fields, which if they are wise ought to redound to the benefit of the shareholders in due course. In the case of the sale of a

substantial part of the company's assets, what we apprehend there is that this could in a sufficient number of cases leave a much less satisfactory corpus of property in the company than the shareholders have hitherto depended on. For that reason we think that where it is a question of the disposal of a substantial part of the physical assets of the company (which might be the nugget of gold in the whole piece of rock, so to say), then the shareholders should have a deciding voice in whether that should go forward.

1033. It occurs to me that so far as acquisitions of property are concerned, a great proportion might be satisfactorily covered by your proposals in regard to the issue of shares?—Yes.

1034. And in looking at that the first possibility is that a company has to increase its share capital to provide the wherewithal to make the acquisition. That case, I take it, looks after itself because the shareholders in general meeting will have to pass the necessary resolution for the increase?—Yes.

1035. And the directors could hardly expect them to do that without including reference to the purposes on which the increased capital was going to be spent?—Quite, Sir.

1036. Then supposing there is an issue of authorised capital and the purchase money is provided in that way, according to your recommendation if the amount raised exceeded some percentage of the total issued capital of the company, then consent in general meeting would be the requirement?—Yes, Sir.

1037. So that case would be covered and again I think under the same recommendation, an acquisition for shares paid up otherwise than in cash would probably equally be covered?—Yes.

1038. And that leaves the disposals, with which you have dealt already?—That is so.

1039. You say on page 10, I think, of your report, that directors should not place assets beyond the control of shareholders without their consent. I wonder whether you could explain that a little further.—We had hoped, Sir, that the words "Savoy Hotel" might cover that point.

1040. It was done there?—It was attempted there.

1041. Then there is the question of non-voting shares and there I think your view is that such shares ought to be clearly designated as non-voting shares, not just as A shares or B shares or something of that sort: subject to that you think their continued existence, if they do continue, should be left to the pressures of the market?—That is so.

1042. That is to say, if they are so bad as some people think, they will in due course disappear because nobody will want them?—Yes.

1043. Then there is the important and difficult question about nominee holdings which enters so much into this discussion. Your view is that the directors should be able to discover for whom they are acting and that shareholders should be able to discover who their fellows are and you make, I think, two possible proposals. You suggest first of all that the register of members should include a register of beneficial interests in effect, I think; and you further suggest that, if this requirement were thought to be burdensome in the case of existing nominee holdings, then the directors should be empowered, if they think necessary, to inquire into the beneficial ownership of shares?—Yes, Sir.

1044. I would like to put this to you: as to the directors being able to discover for whom they are acting and the shareholders knowing who their fellows are, I appreciate that that would be a very desirable thing, but is it something that can be regarded as practicable in these days? In big companies the shareholders may run into thousands and the changes on the register may be very voluminous. One might say that the shareholders' fellows are changing every day. Is it not difficult to apply a condition of registration of beneficial ownership to conditions of that sort?—I think it would certainly be difficult. I am not sufficient of a lawyer to know whether the words "registration of beneficial ownership" are the right ones.

1045. I may have mis-quoted you. I simply meant "recorded".—We would think desirable a note, a recording or memorandum only of beneficial interests

behind shares held by nominees. In the great majority of cases the beneficial owners are straightforwardly known, I would have supposed. The shares appear, say, in the names of recognisable bank nominee companies or joint accounts and the beneficial interests behind them should usually be identifiable without much trouble.

1046. Of course the objection has been made, and it is the fundamental objection to proposals of this kind, that however desirable it may be, in practice it simply would not be practicable so far as shares of all the larger companies are concerned. The trouble is, it would involve in each case an investigation into beneficial ownership and you get the case of a man who does not even know for whom he is holding.—With respect, I would not have imagined that this involved an investigation by the company so much as a declaration by the purchaser.

1047. You are putting it on the holder of the shares to declare that he is the sole beneficial owner, or alternatively that he holds it in trust for others?—Yes.

1048. I think an expedient of this sort was suggested in the Cohen Committee but then withdrawn as involving a really impossible amount of work.—I think the amount of work is formidable. The amount of straightforward share registration work for the biggest companies is formidable too, but the only way it appears to me to obtain disclosure of nominee holdings—if that is desirable, as many people think—would be by some simple form of declaration of this kind.

1049. It is true to say that the work would be reduced and possibly some result might be achieved, if all that was required was for a man to state either that he was or was not beneficial owner, without naming his nominees.—Yes, you could identify then the proportion of the total holdings which were directly owned.

1050. If that practice resulted in a lot of nominees of course one might link it to your alternative suggestion that the directors should be able to hold an inquiry. They might get their *prima facie* case and then proceed to an inquiry.—Yes. There is, if I may add a point here, Sir, the even more formidable problem,

if one were to embark on this procedure, of identifying the beneficial owners of shares already held in nominee names, from which you will see that we shrank with some horror.

1051. I should have said that would be a quite impossible task. As for requiring the holder to say whether he was beneficial owner, that would be only, I think, the preliminary stage. There would have to be a time when the beneficiary was traced out and named. I do not see how one could avoid that if one were having an effective check on beneficial ownership.—Yes, Sir.

1052. And surely the work would be enormous?—Formidable, Sir.

1053. Then there are various ways in which the reluctant beneficial owner could cover his tracks, are there not?—Certainly.

1054. He might hold for a company, and the company might hold for goodness knows whom, and all entries might be subdivided down without limit almost?—Yes. I think the people determined to hide could hide still.

1055. So that after all one's trouble one would not have achieved any very practical result?—Unless the law were made stringent and required absolute declaration.

1056. Of course the Board of Trade inspector has power to do this and one solution would be to leave the matter in that way, and propose any practical measures for making that procedure by the inspector of more practical value?—Yes, that would be an improvement.

1057. Then, on the same point, there would have to be a sanction to compel the beneficial owner to disclose his interest, or the nominee to disclose for whom he was holding?—Yes, there would have to be some sanction.

1058. What form would it take—five, ten shillings a day, or deprivation of voting rights?—I do not know what the penalty might be.

1059. The obvious penalty is deprivation of voting rights. But imagine between two factions in a company how useful it might be for the directors to say—"none

of these shares can vote, all the proxies are bad because the provision for disclosure of nominee holdings has not been complied with". It would yield a remarkable result?—Yes.

1060. I do not know that we can develop that much further. This is a point everyone wants to meet in some way or other but so far the difficulties of doing so, I must say, have loomed rather large.—We are very conscious of those difficulties; they are almost insuperable.

1061. Passing to quite another thing, take-over bids, I gather that you are familiar with the new Board of Trade regulations and that, subject to the appropriate legislation to bring them into any new Act, you are content with them?—Yes, Sir.

1062. Then the unit trusts: you were kind enough to give us a special annex to your memorandum on the subject of unit trusts. I am afraid it is a topic I am not so well versed in as I might be, but could you just tell me this. The well-established unit trusts—and of course they are well established in this country now—may be either the old fashioned fixed trust—I do not know if that is done so much now, but that was the prototype?—*Mr. Lee*: The old fixed trust has practically disappeared and now most of them are flexible open-ended trusts.

1063. They are flexible trusts so that the trustees, by direction of the managers, can vary the investments from time to time?—The management vary the investments with the consent of the trustees.

1064. Are the trustees given power to veto? Could they refuse consent in a particular case?—*Mr. Bird*: Only I think, Sir, if the trustees are convinced the managers are investing outside the powers they have taken. Otherwise it is the managers' initiative.

1065. Within the permitted powers I suppose the managers' discretion is absolute?—The trustees are in my understanding depository trustees only. Their function here is to ensure the securities are there and that the units issued are supported by investments which they hold.

1066. So the unit holder is given a document of title entitling him to a share

of the investments in the pool: that is how it works?—Yes.

1067. And he is protected because the trustees hold all the investments which are held in trust for the purposes of this transaction, and are segregated from any other assets because they are vested in fact in the trustees?—They are held by the trustees.

1068. And broadly speaking these arrangements have been found satisfactory although there are various points of difference, which are gradually being cleared up, as to the methods of administration?—That is correct.

1069. Over and above that there is something that has never come into this country yet, and that is the "open-ended fund" where you dispense with the trustee and have a company which combines the function of trustee and manager?—*Mr. Lee*: Yes, Sir, as some funds do in the United States.

1070. What are your views on that form of unit trust operation?—The trust system over here has worked very well indeed. The suggestion has been put forward that we should have the company method because the company method would require agency principles in the management of the units and the securities. That is the only reason that I can see why it has been put forward.

1071. If I wanted to invest in units I would very much prefer to invest in units where I knew all underlying securities were in the hands of a trustee than I would in units issued by a company which was doubling the roles as it were of trustee and manager; that is to say, had the underlying assets under its own control, and I suppose not segregated or, if so, how?—I think there is attempted segregation between the management and the custodian function in the company form, but they are wearing in fact two hats at once.

1072. No doubt these points can be met but it seems to me there must be some safeguard afforded by having a trustee.—I think the merits of having an independent trustee are practically overwhelming.

1073. I do not think one can really carry that discussion much further, but

there is nothing radically wrong with the existing arrangements in this country as I understand it. There is no radical criticism of the present forms of unit trust?—No.

1074. Then there is a rather important matter on which I suppose there is some divergence of view, and that is the exemption of banks, insurance companies and discount houses from some of the accounting provisions of the Act, and the similar exemption afforded to shipping companies by the Board of Trade under its powers. I gather you are against the continuance of all these exemptions.—*Mr. Bird*: Yes, Sir.

1075. And I gather, if one might read between the lines, you are more against it in the case of shipping companies than you are in the case of, say, banks. Would that be right, or do you think it is equally reprehensible in both cases?—I think that would be right, Sir, on these grounds; we are conscious of the force in the argument that if a bank brings everything into the shop window and falls into a period of difficulty, then the depositors may become apprehensive about its credit standing. There is that important element to be argued in favour of some kind of exemption for the banks.

In the case of the shipping companies the argument is usually put forward that disclosure would expose them more directly to foreign competition. This seems to us to be little more acceptable than were the arguments, since abandoned, against disclosure within this country on the ground that competitors in the same industry would then learn how one's business was faring.

I would add a footnote in the case of shipping. These are companies which have had considerable assistance from public funds, particularly in the way of investment allowances; that would seem to us to justify some meaningful publication of what they have been doing. The P. and O. for example have shown that this can be done, provided that more intimate details—voyage accounts and so on—are not disclosed, and we think this principle should be applied to other shipping companies.

1076. Do you see any harm likely to accrue to other people through the

shipping companies' exemption being continued?—I could not put it as positively; it is not being apprehensive of harm so much as expecting good to emerge from greater disclosure.

1077. Good to whom?—To the public weal. This is an industry which the public is supporting and therefore might be presumed to have an interest in its results.

1078. The public could pull it up and see how it is growing? But how about the shareholders of the shipping companies? Do you think it would be to their advantage or their disadvantage?—I should have thought it could easily be to their advantage. Shareholders in shipping companies have sometimes been treated with less regard than shareholders in other types of company, though there are examples to the contrary.

1079. But if no great harm or appreciable harm is done to anyone else, except on theoretical grounds, and there is reasonable ground for holding that this exemption helps the shipping companies in carrying on their undertaking, is there any sufficient reason for reversing the decision to exempt them?—Not on those premises, Sir. My argument for publication is based on the view that the public have a direct interest in what goes on in shipping.

1080. One gets at that point into realms of accounts, I think. So far as the banks are concerned, what they do is to make themselves appear a little worse off than in fact they are?—And on occasion rather better off than they in fact are.

1081. Do they do that?—They have done that.

Mr. Hirsch: I think the point, Sir, is that a balance sheet for a bank is not comparable with a balance sheet for any other industry, and a shareholder does not really know how the bank is doing because it does not reveal the real profits it is making.

1082. But if the banks exhausted their secret reserves they could not cook their balance sheet to conceal the fact that they had made a loss?—No, Sir. I would guess there are very few banks anywhere near exhausting their secret reserves but, if there are, it might not be a bad thing if it were revealed.

1083. The crude argument is that a bank should not only be solvent but manifestly appear to be solvent.—Yes, Sir. The view we have taken is that, at present, these are institutions that even the general public now feels can never fail. If there were ever any question of failure they would be supported in one way or another. Therefore the original argument that they should be allowed to conceal facts which might lead even to suspicions of weakness has lost force. We did suggest that in order that bank profits should not fluctuate unduly because of fluctuations in investment valuations, they should be permitted to smooth out fluctuations in market value to some extent, as indeed they do.

1084. That is an argument against continuing the exemption; and in due course no doubt we shall be hearing banks and shipping companies arguing in the opposite direction. I do not think we can carry it much further today. There is just this about insurance companies: I am under the impression that their accounts are subject to special statutory regulation.—*Mr. Bird*: Yes, Sir.

1085. And I suppose they can enjoy exemption. They must be able to, because the Act said they could, within the framework of their special statutory obligations as to accounts, I suppose?—That is true, Sir. On the other hand there are very few people except a handful of specialists, who go through the elaborate returns which insurance offices make to the Board of Trade. I believe there is need for a good deal of improvement in the general quality of insurance accounts. The particular difficulty is that one cannot look solely to the financial state of the company at a particular moment of time in the case of the insurance office; one must have regard to the flow of its income and liabilities over possibly twenty or fifty years.

1086. In the case of a life office, obviously the commitments may extend to very substantial periods.—Certainly. But I am afraid the obscurities in insurance accounts extend beyond the accounts of the life funds, they also affect the general funds in which the shareholders have a direct interest.

1087. *Sir George Erskine*: I was interested in your references, in the early part of

our discussion, to incorporation of companies; you thought today incorporation was acquired too cheaply and easily. Do I take it that your reason for raising this is the protection of creditors?—Partly that, but primarily to check the notion that limited liability is something that anybody can have almost for nothing.

1088. If you are not worried about protection of creditors, is there any reason why the facilities should not be available easily and cheaply?—There are some general reasons, I think, why the creation or setting up of a company should be, so to say, a responsible act. One of them is the special treatment of companies for tax purposes; and broadly speaking I should have thought there should be public interest in any process which lifts responsibility from the shoulders of a person and puts it on to an autonomous ungetatable thing.

1089. Looking at it from the point of view of protection of creditors, does it ultimately protect the creditor if the new company has to pay higher fees? And do you think your suggestion that a minimum capital should be prescribed would work. The capital does not necessarily have to be put up in cash and the assets which may represent the capital may in the end prove worthless—an invention or something like that?—If I could sketch in briefly the two points we have in mind here, first, we suggest that the capital duty should not be, as it has been in the past, in my judgment, negligible; secondly, the machinery of company registration—presumably the Board of Trade will be talking about this—seems to be very costly and it is very much in the public interest that much more of that cost should be covered by the people who get the benefit of it.

1090. I, to some extent, sympathise with your views about the exempt private company, particularly the small family business, where perhaps it would be rather hard if they had to disclose all the secrets of their business by filing their accounts. Have you considered whether there might be a sort of half-way house which would satisfy you, from the point of view of information, in requiring the company which is now an exempt private company to file its balance sheet only and not its

profit and loss account?—No, I have not considered that. But if the balance sheet, then I would have thought without much question the profit and loss account too. I do not know whether Mr. Lee or Mr. Hirsch have any views on that.

Mr. Lee: No, I think I agree with Mr. Bird.

1091. Can I just ask you a question on a subject which has been very much in the public eye at the moment, namely take-over bids? There have been suggestions made to us that, in one way or another, more time should be given for consideration of certain of these proposals; that perhaps a shareholder should have more say, particularly the shareholder of a company which might be offering its shares; and that perhaps also more information should be given. For instance, one suggestion has been that the take-over should be subject to a special resolution of the shareholders of both the offeror company and the offeree company. Another suggestion has been made that the formal offer of shares should be made accompanied by a full-scale prospectus. These suggestions are all directed, I assume, to giving the shareholder greater say and greater information. Have you any views on that aspect?—*Mr. Bird:* I think on both these suggestions that the difficulty is the commercial one of getting the bargain finished and through. If directors are to be trusted and are pursuing wise courses then shareholders should be content with a fairly limited opportunity of objecting to a take-over bid, but should not have the sovereign voice in deciding whether what the directors are doing is right or not. A board of directors, on the edge of decision whether to go forward with a project, will be discouraged if its decisions are subject to an elaborate process of cross-checking. I think one has to pay attention not only to the rights of shareholders in situations of this kind but also to the practicability of business affairs. I would have thought special resolutions and prospectuses for issues of shares in a take-over were prolonged and elaborate ways of safeguarding the interests of shareholders.

1092. Would you not agree that the individual shareholder of the offeree company has the final decision as to whether he is prepared to part with his holding or

not?—Certainly. So long as he is prepared also to run the chance of remaining a minority shareholder.

1093. I was interested in your approach to the exemption of banks. Other evidence we have had has emphasised the question of the bank's investment assets and the effect of changes in interest rates on its portfolio. But originally the main object, as I understand it, of this exemption was directed to their advances. It enabled banks to make inner reserves against their advances so that in bad times when they were making substantial bad debts these bad debts could be taken care of without necessarily affecting the level of published profits. That aspect seems to have been rather overlooked. Once an exemption of this kind is taken away you would never get it back, and one cannot say that for all time there may not be any period of major recession when the banks will have to take care of very big losses. Did you consider that aspect of it when you expressed your view that this exemption should be cancelled?—I think we may have assumed perhaps a little too readily that nobody goes broke nowadays. Your point is entirely relevant to the exemption, I entirely agree. The balance of the argument, of course, is affected by the composition of bank assets nowadays compared with a generation ago; and if we have over-emphasised investments it is because they themselves are now much more important.

1094. Still bank advances now are very much getting on to the percentages they were in former days?—Certainly.

1095. *Mr. Lawson:* Mr. Bird, you must have a great deal of experience in analysing and summarising accounts of public companies and indeed your paper publishes statistics in which these accounts are summarised. Do you find that there are any serious difficulties arising from the present form of profit and loss account?—The main difficulty that we find arises not so much from deficiencies in the information which is now provided as in the infinite variety of forms in which it comes to us. I think any notion of a standardised accounting form would be repugnant to me, but the present variety does involve us in a great deal of effort which, with a standardised form, we

should avoid. I would certainly not regard that as an argument in favour of a standardised form of accounts. Their content is nearly as adequate as you could hope to get apart perhaps from disclosure of turnover and a few other minor points.

1096. In other words, you would welcome a greater degree of uniformity if that could be brought about without stultifying a new incentive?—Yes, but I should hate it to go out that *The Economist* was asking for uniformity in accounts.

1097. You do refer to turnover and I think you make rather a qualified recommendation about disclosure of turnover. You feel there should be a right of companies to get exemption from somebody or other from that requirement if it were brought in, is that so?—If the disclosure of turnover were made compulsory then it would clearly be necessary to exempt some people who could not provide meaningful figures for turnover. The conclusion to which we come is that some reference should be required in the accounts or the directors' report to turnover, and that the directors, if they do not decide to disclose their turnover, should explain why they have taken that course.

1098. Do you think the only reason why turnover should not be disclosed is because meaningful figures could not be provided, or do you think that turnover should not be disclosed in cases where the directors felt it would be harmful to the interests of the shareholders to disclose that information?—In general I would be in favour of the disclosure of turnover figures wherever possible and I would, in general, be sceptical of arguments that it would damage the company's business. But in the end I think one probably has to respect directors' decisions on this, provided that they explain to their shareholders why they are not disclosing turnover; then it is open to the shareholders to take the matter up in general meeting.

1099. Then you think it would be desirable that companies should give a list of their main fields of activity and the principal areas of the world in which they trade but, again, that there should be exemption in appropriate cases.—Yes. There again I think the end of our argument comes out against any form of

compulsion because you cannot make a tidy regulation of this kind. What you can do is to encourage and cajole companies to be more informative about the bulk of their interests or principal places where they work.

1100. In some cases it could be quite harmful to disclose the proportion of profits derived from a particular country?—Indeed.

1101. *Mr. Bingen*: You have advocated that companies should show their turnover globally but that this should not be a statutory obligation. What would you say in regard to a company which has six or seven different businesses to some extent related? Would you say they ought to publish details of the turnover of each department or subsidiary company or division? These figures might not be meaningful. Would you be satisfied if they showed the total overall figures?—I think we have to start fairly gently on this. I would be grateful for a net turnover figure with inter-branch and departmental figures eliminated and, of course, any distorting effects of indirect taxation taken out too. On the other hand, one would be even more grateful if I.C.I. and Unilever and so on were to give us more information about their different branches, as they tend increasingly to do.

1102. Do you think that *The Economist*, and the people who read *The Economist*, would be better able to judge the merits of the shares in a large company merely because the turnover was broken down into constituent elements?—In a very general way I would have thought so. If the turnover figures enabled shareholders to establish that the rate of return on one branch of the business had been in a serious decline for the past ten years, say, they would surely have an interest in asking why the directors continued operating it.

1103. Would you not expect that the directors would themselves be aware of those trends and would be taking what remedial action was necessary?—In I.C.I. most certainly!

1104. You see no objection to the one-man company. There are really two classes of one-man company. First there is the wholly owned subsidiary of a public

company and one group of companies has told us that it was a bit of a nuisance to them to have to get two shareholders, and to go through all the rignarole when everybody knew the wholly owned subsidiary was a branch protected by the parent. The other case is the one-man company where you have a wife or sister of the principal shareholder holding a qualification share so as to get the benefit of incorporation. I wondered how you visualised company law being carried out in the case of a one-man company of the private type where you have one director and one share. In that event I found some difficulty myself in seeing how you would have a director's meeting, how you would have an annual general meeting or how would you go through all the other procedures which are designed for some purpose and for which the Companies Act legislates? You would simply get limited liability without real compliance with any procedures required by the Companies Act?—I know no more law than is good for laymen but these forms and procedures are artificialities in many cases, are they not? The procedures by which I imagine the great bulk of private companies of this kind work are purely notional exercises. If the law insists on these procedures being carried through it is not because they have any real significance, I would take it.

1105. Would you like to go then to the question of partnerships exceeding 20 in number, and I think you were thinking generally of professional firms. The number of 20 might be too low today but I think Mr. Lee said he thought it was unlikely that you would find trading partnerships of over 20; if you had that number of people interested they would incorporate themselves. However, our attention has been drawn to the problem of the investment clubs which have been formed throughout the country today with the idea of forming a sort of pool to buy shares on the market. I do not know whether those might be partnerships of over 20 and if so whether you think some legislation might be set up to keep an eye on those activities if unincorporated.—When people band together to swap ideas about investment and make subscriptions towards holdings it seems to me that they are still acting as members of a group or a club just as they would if they were going

to play golf. I would see no reason why these activities should be brought under the purview of company law as such.

1106. In your written evidence you have referred to the German system set up since the war with its *Aufsichtsrat* or supervisory board and *Vorstand* or executive board, but I gather you do not seriously suggest that that would be desirable here. As I understand it, this was really a political move after the war. It was not that there was anything wrong with company law as such but it was designed really to make the workers sit on the supervisory board.—Yes, and also I think to impose a more general kind of public control over companies whose activities in the Hitler period had come to be regarded as thoroughly undesirable. I think this is political in origin but it may provide a formula for the general assertion of public interest in what companies do.

1107. But if you ignore the political element which is giving a compulsory seat on the supervisory board to some members who work in the company, the only effect, is it not, is to go back to the old system which used to be operated in this country where you had a board of names and below that the management who were not directors? In other words, it would be going back to the old railway system of this country and to what, to some extent, is the banking and the insurance system of today.—Yes. I would think that the combination we have in many large undertakings here of part-time and executive directors sitting together round one board table is probably the ideal; but there are many people outside board rooms who do not regard this as being ideal and if you can accommodate their criticisms by anything on the German pattern, assuming that the German pattern is a workable one, there might be in the long run some important public advantage.

1108. You consider that the modern board composed of outside directors and executive directors is generally accepted but that there are many people outside who do not accept it. Would you like to amplify that?—What I had in my mind was a common criticism of the company form in this country from people who say

that directors are irresponsible and shareholders are useless; that companies are increasing in size and power, and that there is nobody who is in control of them.

1109. Then you would have the question, if that was a valid argument, as to who appointed the supervisory board? —Oh, yes.

1110. I do not know under the German code who does appoint them?—I am not at all sure on that point.

1111. There is one question on shareholder/director relationships. I think you are not advocating that every time a company issues new shares it would have to get the shareholders' consent. I gather you say only in the case of a substantial issue would it be right to go to shareholders and get their consent, before issue on a *pro rata* basis to existing shareholders. But what sort of measuring stick would you use as to when the company must get the shareholders' consent and when it would be in the powers of the directors themselves to act?—It is a very difficult matter to define but in our evidence we have suggested that the dividing line might be one-eighth of the total issued capital of the company and that seemed to us probably as good a shot as any.

1112. Could I now turn to the question of nominee ownership. I think you said that directors ought to know whom they were representing, whose interests they were managing and also that the shareholders would like to know who their co-shareholders were. Ignore the fact that in the very large company that is very difficult to achieve in any event. We had the other day the chairman of quite a large public company and I put that sort of question to him and used your argument and he said he could not care less. He was managing the company and had no interest who his shareholders were, whether they were changing day to day or whether somebody was trying to acquire control through nominee holdings.—I think this is the perfect formula for the day-to-day responsibility of a director but from time to time I suspect that even this gentleman might be interested to know who his shareholders were. Moreover the law as it now stands enables a director, if he is apprehensive, to go to

the Board of Trade and to seek an inspection of the affairs of his company, including the composition of its shareholders.

1113. You did mention the powers of the Board of Trade. Do you think that really is very useful because you would probably only get an inspector appointed after the mischief, if it is mischief, has been done and it is rather late in the day? —It is late in the day, sometimes too late in the day.

1114. One further point. Would you think some intermediate solution of this problem of nominee ownership might be achieved if it were laid down by statute that no limited company should be allowed to hold shares in another company in a nominee name? The idea behind that is that most substantial acquisitions are on behalf of companies.—I would have thought this would be intolerably inconvenient for bank nominee companies and bodies of that kind who hold shares.

1115. Suppose company A was trying to acquire shares in company B. Company A could not acquire such shares except in the name of company A. The bank nominee companies would in that sort of contingency be much less used obviously. —They would indeed be much less used and one would think that could be objectionable.

1116. In other words, you do not think it is a good suggestion. I know the argument against it is that it would not control a foreign company trying to acquire shares here but you do not think it is a good suggestion at all?—The bugbear is that one does not know who is behind the scenes but I am not opposed *en principe* to nominee shares. They are of the utmost commercial convenience all the time.

1117. *Mr. Brown:* There has been some considerable discussion about the apathy of shareholders who, generally speaking, take no action unless things become desperate. Would you not nevertheless feel that there is a considerable sanction in the powers that those shareholders can use in emergency?—Certainly.

1118. I think you offer no criticism at all of non-voting shares in your evidence. Does that imply that you think they should be completely free, that it would be

desirable they should be increased *ad lib*?—I hate the things in principle. Many sensible investors refuse to buy them but if a man wants to buy a non-voting share in an open market, then it is up to him.

1119. What sort of criticism do you find of non-voting shares?—They grow into a monster, that is the difficulty about them. What starts off as a device justifiable in the case of the young developing company can be exploited to keep shareholders of a mature company at arm's length. Having started on the road of issuing non-voting shares it is often difficult to go into reverse.

1120. You do not think a widespread extension would be so harmful that it would be proper to take some steps towards going into reverse?—I would very much deprecate a widespread extension of non-voting shares.

1121. If this Committee were, in fact, to make no criticism of non-voting shares, would it not follow that the present pressure in the market against them would inevitably weaken and you would get your widespread expansion?—I suppose that might conceivably happen, but I have great respect for the pressures in the market at the moment!

1122. When we were dealing with exempt companies' accounts, on the whole you were for publication of their accounts, but you see some difficulties. Would it be a practical solution to require publication by companies above a certain size?—Defined by capital, I suppose. You would then have to meet the difficulty that capital could be arbitrarily arranged below the statutory level.

1123. But supposing it were practicable, do you think it would be a good compromise to put a limit?—Yes, that would be a good compromise. I would have difficulty in defining the yard-stick.

1124. No par preference shares have not been mentioned. You approve of the issue of no par preference shares?—No. No par preference shares with a fixed rate of return must have a nominal value attached to them.

1125. They exist in America. But I think your point is that the balance sheet must show a redemption or liquidation figure?—Quite.

1126. On the whole you approve the Board of Trade regulations about takeover bids but in your evidence you put in one point which I think does not come into those regulations; that is that when the offer is declared unconditional the bidder should reveal the number of shares which he then holds or for which acceptances have been received. Would you like to expand your reasons for asking for that?—*Mr. Lee*: I think this is linked with another point we made that, in the first public announcement, the name of the principal should be disclosed and the number of shares he has already acquired. Then there is a second stage where in fact he may be buying in the market, adding to his holding, and I think it is important for the shareholders to know when the offer is declared unconditional how much the offeror holds himself and how many acceptances have been received for the bid and these should be distinguished.

1127. Why do you think it is important?—I think it is important for the minority shareholders in this case to know. Sometimes bids have been declared unconditional before the 90 per cent. has been accepted and I think it is important for the minority shareholders then to know what degree of control the bidder then has.

1128. The point is why should the shareholders particularly want to know at the moment the bid is declared unconditional when it will very likely be open for acceptance for some time thereafter?—The offeror may declare the bid unconditional and then extend it for late acceptances. I would like to see this information disclosed, both at the time when the bid is declared unconditional and when it is finally closed.

1129. Why?—*Mr. Bird*: To give the shareholder a clear idea whether he should accept the bid or whether it would be better, which it might be, to stay as a minority shareholder.

1130. *Sir George Erskine*: Or whether in fact the bidder had acquired control? He might make the bid unconditional without having acquired control at all?—*Mr. Lee*: Certainly.

1131. *Mr. Brown*: On the whole you are in favour of some method, if it could

be achieved, of knowing who the shareholders are. Does that mean you would go to the logical extreme of forbidding bearer shares and deposit certificates?—*Mr. Bird*: That decision has been taken for us.

1132. That is not necessarily for ever. Anyway, deposit certificates?—If one were to have disclosure of nominee holdings on the general argument that one should know who the shareholders were, then presumably bearer shares would not be allowable.

1133. There are some in existence.—Yes. One would also have to make arrangements for any depository to reveal periodically who the holders of the shares were. But if they were passing round on blank transfers then no information would be possible.

1134. Is not that the essence of deposit receipts? In that respect nothing could be done?—Nothing could be done.

1135. In regard to company accounts—on the whole you are not in favour of legislation requiring further disclosure. Would you think your purpose would be achieved if attention really were directed to Section 157 (the matters to be dealt with in the directors' report)—to give clearer definition of what should be disclosed in the directors' report?—I am not absolutely certain about that. I think on balance I would prefer to make the directors' report, apart from the statutory information which is contained in it, an opportunity for the directors to address themselves to their shareholders.

1136. My point was would you require directors to disclose more in the directors' report, for example, turnover?—Whether the information, or the declaration, about turnover appeared in the directors' report or the accounts would be for decision in every case. If the turnover figures mesh in with the accounts themselves, then the accounts would be the best place for them. If, at the other extreme, the directors thought it right not to make any disclosure about turnover, the report would seem the best place to explain their reasons.

1137. In that respect it would involve some amplification of Section 157?—Yes, that is so.

1138. With that thought and the other comment you have made, would you wish that section to be altered by eliminating or in any way modifying "and will not in the directors' opinion be harmful to the business of the company"? Do you think that should remain?—I should have thought so, yes.

1139. You wish to leave it that on any matters the directors should be able to say disclosure would be harmful to the company?—On turnover, certainly. Otherwise, apart from what they have to put in, they need not now say a thing.

1140. Do you think companies should list all their subsidiary companies and should give more information about associated companies, details of holdings and profits?—I shrink a little from compelling them to list all subsidiary companies; many subsidiaries are, after all, devices for doing things in convenient ways, and not meaningful to the shareholder.

1141. All sizable trade investments and subsidiary companies?—Yes, I would support that, but whether to the point of requiring it to be done, I am not sure.

1142. The question of disclosure with regard to banks and insurance companies—would you require a bank to include in its profit any appreciation or depreciation of investments? I have read it that way: "The banks and discount houses should be forced to show their true current earnings; the one concession might be to allow them to modify this principle by valuing their investments in such a way as to avoid any artificial swelling of profits for a period of rising bond values and to avoid any extreme fall in profits when bond prices are falling."—*Mr. Hirsch*: I think that was just our point. We think true current earnings should always be shown, but we do not want to go as far as saying the banks should be forced to swell or artificially reduce those current earnings by the change in the market value of their investments in any one year.

1143. Then you ask whether anyone would be less confident in insurance companies if they disclosed their reserves in full. But surely that is not the point. The point is what happens in a year's accounts. Would you think there would

be any harm to an insurance company in a year in which investment values moved by, say, 10 per cent. and its effects were disclosed? What would the headlines be if one insurance company disclosed a gain or a loss in the year of £100 m.? Would that not produce criticism of the company and could it not be misleading?—*Mr. Bird*: I would not have thought so. I would not have imagined that the picking up of the apparent paper profit in one year in a popular newspaper headline would be damaging to the business. On the contrary, it might be helpful to it. At least one office does this and I am not sure it has suffered greatly from the disclosure in one direction or the other.

Mr. Hirsch: If I might just add, in 1952 the banks first started showing their investments sometimes above market value and disclosing in a marginal note the depreciation they had taken. There really was hardly a stir.

1144. Those were short, redeemable securities which, it was known, would recover in a short period of years?—*Mr. Bird*: Not all of them as short as they should have been.

1145. *Professor Gower*: Could I follow up the question of no par preference shares. There is a company at the moment which has shares on tap which it describes as 9 per cent. preference shares, 9 per cent. 5s. preference shares. These are issued at 6s. 3d. So that the 9 per cent. is not really 9 per cent. as a sophisticated investor will no doubt see. If he reads right through the prospectus he will see in the very small print that in the event of winding up or return of capital he will get the capital paid-up. If he is very experienced he knows that is 5s. and not 6s. 3d. If that company had to issue no par preference shares it would have to say that the preference shares carried a dividend of so many pence per annum and that in the event of winding up or return of capital the investor would get 5s. back. Would that not be much more helpful to the investor?—I suppose it would. More helpful to the investor would be avoidance of 9 per cent. preference shares such as you have described.

1146. Could I turn to another question, dealings by people in their own shares at a time when there is a take-over bid or

merger pending. Could I illustrate what I have in mind by referring to two extracts from *The Times* of last week. The first said this. Yesterday the chairman of such and such a company had merger discussions with another company. This explains the recent rise in the 5s. shares from 18s. 6d. only a week ago to 22s. 6d. yesterday before the announcement. And then two days later you have reference to another case where, it is said, there has been no announcement that merger talks were in progress during the time when the company's ordinary issues had risen from about 25s. on August 1st to 33s. on September 1st and 44s. on Thursday, the night before the news of such talks was officially made known. What *The Times* is saying here is that people who have inside information have been dealing in these shares in a sufficiently big way to have caused in one case a rise of 20 per cent. in a week and in another case a rise of 76 per cent. in two months. Do you think that this is an abuse which the law should try to do something about?—Yes, I am sure it is an abuse, if the innuendoes of *The Times* and the construction you put on them are justified.

1147. What other construction is there?—There is at least one alternative construction—that people outside the actual operations had come to regard them as possible. It does not necessarily follow that it was directors or officers of the companies involved who were dealing in the shares.

1148. I am not suggesting it was directors or officers but surely some people had inside information; it could not just be an intelligent guess to bring about a rise of 20 per cent. in one case and 76 per cent. in the other.—It sometimes can be partly, if not wholly, explained in that way; and particularly if the shares concerned are a very poor market you get a correspondingly pronounced rise in prices. I appreciate your point entirely. It seems to me that the only way of meeting this—and I have often thought this desirable—is the complete recording and publication and regular inspection of dealings by directors in the shares of their companies.

1149. Would you not have to go further than just directors? The American law

relates to directors, officers, and any shareholder holding 10 per cent. or more of the issued shares.—Yes, but you would also like to know something beyond even that—the activities of solicitors' clerks, people in printing shops and so on, who may get to know about this kind of transaction at a pretty early stage—even secretaries and typists, I suppose.

1150. Would you think it would be useful to this Committee if the Board of Trade could take one example of this—I am not suggesting this necessarily—and appoint an inspector to find out how this occurred in order that they could give us this information which we could then consider?—I think that would be perfectly reasonable. I would only make this suggestion, that you should also ask the Board of Trade to examine a case, of which there are many, where this has not occurred and discover just why it occurred in the one case and not in the other. I am very much impressed not only by cases of the kind which you have mentioned but also by the considerable number of cases where delicate and very large negotiations go on and of which not a whisper is heard. I think this is as commendable to the business community and significant of the integrity of directors as these other cases—if there is any malpractice there—are the opposite.

1151. One of the troubles surely is that with a straightforward merger I imagine that City opinion would say this sort of dealing is most improper. On the other hand, on a take-over, I doubt if City opinion would say that it would be wrong if the directors suddenly learned somebody was buying a lot of shares, presumably with a view to a take-over, and went out and increased their holdings. Take the case of the Savoy Hotel which you have quoted yourself. When the Savoy Hotel directors realised that Mr. Samuel and Mr. Clore were apparently about to make a take-over bid, their immediate reaction was to increase their own holdings in order to stave off the take-over bid. As I say, nobody thought this was improper. But since they knew of the take-over bid they ran precious little risk, the shares were almost certain to go up, even if they did not stave off the take-over bid, they were on to a good thing; and it would not be frowned upon?

—I think directors are entitled to compete against another buyer in the market.

1152. It is a little hard on the shareholder who has not got the information which the director has and presumably would not have sold his shares if he had realised that because of what was happening they were suddenly going up astronomically?—But at some fairly early stage the shareholder will know what is going on.

1153. Two months later.—It depends on what arrangements you make about take-over bids, at what stage you require directors to disclose to shareholders that something is in the wind.

1154. Yes. Coming back again, the City code on this more or less suggests that you should not make any announcement until the thing is pretty firm, would you agree with that? In the meantime the directors are in a position, if they are so minded, to have dealings themselves with information that the general body of shareholders lacks?—That is true, but the same applies to the position of directors at any stage through the year, even in the absence of any question of a bid.

1155. You do think there is a problem here?—There is a problem always about the integrity of directors and how they preserve the distinction in their own minds between the responsibilities which they have towards their shareholders and towards the company which they serve. This can on occasion be embarrassing for them, but, it is less than is commonly supposed an opportunity they seize for making money though these opportunities do occur and are sometimes taken.

1156. *Mr. Brown:* Would you not say it was the City code that directors and officers would be misbehaving if they bought shares, on the knowledge that a take-over bid was on, simply in order to make a profit?—Certainly.

Mrs. Naylor: But is it to make a profit or is it to stave off a bid?

1157. *Chairman:* There is one question I should have asked and that is your views about the United States Securities and Exchange Commission (S.E.C.) and I gather you do not view any such institution as

that as really called for in this country because enough protection is given by the Companies Act and the rules of the Stock Exchange?—Yes, Sir.

1158. Have you considered the case of the person who may buy an unquoted share which has never therefore received the blessing of the Stock Exchange? He loses that degree of protection?—That is so.

1159. Can you suggest anything to substitute for it?—No. I would think any person who buys an unquoted share is likely to be a sufficiently sophisticated investor to make all the appropriate enquiries—though some inexperienced investors may be taken in by offers of unquoted shares.

1160. But it is a point, is it not, that there must be transactions in unquoted shares where the person investing does not get the same degree of protection as he would when he buys a quoted share?—I suppose the biggest risk is where something which purports to be a share really amounts to little more than a deposit receipt for money.

1161. But surely you may have shares that are unquoted for perfectly good reasons, there may not be enough shares to make a market and the Stock Exchange would not grant a quotation in those circumstances, as I understand it?—Certainly. But I am not sufficiently conversant with the S.E.C. to be certain whether that would avail to cover the case of unquoted securities.

Chairman: Yes, I see. I do not know if Professor Gower could help us on that?

Professor Gower: S.E.C. regulations would come into operation only if the issue was made in more than one State. If it was limited to one State the S.E.C. would not come in.

Chairman: Where it did come in the S.E.C. would require full disclosure?

Professor Gower: Yes.

1162. *Chairman:* Finally, there is your three wise men suggestion which opens up most pleasing vistas. Do you have in mind a body constituted by the President of the Board of Trade to consider questions of company law arising?—Yes.

1163. A sort of company law reform committee which would either have matters referred to it by the Department or would itself report something that is developing in practice which seemed rather debatable and to get terms of reference to express a view about that?—Quite so.

1164. And so build up a body of authoritative opinion, so to speak?—Yes.

1165. Which later on perhaps, as education of the public in these matters is advanced, might be given effect by statute; that is your conception?—Yes; it has some analogy in my conception with the Committee on Law Reform.

1166. That Committee roves far and wide because problems of law of all kinds are submitted to it. This would be the same sort of thing, only directed to company law?—Yes, and not necessarily restricted to company law. Company practice and good manners could be a helpful part of its work too.

1167. *Professor Gower:* Surely the Board of Trade do have two standing committees at the moment? As I understand it they merely act when the Board of Trade refer particular problems to them. You would want this enlarged and given a right to start things itself?—I would not argue for a large committee. I would much prefer to have a small committee of a relatively informal but continuing kind.

1168. *Mr. Bingen:* Would you think there is something to be said for a code of practice as opposed to statutory obligations, so that recommendations could be made that this, that or the other course of action should be regarded as unethical. The sort of views that the Institute of Directors have in the past put forward but promulgated authoritatively. This might be a useful alternative where you cannot legislate easily?—That would be very helpful. This goes to the nature of the document which we have submitted to you, Sir. We have been anxious to get improvement but sceptical or nervous, in many cases, whether improvement could usefully be sought through the law. That is the continuing dilemma in all this. It is not solely a matter of law but also a matter of good business practice.

1169. *Mrs. Naylor:* Going back to the question of filing accounts by all private

companies, I was attracted by Sir George Erskine's proposition that balance sheets should be filed. For three reasons—that we have a precedent that when for the first time public companies had to file accounts in 1909 they did not have to file a profit and loss account. The other more important reasons, on which I would like your views, are that it does meet to quite a considerable extent the interests of creditors, and also to a certain extent the desires of the proprietors of private companies who object to disclosure because it would reveal to their competitors and to their relatives the magnitude of recent profits. —These are, I agree, relevant and acceptable points. Whether you should settle for a balance sheet only or whether you should go on and ask for the profit and loss account is a point of genuine argument. If you get a balance sheet you are doing all right. If you get to the point of including profit and loss account too you are doing splendidly.

1170. *Mr. Lawson*: The balance sheet does, of course, include the balance on the profit and loss account.—Yes.

1171. Comparing the balance sheet, one year with the previous year, you can, in fact, see the trend of profits?—You can get some notion of what has been going on.

1172. The auditor has to take responsibility for that.—Yes.

1173. *Mrs. Naylor*: I am getting the feeling that the evidence before this Committee—the proposals for changes—could be classified under three heads. One concerns changes in the enforcement of the law. The second concerns changes designed towards specific and practical ends, such as more disclosure to individual shareholders. The third concerns changes to get rather diffuse ends such as more effective control by shareholders, and this is difficult because it involves determining the philosophical basis of the privileges of incorporation. Your evidence was illuminating on that subject but I wonder whether you would elaborate on it a little because I am still left uncertain in my mind in whose interests the directors are supposed to act. Is it the staff, is it the shareholders, is it the community or is it, as I think you suggest, the undertaking;

and when you talk about the directors' responsibility to the undertaking I feel it is slightly playing with words, or at any rate that you can only determine the interests of the undertaking within the limits of a measured time: either short term, long term or indefinite term.—I think your time scale is important here. At the limit of that horizon there is the possibility of a check on arbitrary behaviour by directors who would otherwise be in the strict meaning of the word irresponsible. They are subject to the Companies Act but they are not responsible in detail for what they do within the law. In the end, the shareholders, with some help maybe from the Press, can make a great fuss and get things changed. The things that really keep directors working efficiently are firstly, their sense of obligation to an organisation, to a company, to a thing which combines the interests of staff, customers and shareholders, in a very mixed up way, but probably staff first, customers next and shareholders last. There is in most directors' minds some sense of social and personal obligation coupled with the urge for improvement and profit. If they do not fill these responsibilities satisfactorily a sufficient number of shareholders, a sufficient number of financial journalists, a sufficient number of competitors, will urge them or move in to do something different. How long this process takes no-one can tell but it does not stretch on indefinitely. Even for a bigish company in what appears to be an unassailable position things can go terribly wrong very quickly. This kind of criticism, this opposition, this moving in by other forces to take over from an unsatisfactory or incompetent board does work in a remarkable number of important cases. Boards are generally much more alive to their public responsibilities in the broadest sense than ever before in this country. This complex of law, practice and social pressures is tending to produce better behaviour and a higher standard of business practice than we have ever known.

1174. *Mr. Scott*: Just one small point on take-over bids. Your recommendation is that the bidder should give some broad outline of the policy he intends to pursue. Although that probably is an excellent idea to lay down as a principle,

do you think in fact a bidder might find considerable difficulty in framing, when he makes his offer, a policy statement depending as it must on so many things; the number of shares he gets for one thing, what he finds when he gets into the business in relation to its outside commitments, and things of that sort? Is it not, in fact, imposing rather a serious and difficult responsibility on a bidder and is it really justified as far as the shareholder is concerned? He is offered a price for his share. Is he entitled to say "If I do not accept this bid I shall be remaining in a company where the bidder has told me he proposes to follow such and such a policy"? I am not quite sure in whose interests the recommendation is made and would you like to comment on my view at any rate that that could impose a very difficult responsibility on a bidder?—I suppose it could, yes. But bidder A may seek to take over B in order to expand B, or at the other extreme just to close B down. Between those two extremes there is a pretty relevant field for any shareholder who has the option of selling out to the bidder or staying as a minority shareholder.

1175. Would you draw a distinction between the case where the bidder is offering cash and where he is offering shares in his company, which will give the offeree a continuing stake in the combined business?—I can see that kind of distinction could be drawn.

Mr. Lee: The thing that seems here to be of concern is that occasionally a bidder will take-over a company and then use its assets in order to provide the eventual finance for the bid he has to meet. I feel

that if it is the bidder's intention to take out this money and use it to finance the bid then that should be made clear to the shareholders.

1176. There again you get extreme cases. It is easy to cite that one. Would you not get a large number of indeterminate cases? He might decide to discontinue one branch of a company's activities because when he gets into the saddle he finds it is not lucrative, and he may sell the assets and may use the money to defray the cost of the acquisition; a fact he may have been unaware of when he made his bid and not his original intention. —I agree it would be very difficult to distinguish but I think it is still possible in broad outline for the directors to give some indication of what they are going to do.

1177. Is it really going to be helpful to the shareholders to give them broad general statements of intent such as "integrating the businesses for the benefit of the whole"?—*Mr. Bird:* I agree they do not mean a lot. But to go back to my earlier example, if it were clearly in his mind that he was going to liquidate the second company that would have been highly relevant for shareholders to know. He cannot do much more in the normal course when he is taking over a business in order to integrate than say "we hope to forge ahead as a combined show".

Chairman: Gentlemen, we are very much obliged to you for your memorandum and for the help you have given us this morning. I do not think anyone has any more questions to ask. Thank you very much indeed.—Thank you, Sir.

(The witnesses withdrew.)

(Adjourned until 2 p.m.)

PROFESSOR E. V. MORGAN called and examined

1178. *Chairman:* Professor Morgan, we are all most obliged to you for your memorandum and for coming to help us today. You are Professor of Economics in the University of Wales?—That is so—the University College of Swansea, which is a college of the University of Wales.

1179. Your interests mainly lie in the accountancy side of this discussion, I think.—In my memorandum I concentrated mostly on that side because, as you know, I am no lawyer and I felt that most of the headings in the annexes to the Secretary's letter were things of which I did not have enough legal knowledge to

be able to offer an opinion that would be useful to you.

1180. I have two questions to ask you and then I will ask Mr. Lawson to discuss the accountancy questions with you. My first question is this: you consider that share registers should be required to disclose the beneficial ownership of all shares?—Yes.

1181. Would you agree that would be a very formidable undertaking for one of those companies with thousands of members?—I had not really considered how much labour would be involved. I think other people are more expert than I am on that. I think it would probably involve some labour, but it would probably be worth a good deal if one could have the information.

1182. So your position really is that you are in favour of disclosure so far as it is reasonably practicable to disclose?—Yes.

1183. The second question is directed to methods of ascertaining beneficial ownership up to a point, without going to the length of having a complete register. One suggestion which has been made is that disclosure might be required of beneficial ownership of shareholdings above a certain size, say 10 per cent. of the total shares of the class. That would restrict the enquiry to some extent, would it not?—Yes, 10 per cent. of the total share capital of the company?

1184. Well it could be 10 per cent. of the share capital of a particular class or of the entire issued capital.—Yes.

1185. That is one suggestion. Would you consider that to be a good move towards the desired object?—I would have thought 10 per cent. might be rather high, because one of the things that seems to me undesirable—the most important thing—is that people shelter behind various devices to acquire a controlling interest—or at least somewhere near a controlling interest—in a firm without the possibility of this becoming general knowledge. I would have thought that 10 per cent. would still leave it open to, say, three or four people acting together to acquire a very formidable holding in a company. I do not know whether it would be possible to take a smaller figure, say

5 per cent., or even 3 per cent., without adding inordinately to the labour involved. I would like that percentage figure to be as small as is compatible with a reasonable amount of labour.

1186. Then there is this suggestion, that the Board of Trade might be required to investigate and publish details of the beneficial ownership of shares in a company, on the request of the directors: that would be an enlargement of the existing power of the Board of Trade to appoint an inspector to conduct that form of enquiry.—On request by the directors only?

1187. Yes, the directors would be able to put the Board of Trade's powers in motion, so to speak: but of course it might be said that it could be done really only after the mischief to be guarded against had been achieved.—Again, I would have preferred to have seen the power extended rather more widely than just to the directors—perhaps to a number of shareholders, or to shareholders holding a certain proportion of shares.

1188. There is a power already for the Board of Trade to make such an enquiry on the application of not less than 200 members or of members holding not less than 1/10th of the shares issued. So this suggestion would make the procedure probably quicker and less cumbersome, because it would only be necessary for the directors to ask.—The proposal is to give the directors this right, whilst retaining the existing rights of shareholders, I presume?

1189. Oh yes: if anything of the kind were adopted it would be an additional one.—I would have thought that would have been a useful thing to do.

1190. And what would you say if the directors themselves were given power to make this investigation on their own responsibility, so to speak?—The difficulty I see about that is, what would be the procedure? You would propose to give the directors the legal right to require the disclosure of the beneficial ownership by any registered holder, if that was not obvious from the register—is that it?

1191. If it was going to work at all the directors would have to have power to require disclosure.—It seems to me a

little unusual and possibly undesirable to give one private person that sort of power of enquiry into the affairs of another. Quite frankly, I had not considered this point before, and my first reaction to it is that if it was going to be done it would be better to have it done under some official sanction rather than by people who happen to be directors of a particular company.

1192. I quite see the force of that. Has it occurred to you how easily any requirement as to the disclosure of beneficial ownership can be avoided?—I can think of a number of ways in which it can be avoided although I am not sure I would regard that as necessarily a good argument against requiring it. One should not have laws which one does not enforce, but the law does set a standard of conduct, does it not? And I would have felt that even if one could evade it, it would have the merit that many people, who now regard this sort of concealment as permissible, would refrain from doing it if it were contrary to the law—or at least I would hope so.

1193. Yes, if you enact it as the law you hope for the best, and you hope that the majority will be amenable?—Yes. I imagine it is again a question of how far this goes, but any law can be evaded and is evaded to some extent. No law is 100 per cent. effective, unfortunately.

1194. The kind of thing that might happen would be a delay in the registration of transfers and then passing them over at the critical moment; this might defeat investigation.—Yes.

1195. And then the beneficiary might be a company and the beneficial interest in that company might be extended to one does not know how many people? And finally the question of bearer documents—share certificates to bearer, and that kind of thing. That would create a difficulty, would it not?—Yes, I cannot see how one could get over that. Am I not right in thinking that at present at any rate, the number of companies which issue bearer shares is small?

1196. I believe they are on the decline with companies: they are expensive in stamp duty too. But anyhow I do not think I need trouble you further on this aspect of the matter. It is your view that

disclosure is eminently desirable, so far as it is reasonably practicable—would that really represent your view about it?—That is my feeling. I feel strongly it is desirable. I know there are a great many difficulties, and many of your witnesses will have far more knowledge of this than I have; but so far as it is practicable I would certainly regard it as desirable.

1197. Can I formally summarise your view about charitable and political donations in this way—that you take a liberal view of both these kinds of payments but consider they should be disclosed to the shareholders in the accounts?—Yes, that would be my view. Again, if one was thinking of the amount of labour involved, if the company gave a donation to the local cricket club I do not know that I would necessarily want to put that in: but possibly above a certain limit I would be in favour of putting it in.

1198. One would not need to put in the trifling things, but any payments of consequence would go in?—One might have a financial limit, possibly a figure of more than £1,000, or whatever the figure was which was thought reasonable.

Chairman: Thank you. Then I ask Mr. Lawson to take up the questioning on the accountancy side.

1199. *Mr. Lawson:* Professor Morgan, you have made quite a number of comments about the valuation of fixed assets?—Yes.

1200. And you say the main object of attaching a value to fixed assets in a balance sheet is to enable those who are directing or investing in a firm to compare the return on their capital with what is obtainable elsewhere: that is one of your reasons, is it not, for attaching a value to fixed assets?—Yes.

1201. As you know, normally stock-brokers and other financial advisers calculate the ratio of earnings to the market price of the shares?—Yes.

1202. So that the point of view is held that that is a figure which is of more value to the shareholders than a ratio of earnings to the assets employed in the business. Would you care to comment on that?—I would agree that it is a very valuable indication. I do not think I

would be prepared to say that any one indicator is necessarily of more or less value than another, but I think the point is that if one is to make an assessment, which is as accurate as possible, of the potential value of an investment, one requires a number of indicators. The difficulty I see about the conventional earnings yield, or dividend yield, apart from the fact that it is well out of date for a large part of the year, is the fact that market valuations can be influenced by a number of other factors. For example, if a company has the reputation for pursuing a conservative dividend policy its shares tend to stand lower than the shares of a company with apparently equal earnings and earnings prospects, but whose directors are rather more lavish in their distribution. There are sometimes other factors which affect the market price such as the view taken of the management so that I would have said the earnings yield given by the market is an indicator and a valuable one, but if one had more accurate valuations of capital employed I would have thought that, too, would have been an indicator which would have been very valuable to compare with the traditional earnings or dividend yield.

1203. I am wondering whether that indicator is really required for the same purpose. I can see it might be useful to try and form an opinion as to the efficiency of the management by comparing the earnings to the capital which they are using in the business; and that, of course, is for a very different purpose than that of the shareholder, who is trying to assess whether he is paying a fair price for the shares. Do you think it is useful for that second purpose as well?—I would have thought the two were closely related, are they not? I would agree with you on your first point, but I would have thought that if one had two companies with comparable capital assets—assuming that one can get a true valuation of them—and you then find that these companies are earning very different rates on the capital employed in the business, this is surely a comment either on the quality of the management or on the fortunes of the industry in which they are engaged which, I would have thought, would have been reflected in the market valuation of the shares. If it is so reflected, well and good;

if it is not, I should have thought it would be an indication that something was wrong with the market valuation; and it is a point that, as an additional check, it is an additional way of making sure your market valuation is as objective as can be.

1204. Of course, it is very much used by management itself in estimating the desirability of embarking on a new project or laying down a new factory, but there are no figures published of this type so far as I know. Do the financial journalists and others make comparisons of this kind between different companies?—Comparisons of earnings based on the balance sheet value of assets? I know of no published ones here; I do know of investment managers of financial institutions that do a certain number of calculations of this kind for their own purposes, though I think they place very limited reliance on them because of the difficulty of valuing assets.

1205. You refer in your paper to the difficulties of trying to arrive at a true comparison of capital employed. Have you any view about this problem—where assets are very old you tend to get a very large return of profit in relation to capital employed, merely because the assets are old and have therefore been written down to a very low figure. Even if one were to take quite a different basis of calculation or valuation, you would still arrive at a very low figure as a value for an asset which had only another few years' life in it. The earnings might still be very substantial, and therefore you might get a very high ratio of earnings to capital. Do you see what I mean?—Yes, I think I see the point. The implication behind it, I take it, is that depreciation allowances have been on a generous basis, that the asset has been written off more quickly than it has in fact worn out or become obsolete?

1206. Not necessarily; there are some assets which really retain their earning capacity almost to the end and then overnight they are replaced by some completely new asset, which takes their place because of the new techniques which have been developed. In the last few years of the life of that old asset the earnings revenue will be very high, and I am putting the point really that there is great difficulty in interpreting these figures of earnings in

relation to capital employed. It has to be done with a certain amount of care.—Oh yes, with a great deal of care. If one is thinking of a company which had a large part of its capital in this position, it would presumably have accumulated funds to cover its eventual replacement, which would presumably be held in some form of fairly liquid assets and which would show up in the balance sheet. Clearly one could not simply take the return on the value of the fixed assets which are employed in the business—I do not think anyone normally does this—but if the asset was being written off in this way and was on the point of replacement, would not the funds which had been accumulated against this appear in the balance sheet? And would not the careful and serious analyst of these things be able, from this and from the explanatory notes which would presumably appear, to make some allowance for it? I agree it would require a great deal of careful study.

1207. I think the experienced analyst would be able to do it, but the only point I am making is that these figures, as a comparison of earnings to capital employed, have to be taken with a great deal of reserve and are not figures which can be presented by all companies in a form which would necessarily be helpful to their own shareholders. That is really the point. They have a limited value.—I agree they would not be helpful to the ordinary small and uninformed shareholder. On the other hand my feeling is that you have institutional shareholders who, by the scale of their operations, can afford to take expert advice. You have a sufficient body of serious financial journalists who are making it their business to offer comment and advice to small investors, who would probably have neither the time nor skill to go into these things for themselves. If you make the information available in a form which the reasonably expert or skilful investment manager can make sense of, you are going quite a long way to help shareholders.

1208. I see. Thank you. Do you think the under-valuation of assets in balance sheets—particularly land and buildings—is due to the exceptional amount of inflation we have had over the last ten or twenty years?—That is a

large part of the cause. I would have thought that in a developing community there is a general tendency for property values to rise over a fairly long historical period, even in the absence of inflation. I believe that inflation has been a major factor for the last twenty years.

1209. And you limit your remarks largely to this question of land and buildings—you would say that rather different considerations apply to plant and machinery?—Yes, I felt that probably so far as plant and machinery were concerned the difficulty was in giving a valuation better than historical cost less depreciation—the difficulty was probably insuperable; whereas with land and buildings I thought it was probably not.

1210. You set out various alternative methods of valuation, but you do not seem to refer to one of the most common methods, namely the market value as between a willing buyer and a willing seller.—I think I refer to that with regard to land and buildings. I do not think I did specifically with regard to plant and machinery. The reason for that was that I did discuss at some length prospective earnings, and I assumed—rightly or wrongly—that if one had a transaction in plant and machinery as between a willing buyer and a willing seller it would be an estimate of prospective earnings, and some more or less conventional capitalisation of that figure appropriate to the trade concerned. I think I mentioned, for example, the valuation of certain professional practices where one does have so many years' purchase applied to the earnings of past periods.

1211. Yes. I think some people have drawn a distinction between assets which are specific to the business, and assets which are in a sense non-specific—in the sense that they have a general value—is that not so?—Yes, I think so; and with reference to the willing buyer and willing seller I think I considered that point as arising simply because if you have a very specific asset, transactions in which are very rare, its value is often, to some extent, associated with the personal qualities and know-how of the people running it; and it becomes very difficult to decide quite what is the willing buyer and willing seller basis.

1212. But is it your view, as regards non-specific assets—or at least non-specific land and buildings—that the balance sheet should disclose the approximate value of those assets as between a willing buyer and a willing seller?—I would regard it as desirable that you should have a periodic valuation on that basis and that this should be disclosed.

1213. Even though the company has no intention of selling those assets, and indeed could not sell them without dislocating the entire business—would you still think it would be desirable to tell shareholders of the figure?—I would still think that it would. I would suggest that the desirability of trying to put as objective a value as one can on something for balance sheet purposes is not really closely related to the prospect of your in fact selling. I do not suppose a company has any intention of selling plant or machinery or any of its other assets, unless they are liquid ones. But I would have thought that, if one was trying to put a value on them and if one was trying to make the balance sheet mean something, and if one's values are to be something more than merely historical or conventional ones, then the value one puts upon assets ought to be as objective as possible. One practical reason for this is the stock market one. I am thinking of companies in retail trade, for example, which may own a number of freehold properties. If they suddenly decide to revalue their assets and show a substantial increase in balance sheet values, obviously it has nothing to do with their earning capacity and so on, but nevertheless there is frequently a sharp jump in their shares. This seems to me to be undesirable, and I would like to see the practice of revaluation generally taken up, so that if it is going to be done everybody should do it at intervals.

1214. Yes, I see; and that point is likely to apply more to retail establishments than to large industrial undertakings?—Yes, because generally speaking the latter's holdings of property are comparatively small in relation to their holdings of plant and machinery, stocks and so on, are they not?

1215. If, for example, a business had a factory in the centre of London it might be that the site value was considerable;

but if the business wanted to sell that site for a purpose which would justify that high value, then it would have to remove itself to some other part of the country and there would be the trouble of moving skilled men and training new labour, and that kind of thing; which would all have to be taken into account. So it might be misleading just to say to the shareholders, "This bit of land has this value", knowing full well you could not encash the value without incurring all the other problems?—Yes, but I am not sure I would agree it would be misleading if correctly interpreted, because this is related, I think, to the previous point about return on balance sheet value of assets. If this company is going to occupy this valuable site, whereas some other company is occupying a much less valuable site somewhere out in the suburbs, surely it is up to the management of this company to satisfy itself, and the shareholders, that the economies you mention justify this? One way in which this could come out would be a return on the value of the assets.

1216. I think I understand your view there. About specific assets—where the asset has a specific value only—there I think you say the value of the asset is dependent upon the earnings of the business. I think most people would agree about that.—Yes.

1217. But in that case, if the accounts show a fair picture of the earnings, is there any merit in multiplying those earnings by a certain figure and so arriving at a value of the assets—does it in fact serve any purpose?—If one is relating it to a particular company, no: if one is comparing one with another, I would have thought there would be some way in which this was sensible. If one was doing that, of course, one's valuation would have to be over an appropriate period of years. Mr. Chairman, I find some difficulty in putting this point clearly, and I apologise—but if one has an average rate of return on a particular type of assets of a particular value, I think it should be possible to compare the return which one firm is getting with the return which another firm is getting. I can see the complexities about this, but if it were possible to value assets not on the basis of what they are in fact earning, but of what they would earn

under average management, one would have a valuable criterion. I think we are probably going back to the willing buyer and willing seller basis here; and I think it is possible, if one has enough firms engaged in roughly similar activities, to have an idea of what the "willing buyer and willing seller" valuation of a particular set of assets would be.

1218. And you would have another difficulty, would you not? In that type of valuation you could not distinguish between land and buildings—which are the assets you feel should be revalued—and the plant and machinery. You could not say that some part of the earnings is attributable to the buildings and another part to the plant. Of course, with specific assets you would really have to value the whole of the assets, would you not, and not only land and buildings?—It is a question here of where one draws the distinction. I think in my original note I suggested I would not quarrel with the historic cost less depreciation value of machinery and plant; and while it does not give you the ideal, I cannot see how anything else can give you anything better. But with land and buildings I did think it was possible to get a better valuation. Of course, with specific land and buildings the valuation would be less accurate than with non-specific ones, but the point which I had in mind was that if one is going to try to draw a distinction between them here at all, it has to be on some readily-defined category. I thought perhaps it might be possible to draw a distinction between land and buildings and other assets. I do not think it would be possible to draw a distinction between specific assets and other assets. What I was trying to get at was a distinction which would be reasonably practicable and, at the same time, one which would bring your actual balance sheet at any rate nearer to the ideal.

1219. Some witnesses have suggested to us that companies should disclose in their accounts the amounts for which their assets are insured. Have you any views on that?—I have not, really. I suppose it could be a useful indicator, but I am afraid I just do not know what commercial practice is about the insurance of business assets. Its usefulness would depend, I take it, upon businesses

adopting a fairly uniform practice in respect of the value for which they insured their assets in relation to, I presume, their replacement cost. If that practice is uniform, then I would think it would be useful information; but whether practice is sufficiently uniform for it to be useful I am afraid I simply do not know.

1220. The point that is taken against that method is that it could so easily be abused, because a company could over-insure its assets and so present too rosy a picture of them to its shareholders. That is the other side of the suggestion.—Yes.

1221. If you were to take the case of a company which has revalued its assets and has incorporated that revaluation in its balance sheet, thereby creating a surplus, have you any views as to what a company should be allowed to do with that surplus? Should it, for example, be allowed to distribute it to its shareholders as a dividend?—I do not see any reason why it should not. In one sense I can see it would be using up a capital asset: on the other hand, if a company—with the agreement of its shareholders—prefers to run down the resources that it has in the business rather than accumulate them, I do not see any harm in that. Perhaps I might put it this way: if we are assuming it is not going to sell the assets concerned in order to pay dividends, but will do so by reducing its holding of some liquid asset or other, it seems to me at least arguable that liquid assets can be better used if they are distributed to shareholders and the shareholders are allowed to re-invest them in any way they wish, than if they are kept in the hands of companies whose main business is to do other things. So that in general I would not have thought it was the sort of thing a progressive company would wish to do, but if a company has certain liquid assets on its hands which it wants to use in that way, I would not think it ought to be prevented by law from doing so.

1222. I think the accountancy argument against distributing such a surplus would be that the surplus is not realised until the asset is sold, and that valuations vary from time to time, so that, having distributed the surplus you might find, on another valuation, the asset was not worth as much as it appeared to have been in the earlier valuation. Then you would

have in effect distributed part of your capital in dividend. That would be the accountancy objection, I think.—Yes, I am not sure that this distinction between capital and dividend in that way is something that ought to be legally forced upon shareholders. After all, if a company distributes part of its capital in this way, its shareholders presumably pay tax on the distribution, and I should have thought this, in itself, would ordinarily have been a fairly good reason for not doing it. If a company still prefers to distribute some of its assets in the face of that, I would suggest that it is probably better without them anyway.

1223. The problem really is that of the creditors, is it not? If it amounts to a reduction of capital then there may be debenture holders or other creditors who would claim they had been harmed. Normally a capital reduction requires the sanction of the Court, but this kind of capital reduction could take place without it. That is the argument against it.—Yes, I must confess I had not thought of that.

1224. Are you familiar with the definition of a balance sheet which appears in the Cohen Committee's Report?—No.

1225. Perhaps I might read it to you. It is:—

"the function of a balance sheet may be stated briefly to be an endeavour to show the share capital, reserves (distinguishing those which are available for distribution as dividends from those not regarded as so available) and liabilities of a company at the date as at which it is prepared, and the manner in which the total moneys representing them are distributed over the several types of assets."

—This is the important point—

"A balance sheet is thus an historical document and does not as a general rule purport to show the net worth of an undertaking at any particular date or the present realisable value of such items as goodwill, land, buildings, plant and machinery, nor, except in cases where the realisable value is less than cost, does it normally show the realisable value of stock in trade."

I wonder whether you agree with this definition, or whether you feel that changes are needed in this definition of the function of a balance sheet—particularly that

it is "an historical document" and does not purport to show present values?—I think it is a difficult one to comment on without notice. I would have thought it was an accurate description of current practice. I would have thought that there is certainly a relationship between past history and current values: it is one that may be very complicated, of course, when some investment decisions turn out well and others badly—and particularly so when you have inflation distorting the picture as well—but I would still have hoped that one could derive indications of current values from history; and at least if it is possible to put the history in a form which enables one to get as much information of current values as possible, I would be in favour of doing that.

1226. Of course, there are quite a number of companies which have revalued their assets on one basis or another in order to get to something approaching current value instead of historical cost. Both methods are today in use, and that is really why I asked you the question: but I think it is perhaps not a fair question to ask without notice.—I do think it is undesirable that you should have both being done together, with people apparently taking the choice according to which happens to suit them best. It is best to have generally accepted conventions that have the support of law: it is a good thing to have everybody doing the same thing, so that items are at least comparable one with another.

1227. Of course, it would be practicable, I suppose, to say that everybody should show the historical cost, even though in addition they showed the current value. I suppose that might be a practical proposition. It might be troublesome, because it would mean a duplicate set of records. Do you think something like that would be desirable, so that if somebody wanted to have all the figures on one basis he could have them?—I would think so, provided that revaluations were done at not too frequent intervals, so that an intolerable strain was not thrown on the people concerned.

1228. A question on quite a different subject now—you advocate that earnings figures should be given more frequently than once a year?—Yes.

1229. Would you limit that to companies which are quoted on the Stock Exchange, or public companies? You would not want to apply that to private companies, would you?—No, I do not think that any of the reasons which led me to advocate this would really apply to private companies. My reasons were connected with getting a good market assessment of the value of shares, and avoiding undue market fluctuations. I think that, in general, in private companies with a limited shareholding, their shareholders are in a position to ascertain these things for themselves if they want to—at least I hope so. I would be quite happy to see this restricted to public companies, or even to quoted companies.

1230. I see, thank you. You do not refer to exempt private companies. Have you any views as to whether they should continue to be allowed to have exemption, or whether they should all be made to file accounts?—No, I do not refer to them, and frankly I do not think I am competent to have any views on that question.

1231. One more thing: you suggest it is desirable that companies should give details of their cash and investments, Treasury bills, tax reserve certificates, and so on—you give quite a list. I am wondering what particular purpose you have in mind there. They are all very liquid current assets: is there any great advantage in showing them separately in the balance sheet?—I have said there is an advantage, mainly I think, on a broader front now than just the interests of the shareholders in a particular company: I am thinking now of the sort of view which the Radcliffe Committee was taking of the liquidity of the economy and of the importance of knowing more about the distribution of holdings of various types of assets, from the point of view of monetary policy; and I think, from that point of view, there would be a very considerable advantage.

1232. Yes, I see: you had in mind that economic point of view rather than the need for the figures by the shareholders themselves?—I think there is some need for some information from the point of view of the shareholders, though more about trade investments than liquid assets; and I am not sure, on reflection, that the

protection I suggested goes quite far enough there. But one does find cases of a trade investment being shown at a very nominal figure, then some circumstance leads to the facts coming out, and it turns out that this small nominal holding is, in fact, in a company with assets considerably more substantial. It might turn out the other way on occasions. The investment analysts with whom I have had personal contact feel they would like to know more about that, from the point of view of the shareholder.

1233. *Mr. Bingen*: I have listened with great interest to your answers to Mr. Lawson's questions. I would personally approach the matter a little differently myself and say you have Section 147 of the Companies Act and the 8th schedule, which lay down the contents of a balance sheet. Take, for example, the way in which fixed assets are supposed to be shown in the balance sheet. I would start off with the assumption that, by and large, it has worked pretty well and therefore if one wants to change the law—and it is true that this Committee is considering changing the law—one must produce something which is demonstrably better; better from the point of view of the stockholders, in showing how their investment is being managed, and only secondarily from the point of view of statisticians and economists as a whole. In your discussion with Mr. Lawson you have agreed, I think, that you get into all sorts of difficulties and problems in attempting to revalue assets—particularly industrial plant and machinery. I did not see where we were getting at the end of this interesting debate. Some companies have revalued, and some have not. The market and the investment analysts know which have and which have not, and if you make it compulsory for everybody to adopt the same procedure, I am just wondering whether the public at large would put up the shares in the first instance and if those who buy them would necessarily be any better off.—I was only suggesting revaluation at regular intervals so far as land and buildings were concerned, because I confessed to Mr. Lawson just now that I could not see any prospects of getting a realistic valuation in general of industrial plant and machinery. The thing on this that does seem to me

undesirable in the interests of the shareholding community at large is that companies should be able to revalue at irregular intervals or at times of their own choice. This does seem to me something which is undesirable, and which I should have thought could be avoided if one had uniform criteria for everybody.

1234. Why do we want revaluation? You have your current assets at present-day values; you have your fixed assets at historic values. You then try to revalue the items on the right-hand side of your balance sheet at present-day values. But it is a difficult operation and it may create a reserve on the balance sheet, with the final query, from the point of view of the shareholder, "Is this a profitable company?"—not "Are you making a lower return on a higher value?" nor "Are you making a higher return on a lower value?" That is neither here nor there, is it, to the shareholder?—As I tried to say earlier, I think it may be here or there. I think there may be circumstances in which balance sheet values may be an additional standard of comparison between companies. Mr. Lawson raised this in one of his first questions—distinguishing between the merits of this and the merits of the traditional dividend yield, calculated at current market prices. I would not contend that the return on the balance sheet value of the assets should be more than one of a number of factors in formulating the value of the shares. I would have thought it could be one. But I would still come back to the point—with which I think you would agree—that when companies have revalued, generally as a result of inflation, it may be quite irrational but it has an effect on the market value of its shares. It seems to me undesirable that this should be done occasionally and in an arbitrary manner.

1235. Normally I would have thought that a company, if it did revalue, did so because it felt that its fixed assets in its balance sheet were too low, and depreciation at historic cost would not enable it to replace the assets by comparable assets or new assets to produce the same amount of output, as they became worn out. As I understand it, the objective of revaluation is not to record the increase in the market value of the shares but to enable those who are directing the industry

to see that they set aside a sufficient amount of depreciation so that they would be able to maintain the value of their shares throughout—in other words, to preserve their capital intact. Would you accept that as the primary objective?—I would not suggest that the objective of managements in revaluing was to create an addition to the market value of their shares. I certainly would not suggest that management in general was as cynical as that, though it would not surprise me if it were so occasionally. But I was trying to say that this does seem to be a result of valuations at infrequent intervals, which I would regard as undesirable. So far as revaluation of replacement cost and depreciation goes, I would of course agree with you: it is most important that management should have an indication of what is a proper depreciation allowance, in order to maintain the value of assets. I am not sure they necessarily need to revalue for balance sheet purposes in order to do that, but to have in their minds an idea of what they need to replace.

1236. I do not think we are in disagreement, between the two of us, that there might be cases where revaluation is desirable. I would suggest it as a guide to management in conceiving its depreciation policy and its price policy. But I am querying your suggestion that all companies should be compulsorily made to revalue their assets and whether it might not really create problems for management with no compensating benefits. I think it is a question of the compulsory nature of the proposal on which I am trying to focus attention. I think you are suggesting this should be done periodically, particularly for land and buildings?—Yes, my answer to this one is that I would not wish to defend my suggestion as being the only right one—far from it: but the point I would regard as important is that from the point of view, in part, of the individual shareholder—and still more from the point of view of the investing public in general and from the point of view of enabling the capital market to perform what is always supposed to be its economic function of guiding the capital of the company into the most profitable channels—one does need one standard in these things, so far as it is at all practicable.

1237. Do you think the investing public really looks at the return on revalued assets rather than the earnings-price ratio, or if you like, the dividend-price ratio, as an indication of where they should put their money?—I think this is a question of who are the investing public? I have no doubt that a large number of small investors use very few rational criteria. I know that the financial journalists, investment managers, and so on, use these ratios. As I told Mr. Lawson, I do know some, at any rate, who are concerned in investment policy in quite large institutions, who like to do their own calculations of return on assets and who wish they had more consistent sets of balance sheet calculations. They feel these things would be more useful and they would be a useful indicator. I have little experience of the way these people work, but such as I have indicates that they have a desire for uniformity here, so far as it is practicable.

1238. *Sir George Erskine*: I would like to ask you one question on the same subject of revaluation. I think you have agreed about the difficulties in requiring every company by legislation to reflect current values in its balance sheet. I think these difficulties are there, even in what you might regard as the simplest cases. For example, if you take one of our big banks with, say, a thousand branches. The value of all these properties on sites in all our cities, may be much in excess of the value which appears in the balance sheet. But is it going to be any help for the bank to reflect in its balance sheet these new figures? They would not be realised, because the banks have to carry on their business in these properties. However, would it meet your views if, although there was some obligation to show up-to-date values, the Statute did not go to the length of requiring the balance sheet to be adjusted, but only required that there should be some note with the balance sheet, saying what the adjusted value was, and how it had been arrived at?—Yes, that would meet my requirement perfectly well, I think. I am not concerned really with how or where this information is presented, so long as it is presented by all the companies, or at least by all the quoted companies; and presented in as nearly as possible a com-

parable form, and in a form where any reasonably well-informed investor, at any rate, has access to it.

1239. *Professor Gower*: Linking up with Mr. Bingen's question, as I understood it he was suggesting to you that at present one can tell from the Companies Act exactly what the balance sheet will show you and, unless very potent reasons are given why one should be shown different things, there is no object in altering this; that an unsophisticated investor can look at the Companies Act and will from this realise what he will get from the company's accounts. What always worries me is this, that I as an unsophisticated investor look at section 149 and it says that every balance sheet of the company shall give a true and fair view of the present state of the company as at the end of its financial year. On the other hand, I look at the balance sheet and I see it says fixed assets £100,000. I confess that to me this would suggest that as at the end of its financial year its fixed assets are worth £100,000. Do you feel there is anything in this?—I would have a great deal of sympathy with your point of view.

1240. If it be a fact that there is no harm in keeping the balance sheet as a purely historical document, then is not section 149 misleading in that it includes the words "as at the end of the financial year" which suggests that it is not an historical document?—Yes.

1241. And if we are going to keep it as an historical document ought we not to recommend that section 149 at least should be amended to make it perfectly clear that it does not give the position as at the end of the financial year but is merely an historical document?—That would seem to be logical, but it is a point I must confess that had not occurred to me before.

1242. In answering Mr. Lawson about the distribution of a capital surplus on revaluation, I understood you to say that as an economist you saw no objection to the company declaring a dividend out of an unrealised profit of this nature. Very recently a Scottish court has held that this sort of profit is not distributable by way of dividend, and unless that decision is reversed on appeal that would presumably be the law, certainly as far as

Scotland is concerned and probably as regards England. Are you as an economist recommending us to recommend that that rule should be altered?—On that I had not taken I am afraid the point which was put to me subsequently about the protection of debenture holders and others who might suffer from this, and I can see that if this were allowed to go on unrestricted there could be cases in which it might be abused and do grave injury to debenture holders and others. I would think some safeguard against that is necessary. As an economist I was trying to think where the actual money for this payment would come from, and I assumed that it could only come from liquid assets which the company had accumulated and which it regarded as better to distribute to its shareholders than to keep in the business. Now it does seem to me that there are occasions when this is economically true. One sees companies with very large amounts in cash and various types of securities which it is not really their business to hold, and if a company of that kind wishes to distribute some of those assets to shareholders it would seem to me economically desirable that it should be allowed to, provided of course that the interests of debenture holders and other creditors were safeguarded. It does not seem to me desirable, merely because of the distinction between capital and income, to encourage a business to retain under its own control funds which it does not need for the purpose in which it is primarily engaged.

1243. Of course as the law stands at the moment you can always go to the Court and ask the Court to sanction a reduction scheme and thus to distribute any surplus capital you have got which is surplus to requirements. But, as the law stands at the moment—assuming the Scottish decision is right—this would involve a special resolution plus an application to the Court which is a somewhat cumbersome procedure.—It would be cumbersome and I presume a fairly expensive business. I am afraid I would not be competent to advise you whether there was any simpler and less expensive legal means of enabling that to come about with adequate protection of those entitled to it. All I would say is that if any procedure that would safeguard legitimate interests and which

was less cumbersome could be devised I would think that it would be economically desirable.

1244. Could I just ask one other question of you, as an economist. We have evidence from other economists to the effect that it is desirable economically that foreign investors, and in particular American investors, should be encouraged to invest in English companies, and that the fact that English companies at the moment are not required to give turnover figures—whereas American companies do, and German and French companies are about to—is a discouragement to the American investor. Is it accepted economic doctrine that it is a good thing to encourage foreign investors, and particularly American ones, to invest in English companies?—I would have thought that this was generally accepted economic doctrine. One knows that there are other objections to it of course; the sort of objection that it may be a bad thing for foreign interests to control large sections of the country's industry—but I think that is a political rather than an economic objection. I would have felt that there were at least two reasons why it is desirable to encourage foreign investment here at present. One is primarily a balance of payments reason since we are under strong pressure, both economic and political, to invest abroad rather more than the current surplus that we seem likely to earn. It would seem to me desirable on that ground to offset some of the investments that we are making abroad by a reverse flow of investments here. I would also think that there is a pretty close relationship between this sort of investment and technological advance, and from that point of view that there is a lot to be said for encouraging free interchange of capital in this way between countries. Of course it is not only one way; as you know, we have a number of British companies investing substantially in America, and I would have felt this sort of interchange would have been generally recognised by economists as a good thing.

1245. *Mrs. Naylor*: Would not one argument against cash distribution of capital surpluses be that the next revaluation might be downward, because even in periods of inflation property values do not go up all over the country?

One can think, for example, of seaside hotels when more and more people go abroad. If the revaluation surplus had been distributed it would look rather discouraging in the balance sheet later on, would it not?—I do not find that worrying me really. If this happens of course it simply means that the shareholders will find themselves with less valuable assets than they otherwise would have done.

1246. Possibly the creditors too, though?—Yes, I think I did admit the point that Mr. Lawson put to me that I did not take originally, that rights of creditors need to be safeguarded here. This I think is one which I am perhaps not very competent to discuss with the Committee, but there is a distinction, is there not, between the rights of debenture holders, who normally have a long-standing interest in the company, and the rights of people like trade creditors who have lent only for a very short time and they will presumably be repaid within a very short time anyway; and if they give the company fresh credit they know it has distributed some of its capital and they can presumably reassess its credit rating accordingly. But I quite agree that so far as debenture holders in particular and other long-term creditors might be concerned one would have to safeguard their interests.

1247. Coming back to the question of relating earnings to the true value of assets, would it be reflecting your views to say that you think it is important from the point of view of shareholders and financial analysts to have this figure as a measure of managerial competence?—Yes, I think so; it could be a measure of other things as well. I would stress that it is only of limited usefulness and would need to be used very carefully and along with a number of other indicators. But with that qualification I would suggest that there are cases in which it could give a useful clue to managerial competence and, rather more widely than that, it is true that it could give a useful clue to the relative profitability of investment in operations which were so different that you could not really say that different performance was a matter of different managerial competence, but just that one line was more profitable than another.

1248. And therefore it would be more in the national interest to pursue a certain line?—Yes.

1249. Finally, some people object to the fact that the amounts that the directors have set aside for depreciation are partly out of taxed profits and partly out of untaxed profits and that this is not revealed. Do you see any advantage in the breakdown between the two classes of depreciation being revealed? It could presumably be done quite easily by the Inland Revenue figures for wear and tear and other depreciation allowances being given as a note.—I do not see any great advantage in it immediately from the point of view of the shareholder. I can see that it could be an interesting bit of information economically, and I suppose it could be interesting if one aggregated figures for a number of companies, as the Board of Trade does in its balance sheet summaries, and this were one of the items which came in. I suppose it could give one a guide as to the overall relationship between Inland Revenue provision for depreciation and what businessmen themselves felt it was in the interests of their shareholders to provide.

1250. Would it not also give you a clue towards the difference between historical cost and the replacement value of the assets?—I wonder if it would give you very much of a clue there, because of timing—with different assets wearing out at different speeds, starting from a point at which you would have some nearly new assets and some nearly replaceable. I would have felt it would be rather difficult to have inferred much from such information. One could certainly get an indication of the general direction, but I cannot see at the moment how one could infer very precisely what the relationship was.

1251. *Mr. Scott:* You suggest that there is a need for more detailed information about the company's liquid assets, and that they should be split up into different categories which you have enumerated in your memorandum. There is cash in hand and at bank and tax reserve certificates, just to take two items. The day after the balance sheet is published those two items could completely change, because the company could on the next day apply all its cash to buying tax

reserve certificates. There would presumably be nothing remotely blameworthy in the directors doing that, and as the categories are freely transferable between themselves, do you really help the shareholder very much by telling him how the liquid funds have been allocated between those categories just as at the balance sheet date?—I think I said *à propos* of this that I regarded this information as more important from the point of view of the economic system in general and the kind of analysis which the Radcliffe Committee was thinking of, than I do from the point of view of the individual shareholder. So far as that goes, there would still be difficulties with financial years ending at different times and so on of course. Assuming that the balance sheet would represent what the directors regarded at this particular time to be in the best interests of the company—they might change them afterwards in response to a change in circumstances very soon afterwards—but assuming the balance sheet was not deliberately window-dressed, I would think then that when you aggregated a number of balance sheets on different dates the changes would, to some extent at any rate, cancel out. One would get broad pictures of changes between different years or different quarters, and I would have thought that one could have derived useful information from the point of view of economic policy decisions from an aggregate, say, of all the companies reporting in a given quarter.

1252. That would be useful to statisticians and so on rather than to the shareholders of any one individual company, is that right?—I think so. When I say statisticians I am not merely thinking of gratifying the curiosity of people like myself, though I confess that my curiosity is very lively on these matters, but it does seem to me, and I think it seemed to the Radcliffe Committee, that it is important,

(The witness withdrew.)

MR. S. E. PHILLIPS and MR. R. C. STEVEN called and examined

1254. Mr. Phillips, you are the Deputy General Manager and Underwriter, and you, Mr. Steven, are a member of the staff of Trade Indemnity Co. Ltd.?—
Mr. Phillips: That is correct.

both for bankers and civil servants and for politicians who have to make policy, and from the point of view of intelligent discussion of policy by serious economists and such like, that this sort of information should be known.

1253. If the information is important, then would you assume that the directors when they write their report and present their accounts, which is usually some six to nine months after the date of the balance sheet, should state what they had since done with those liquid assets. If you are to draw any particularly valuable conclusions from what they were six months ago it is rather important to know whether that situation is still the same, is it not?—That of course is a difficulty. I am not sure whether one could ask them to do this for this particular piece of information. Of course what has been done with a good deal of other information is that if the government authority regards it as useful enough for its own purpose it does ask, at least from a sample of important companies, for confidential information about up-to-date trends. I would have thought the historical record could be quite useful in itself and could give us an indication of how important these changes were in relation to other matters of economic policy. If it then turned out that in the recent past they had been important I would think it reasonable that the Bank of England, or whatever the appropriate agency was, might request up-to-date information in confidence.

Chairman: Professor Morgan, we are all extremely obliged to you for coming here today and for the interesting way in which you have expressed your views. I do not think anyone else has any further questions to bother you with. We are very grateful to you for your help.—Thank you very much, Mr. Chairman.

1255. I need hardly say that we are very grateful to you for the trouble you have taken in preparing your memorandum and for coming here to give evidence. Will you tell us something about what

you do? I understand your business can be described as underwriting credit risks? —Yes, My Lord, we are a specialist insurance company engaged in insurance against bad debts—in a bald and straightforward form. We insure merchants and manufacturers who sell and deliver goods on credit terms; we give them cover against loss which may arise from the insolvency of their buyers and customers. The method of giving cover can be on what we describe as a whole turnover basis whereby we insure the whole of a man's business—all the customers with whom he deals—or it can be on a specific basis when he may select one or more buyers and submit them to us for approval and quotation for cover and, if acceptable, we will issue policies on those lines. Until two or three years ago we were I think unique in that we were the only company specialising in this business in this country. Recently two other organisations have set up with whom we are very friendly, but so far of course they have not had time to make very much progress, so I think we are still the most experienced in this field. We are really the home market counterpart of the Export Credit Guarantee Department in overseas markets.

1256. I take it that it is very important to your business that when a particular risk is put to you you should be able to assess quickly and with reasonable accuracy the credit-worthiness of the buyer? —Most certainly. Such expertise as we have is in the assessment of credit-worthiness and the extent and terms of credit that can be granted to our insureds' buyers.

1257. I suppose one can take it that the range of your customers' buyers will include individuals carrying on business on their own account, ordinary partnerships and limited companies?—Yes.

1258. And limited companies, of course, comprise public companies, non-exempt private companies and exempt private companies?—That is quite correct, yes.

1259. Of all these, the individual is not obliged to publish his accounts to anybody?—No.

1260. But he is under personal liability to pay his debts because he has not taken advantage of the Companies Act. The

same may be said of the partners in the ordinary partnership firm?—Yes indeed.

1261. Coming to the private company, by far the greater proportion of companies numerically are private companies, exempt or non-exempt. And about 70 to 80 per cent. of private companies are exempt?—That is correct.

1262. And the latter alone of the limited companies enjoy limited liability without filing their accounts. That is the position, is it not?—Exactly, yes.

1263. I understand from your memorandum that you find difficulty in dealing with cases of buyers who are exempt private companies because they are not obliged to file any accounts and of course do not file any?—Yes, that is perfectly true. Admittedly we operate in a somewhat narrow field. Compared with the scope of your own inquiry we see a somewhat limited field of commerce in this country, but it does in fact show to us in our experience that a very large proportion of the risks that we insure are connected with these exempt private companies and it is very difficult to get information which would justify the credit that they seek.

1264. Supposing the buyers are a partnership firm and you want to assess their credit-worthiness, then of course you would not have the advantage of any filed accounts which you could get in a public office?—No, my Lord, that is true, but one starts with the knowledge that they are committed personally to the full extent of their own private resources; they are responsible for everything that they owe. They have no protection, such as is given by the Companies Act, of a nominal capitalisation with a very limited liability. One has to judge the limited company, the partnership, the private trader and the sole trader on the basis of reputation and length of time in business, which are all factors that add up to credit-worth. They are probably common to each of those heads. When it comes to the exempt private company, however, you have less grounds for confidence than in the case of an individual or individuals who are putting their all into their business and who hold themselves personally responsible to their creditors.

1265. I suppose you assess the credit of the partners in a firm by banker's references, by information from trade protection societies and by that sort of means?—Yes, we use them a great deal.

1266. And you know that whatever they are worth will be available towards satisfying the debt?—Yes indeed.

1267. I think you have experienced your share of failures. Your company was involved in the failure of about 530 companies in Great Britain in 1958, and in 1959 in the failure of about 410 companies. I do not know how far it is relevant, but can you say how many of these were exempt private companies?—*Mr. Steven*: Probably about 90 per cent.

1268. Of course it would be fair to say they are the smaller companies on the whole?—*Mr. Phillips*: On the whole, yes, my Lord.

1269. Would you connect the two things in any way?—Yes. For instance, in the distributing trades, of which we insure quite a large number, you get this pattern of small companies, a multiplicity of small companies with limited capital, who are subject to the trials and misfortunes of this life, and they go under perhaps rather more easily than the better capitalised concerns.

1270. Can one fairly link the freedom from any obligation to file accounts with failures?—We would in our experience, yes.

1271. Why is that?—We think that in these trades a number of people go into them in order to make quick money, hoping for luck, hoping for a break in the market which will run their way, and without incurring any very great liability themselves. Sometimes it comes off; more often it does not; and they fail. Then their creditors are in trouble, and we think they unfairly escape themselves from the consequences of the irresponsible way in which they have embarked upon the enterprise.

1272. Would you think it more likely than not that somebody who was not under a statutory obligation to file any accounts anywhere might be a little more careless about keeping his books than

somebody who had to have his accounts audited and had to file them?—As a general observation I would agree with that.

1273. Would you, for the purposes of your business, prefer to have trading in this country more unincorporated partnerships or more exempt private companies?—The former, my Lord. We should prefer more partnerships, more sole traders, more people fully responsible for their obligations, than organisations hiding behind, for want of a better expression, the Acts whereby their liability is limited to their subscribed share capital.

1274. And it is plain I take it from what you have already said that you would rather see non-exempt private companies in business than exempt ones, from your point of view?—Most certainly, yes.

1275. So that it is your view, as you have expressed it of course very clearly in your memorandum and we need not go through it all again, that exempt private companies ought to file their accounts just as much as non-exempt ones?—From our point of view and in our business, most certainly, yes.

1276. Your views are based on considerations of convenience in the carrying on of your business and of the reliability of the information you are able to get?—Yes.

1277. Looking at the matter from another angle, you quote cases in your memorandum where a company with a paid up capital of £2 failed for a sum of £20,000. Would you say that that suggested starting business with wholly insufficient capital?—Yes, and that is not an extremely exceptional case.

1278. What would be your view about an amendment of the law requiring all companies to provide something more than a nominal capital on formation?—I do not know that I hold a firm view about that. If they do not have what in the creditor's or supplier's view is enough capital—or in our view for that matter if we are asked to insure it—then the creditor/supplier does not give the goods and we do not insure it, and the company has to take what other remedies are open to it, either by paying cash or getting more capital into the business and generally inspiring more confidence in its suppliers.

1279. I was thinking so far as failures are concerned, if I set up a retail shop and I only have about £5 in my pocket plus the stock-in-trade, or something of that sort, it is quite likely, is it not, with a bit of bad luck I will fail in my first year?—Yes.

1280. But you do not mind that so long as your own business is able to assess its own risk?—That is true, my Lord. To take the case that you have cited, if we had the information that there was only £5 in capital in the business, we would have assessed the credit-worth of that business at £X and we would have covered it for £X. If it failed we would feel that that was one of the hazards of the business; we should have insured the risk with our eyes open and with full knowledge. Where we do find difficulty, and where we perhaps complain when we make our case to the Committee, is where there is only £5 capital and one does not know it, and trading is done irresponsibly to an extent that is far and away beyond the capabilities of such capital.

1281. Supposing you were a dictator legislating to improve company law, would you look favourably on a proposal that nobody should be allowed to start a company unless he subscribed something more than a purely derisory figure of capital?—No, my Lord, I think that is entirely his business. But those who supply him and take risks on him should be given the opportunity of knowing what his position is, and of making up their own minds about the extent to which they will trust him. What he subscribes himself and how he capitalises his business I feel is his affair.

1282. Assuming that the exempt private company was required to file accounts, would you or would you not think it a necessary corollary to that that the accounts should be properly audited?—Yes, my Lord, they should be audited.

1283. That is to say they should be audited by an auditor qualified under the Act, as the accounts of any company which has to file accounts have to be audited?—Yes indeed.

1284. There is another exemption which the exempt private company enjoys in that it has the right, alone of companies,

to make loans to its directors. Is that a matter of concern to you?—It concerns us, my Lord, under the general heading of information about the disposal of the company's finances and its assets and its liabilities. If we could see a balance sheet which would disclose that, then we would be in a better position, we think, to assess the credit-worth of that concern.

1285. It does not so much matter what they do with their finances as that you should be aware of what is going on; that is really it, is it not?—Yes. What they did would weigh one way or the other, that is, it might be favourable or unfavourable, but at any rate we would know and be able to make, we hope, an intelligent assessment of their credit-worth.

1286. As regards these various failures which have been mentioned, have you in your experience come across any particular causes of failure?—I suppose the answer, my Lord, to that is many; bad luck, irresponsibility, even fraud.

1287. Have you come across any cases where the creditors have been defeated by prior charges in favour of the members of the company? What I had in mind is a very old device and probably it has been defeated now. X decides to enjoy the blessings of limited liability. He forms a little company with virtually no capital and sells his business to the company for a sum of money which is satisfied by a debenture. Then things go wrong and perhaps he can stave off the winding-up beyond the time limit fixed by Section 322 of the Companies Act and when a liquidator comes in he finds the whole of the assets gone.—We have known that happen. One tries to upset the arrangement and I believe it has on occasion been upset, but on many other occasions it has not.

1288. Of course if anyone can contrive to show that new money was paid in respect of this security he may get away with it?—Yes indeed.

1289. I think I am right in saying that the time limit before liquidation within which the debenture is void has been extended to twelve months. But this is a device which might still be open if the trader, turning himself into a company,

could stave off liquidation for more than twelve months?—Yes, it is quite possible, I agree.

1290. So it looks as though there is a possibility of some advantage to the creditors if the time limit were made longer?—Yes, I agree.

1291. Then there is something to be said for the view that any indebtedness to the promoter should be satisfied by shares of the company; he would then come in after his creditors.—Yes, from our point of view we would obviously prefer that any claim he had on the company was deferred until after those of the creditors.

1292. I think what you have told us and what is so clearly stated in your memorandum really covers what we want to know from you on this particular point, the question of the filing of accounts by exempt limited companies. There is another matter on which possibly you can help us and that is the Registration of Business Names Act. The register I believe has assumed enormous proportions and it is an extremely difficult thing to run owing to the large numbers concerned, and so on. Do you or does your company make use of the register under the Registration of Business Names Act as a step in the course of your searching into the position of the proposed buyer?

—We do so indirectly, because one of our sources of information is the usual status inquiry agent, and I think he would make use of the business names register.

1293. Of course you would also have to make the usual inquiries on the spot, so to speak, to see who was carrying on the business?—Yes; again we do that largely through agencies and banks as well as our own organisation.

1294. I thought you might be able to throw some light on the utility of this register, but it is not really your province?—No.

1295. The ease of incorporation has produced so many companies that the Registrar finds it increasingly difficult to christen them all with distinctive names. Does your company ever get into difficulties over the similarity of names used by companies?—Indeed yes, it leads to great confusion. We often blame ourselves for the confusion but perhaps we

do this a little unjustly. There is a great deal of similarity in nomenclature, and a comma or semi-colon can, so to speak, make the difference between one company and another; so that we find we are covering unjustifiable risks on companies that we did not intend to insure. As I say, we have often blamed ourselves for not being a little more careful and meticulous in studying these names and styles, but it is a matter of confusion.

1296. So far as you are concerned you would welcome practical steps by the Board of Trade to try and prevent the similarity of names?—We would.

1297. Whether that is physically possible I do not know.—I would not presume to know whether it is practicable or not.

1298. There was a proposal I believe to start using numbers, but those have very little in the way of trade appeal and are not very popular.—Yes, so I would imagine.

1299. Then you have something to say about accounts, and you point out that you cannot really get a view of the position of the company unless you know the method adopted in valuing stocks and work in progress and the method adopted in assessing depreciation; you want those two items and you want the total sales and purchases in the year?—Yes.

1300. That is to say, you want the turnover?—Yes, my Lord.

1301. Of course in the case of the sole retail trader his turnover would be very simply ascertained, at least I take it so?—Yes.

1302. You also deal with manufacturers and contractors, do you not?—We do.

1303. There of course it is a more complicated matter.—I would suggest, my Lord, that it is not so complicated. In certain businesses obviously it is; in banks, finance houses and organisations of that kind, but in the case of the ordinary merchant trader and manufacturer, of which most of our insured consist, I would think their turnover is a readily ascertainable figure. There is a tendency, I think, in publishing accounts for public companies to state turnover nowadays.

1304. But from your point of view you say you want the turnover stated, and I take it, failing that, you would want some explanation of why it was not possible to do so?—I would hope either that statutorily turnover had to be disclosed or a reason given as to why it could not be.

1305. You have made an interesting proposal that where a company gets into difficulty it would be helpful if there was jurisdiction in the court to appoint a judicial manager. You say that that practice has been adopted in South Africa and I believe in other countries as well. Can you throw light on the way in which the judicial manager would function, what his responsibility would be?

Mr. Steven: The cases we have in mind are really very few, but now and again you come across a case where a company may be of some considerable size, let us say its liabilities are £600,000, and it is part of a group. It has passed the stage where a company doctor can do it any good, and no such person would be willing to go on the board of such a company to pull it round. At the same time the creditors appreciate that if liquidation occurs they are going perhaps to suffer a very sharp fall in the value of the company's assets; they may like to have somebody in control of the company, appointed by the court, acting as a sort of receiver for the general body of creditors just as a receiver might act under a debenture. There is, I understand, provision for this in the South African Companies Act.

1306. I am informed this particular provision has in fact been repealed, but I have not had an opportunity of looking at it.—I knew it was under consideration, but I did not realise it had actually been repealed.

1307. It may be it has been transferred to another Act. It is rash to pronounce opinions on South African Acts, or indeed any other Acts, without looking at them. I think that is probably a bad point.—I know a year ago they were thinking of revising the Companies Act in South Africa.

1308. I understand this particular provision may have been repealed (or perhaps only transferred to another Act). But it does not matter whether it is still in force

in South Africa or not; what we have to consider is whether it is a good thing for the United Kingdom. As to that, you want to appoint somebody who resembles a liquidator, I should have thought rather than a receiver?—No, my Lord, because he may not necessarily realise the assets of the company. The company might not have got to the stage where it was obviously going to fail, and the creditors might think it had only got into its existing state because of the general incompetence of those who were running it.

1309. The effect of appointing a judicial manager would necessarily have to be, would it not, the introduction of some sort of standstill on the carrying on of the company's business, otherwise, if winding up supervened, they might run into difficulties?—No. The effect, I understand, would be that there would be a moratorium on the existing liabilities of the company, but the judicial manager would be empowered to carry on the business, and could incur further liabilities, such liabilities being preferred to the liabilities that had been incurred prior to his appointment.

1310. That would be coming very near a scheme of arrangement under sections 206 and 207, would it not?—Yes.

1311. All that might be done in liquidation by appointing a provisional liquidator?—*Mr. Phillips:* I believe, my Lord, if I may say so here, that the main idea behind the South African method is to give time to decide whether the company should continue trading, whether it was insolvent or whether it needed reorganisation by means of help from the creditors. The judicial manager has to report back to the court within a certain space of time. If he reports that in his opinion the company is insolvent there is no alternative but liquidation, but if he decides it is solvent but in difficulties then presumably he hands over to the creditors, who confer with the management as to what can be done to get the company out of its difficulties.

1312. What it comes down to then is a power in the Court to declare a moratorium for a certain period, and the appointment by the Court of an official called a judicial manager who would investigate the affairs of the company and

report whether it ought to be allowed to continue or to be wound up?—Yes.

1313. That sounds, if I may say so, a very sensible notion as an alternative to more drastic measures.—And it gives complete protection, my Lord, to the assets in the meantime.

1314. There is one thing I ought to have asked you, Mr. Phillips, on the question of the exempt private company. You remember, I expect, that in the Cohen Report considerable weight was attached to the possible advantages which the filing of these accounts might give to the competitors of the company filing them, and in particular it was said that other large companies and also partnerships and individuals, who are not required to file accounts, might derive advantage. I gather from your memorandum you do not think very much of that argument?—No, my Lord, I do not see the force of that argument; in all justice it seems to us that as a *quid pro quo* for limited liability there should be disclosure of the financial position.

1315. *Mr. Lawson*: Could I ask you a question about the disclosure of sales and purchases: is it your view that those figures should be disclosed in all cases even if it might be harmful to the business concerned?—Yes.

1316. Do you think that there is any force in the argument, particularly in the case of small and newly formed businesses, that it would be disadvantageous to the shareholders for those figures to be disclosed?—I can see an argument that some hardship might be imposed. I have tried to put our own point of view, and we frankly admit that there may be other considerations which would outweigh our interests, and this may well be one of them. I do agree that I can imagine circumstances where disclosure on the part of some firms might be harmful to them, yet I must say from our point of view in assessing credit we would like to see it done in all cases.

1317. I suppose you could say that you would not guarantee the credit unless the company told you their figures of turnover?—No. The relationship is difficult because we are dealing with the supplier and not with the buyer, and it is the buyer that we want to know about.

1318. You do not approach the buyer direct?—We do in many cases, because we cannot get enough information through normal sources and we go to him and say: "Will you show us your balance sheet?", that is really what we want to get at. If he wants to be creditworthy in the world of commerce he says: "Certainly, I am only too pleased to show you the balance sheet". If he has anything to hide he will not show it to us.

1319. It would be possible to get at the sales figures in this way, in certain cases?—Yes.

1320. As regards stocks, you would be satisfied, would you, if the balance sheet disclosed the method adopted in valuing stocks? You do not very much mind what the method is as long as it is disclosed, is that it?—Yes. We do not like "directors' valuation".

1321. No, you want an adequate description?—Yes.

1322. Am I right in thinking that where stock is described as being at cost or market value you would want to know how the cost is arrived at and how the market value is arrived at, because there are many different interpretations of those two words?—We would certainly prefer that.

1323. But what you are after is disclosure and not any uniformity in method?—Yes.

1324. *Mr. Bingen*: I can see that from your point of view, you would like to see balance sheets and profit and loss accounts of exempt private companies filed. I have got a great deal of sympathy with that view. But do you see any overall economic or other objection to your idea being carried out?—No, Sir, I see no objection to every private company filing a balance sheet.

1325. My other question arises out of the suggestion made that there should be a procedure in this country under which a judicial manager can be appointed. I gather that that judicial manager would be something like a receiver and manager appointed on behalf of debenture holders, but where in fact there are no debentures. Is that right?—Not quite, I think,

because a receiver and manager for debenture holders is there to realise the assets for the benefit of the debenture holder, but the judicial manager in the South African form is not there to realise assets at all, he is there to protect assets while a decision is made as to continuity or otherwise.

1326. But a receiver and manager carries on the business so long as is necessary to pay off the debentures; if successful he hands it back to the shareholders. Your suggestion goes further than that and would be something new in the Companies Act?—Yes.

1327. Nevertheless, a judicial manager is similar to a receiver and manager except that he acts for unsecured creditors?—Except that the receiver and manager under a debenture is realising assets to pay back his principal, the debenture holder. This does not happen with the judicial manager at all, all the assets remain in the business.

1328. Suppose the suppliers of a company are its creditors for £100,000, and you are behind the suppliers as guarantors. The creditors cannot get paid, they are issued a writ and they have got judgment. Then instead of putting a petition on the file, do they go to the Court and say: "Please will you appoint a judicial manager?"—The procedure, I think, is normally that the company—not the creditors—goes to the court and asks for a judicial manager to be appointed.

1329. I suppose the creditors might apply to the Court?—I am not sure precisely how it operates in South Africa, but I think the creditors could force the company to go to the Court by taking proceedings. When the company cannot meet its day-to-day liabilities and its suppliers take legal action by means of judgment, then the company is forced to go to the Court and say: "Will you appoint a judicial manager to protect me from this judgment and its consequences?"

1330. But it would be useful too if creditors could in effect ask for a judicial manager to be appointed rather than a liquidator?—Yes, in principle, I agree.—*Mr. Steven:* The heading of the section in the South African Act is "Judicial management instead of winding up".

Mr. Bingen: It is interesting and I think it is worth looking at.

Chairman: Yes.

1331. *Mr. Brown:* When you approach a prospective debtor to ask him his position, you said that you asked him to show you his balance sheet. Does that mean that you would be satisfied if exempt companies were asked to file balance sheets but not profit and loss accounts?

—*Mr. Phillips:* It would go a long way to enabling us to make a more logical assessment of creditworthiness. I think the profit and loss account would carry it further. I must admit I have assumed that if it was done at all, the new provision would include the profit and loss account as a document annexed to the balance sheet (as prescribed under the present Act for non-exempt companies).

1332. *Mrs. Naylor:* Do you think it would be very easy to find clever judicial managers who were going to make a success of a derelict business? He is supposed to be a creative dynamic character, is he not? Is he supposed to give full time? How does one get them?—*Mr. Steven:* As long as they are going to be protected, you will get them.

1333. Where would one recruit them?—Probably from the class of people who are generally known as company doctors.

Mr. Phillips: There is in South Africa a very big organisation known as Syfrets, who are trustees and accountants; they perform this function of judicial manager in many cases. They have most able people, of course.

1334. Are bank references for companies any good?—We use them a lot and I would be the last person to say they were no good. But one recognises that a bank has its customers' interests at heart and it cannot be as outspokenly frank in a reference as credit underwriters would like to see. We try to read between the lines, but usually bank references are so brief and non-committal that they really are not a substitute for information such as would be given by a balance sheet.

1335. *Mr. Scott:* Referring to the exemption of private companies from the obligation to file their accounts you said in your memorandum: "Although in 1945 it was no doubt correct to make this

exemption to the principle that the fullest information should be made available to shareholders and the public, it is contended that it is no longer so". Is the reason for your change of view about the situation today as compared with 1945 due to the very large number of companies which take advantage of this exemption?—I think that is right.

Mr. Steven: We accept that the position in 1945 was as the Cohen Committee stated it to be, but something must have changed because when we look at it ourselves nowadays we do not think it is relevant.

1336. The second question I want to raise is on the Registration of Business Names Act. I was not entirely clear what your answer was to the Chairman's question when he said how would it affect you if the register were discontinued. I know you say you use it. Has it been your experience that frequently it has been disregarded by traders and they just have not given particulars under that Act?—*Mr. Phillips:* I do not think I can answer that question. It does not normally come within our province. We have to use the register to confirm that the risk we are asked to insure is in fact in business at a particular address under a

particular style, and we do that indirectly as I said through inquiry agents. But I can express no opinion about the discontinuation of the Business Names Register.

1337. *Chairman:* The Registration of Business Names Act of course provides for registration of the true name of anyone who is not trading in his true name. In addition to the register, there are certain other obligations. There is an obligation, I think, to exhibit on the spot the certificate of registration from the Board of Trade saying who the proprietors are, and there is an obligation to show the true names of the proprietors on all letter headings and so forth. I was wondering whether all those requirements, supposing that they were left out of any repeal of the Act, might not serve your purpose just as well? Your local agent would go down and see what was going on on the spot?—Yes. I do not think I hold any strong views one way or the other about that from the point of view of obtaining information.

Chairman: Then I do not think we need trouble you any further. We are very much obliged to you both for the memorandum and for coming here today and giving evidence. Thank you very much.

(The witnesses withdrew.)

APPENDIX XI

Memorandum by the Economist.

The Economist is grateful for the opportunity to submit to the Jenkins Committee a discussion on company practice and law, together with specific recommendations where these seem advisable. This material, which it is intended shortly to publish in *The Economist*, is in four sections:—

- A Modern View of the Company
- Some Questions for Review
- Protection for Depositors
- Proposals for Unit Trusts

Some of this material is perhaps more discursive than would ideally suit the Committee and for this the compilers ask the indulgence of all the members.

7960

A Modern View of the Company

Ten years, it is said, is about the right time for taking a close look at Company Law. On many matters involving the birth and business of companies, there ought to be many years of valuable service in the 1948 Companies Act. Some other matters that have come to light in the last few years do need attention—take-over bids, as a particular example. The task facing the Jenkins Committee will still not be an easy one if it decides that the need is to improve a basically good structure of law and not to rebuild it. Yet although major reforming battles have long been fought—on accounts, holding companies, and directors' responsibilities, for example—so that the behaviour of companies is infinitely better than it was a generation ago, more voices are nowadays to be heard challenging the nature of the company and the public merits of limited liability and seeking better definitions of the responsibilities of company directors and officials towards shareholders and society. On these questions, views are sharply divided. People can still be found to argue the seventeenth century view that incorporation provides the opportunity for like-minded people to join in a venture, hiring (and when necessary firing) the best administrative talent they can find. The investor today, top hatted or cloth capped, does not see the average company in these terms, but that is not to say that this democratic basis of the company has become wholly irrelevant. At the other extreme, the criticism is heard that the modern company and its board of directors are literally irresponsible—beholden least of all to their shareholders and getting more protection than they should from the company law.

This second view has been gaining ground ever since the last Companies Act was put on the statute book. It involves at bottom the relations between shareholders and directors—for if there is such a thing as an autonomous company, those who hold shares in it cannot be reckoned to have any decision over it or over the people who run it. That would leave a power vacuum which many critics who hold this view would fill simply by bringing in the state as shareholder or by some other appropriate method of dispossession to stop "parasites" sucking dividends and capital gains out of corporate business. Every take-over bid revives the argument and in the classic case of British Aluminium, it was answered in a way that put the directors to rout. What they proposed to shareholders as being good for the company they administered might indeed have proved so; one cannot tell, for they lost the day and primarily because shareholders refused to follow their line without question and got to the point of losing confidence in them.

The terms of reference of the Jenkins Committee ask it to consider in the light of modern conditions and practices, including the practice of take-over bids, what should

be the duties of directors and the rights of shareholders. One does not have to accept all criticisms of present company practice to hold some reservations about the traditional view of democratic association through a company. Imperial Chemical Industries is a progressive, well-managed, socially sensitive concern; but Mr. Chambers and his colleagues, one might dare to assert, are only occasionally activated by the idea of direct service to shareholders. They are working primarily for ICI which has its own legal existence and its developing *persona*. In this attitude, they are strengthened by a body of case law that simply cannot be overthrown by anyone who seeks to assert (against all contemporary evidence) that the shareholder must be regarded still as the absolute boss. In some ultimate ways he always has been and is still. But contrary to the widely accepted idea that ownership of a company rests with the ordinary shareholders because, it is said, they bear the ultimate risk, company law has increasingly distinguished between the company, on the one hand, and the people who hold the equity in it, on the other hand. They have placed not their all, but a limited "all" in it; in return they have certain limited rights, including in particular a residual share in its profits (which they cannot, however, determine for themselves) and a residual right after all other claims to its assets, if it is ever wound up. Hence the members can be said to own the company only in a limited special sense; the company has a separate and continuing entity quite apart from the people who own it from time to time. This principle was confirmed in Lord Evershed's words in the Short Brothers case in 1949, where the question at issue was whether shareholders should be paid on being taken over by the state on the basis of the value of their shares in the market or on the value of the assets that might be imputed to them:

Shareholders are not, in the eyes of the law, part owners of the undertaking. The undertaking is something different from the totality of shareholdings.

And the undertaking is the entity to which the directors owe their fiduciary duty—not to the amorphous body of shareholders and not as agents of them. It follows that views about a particular company may differ as between the shareholders and the directors. Their interests may differ too; a given policy that the directors honestly see as serving the long-term interests of the company may be inimical to the short-term interests of some shareholders. But they are entitled to hold such views and to act on them, even if they may not be in the evident interest of all shareholders. If the members dissent in sufficient strength, they can change the directors and change the policy. (This assumes that they have a vote, though not all have; the vote itself is not a natural right but one specifically conferred by the articles of association on certain shares.) This is the only sanction in our company law for preventing directors from wielding absolute power within the broad fields of *intra vires*. Sometimes they may come close to it; but even the most entrenched board among the biggest companies thinks twice before seeming to act arbitrarily. A few shareholders who make a row will not usually succeed in turning the board out, but directors are usually sensitive when their public relations turn sour. And if they persist in arbitrary courses, they may, in infrequent but effective cases, provoke a revolt among the shareholders. When that happens, they become as vulnerable as they seemed formerly secure.

The question how far the relations between directors and shareholders can be improved by law and how far by better manners (on both sides) is a nice one. Changes in the law aimed at specific improvements—say, in accounts or in the handling of take-over bids—also assist the general aims of securing fuller disclosure of information and the taking of shareholders more completely into the directors' confidence. Again, anything that limits the temptation for directors to look too fixedly at their own self-interest is to be welcomed—here one must applaud the recent step, quite outside the company law, to limit tax-free "compensation for loss of office", if only because shareholders in the past rarely brought themselves to do it.

Is there need for some instrument of control over the behaviour of directors closer than shareholders can exercise themselves in the annual general meeting or by the other means open to them under the Companies Act? No doubt the Jenkins Committee will be looking at post-war German experience of a kind of double-decker management

of companies through the *Vorstand* (or executive board) and the *Aufsichtsrat* (or supervisory board). There are some in Germany who find it hard to explain the division of effective power between the two bodies and it has been common among German business men to treat the *Aufsichtsrat*, with its periodical meetings and labour representation, with a certain disregard. It is too early to decide whether German business, German shareholders, or German workers are better off because of the oversight afforded by the *Aufsichtsrat*. But it has some attributes that critics at both extremes of the British system have demanded—including direct trade union representation and the appearance of more effective supervision over the actions of executive directors. This is not likely to be an article for immediate export to this country, where the common case of a mixed board of executive and part-time directors is likely to give results at least as good, but its course deserves to be watched.

One other general question has to be raised. Should some permanent body be set up to give regular attention to company affairs and if so how should it be constituted? The Securities and Exchange Commission (S.E.C.) in the United States is sometimes put forward as an example for this country to follow. This seems doubtful, since many of the important functions carried out by the SEC are satisfactorily covered by the Companies Act and by the rules of the Stock Exchange. What might serve better in this country would perhaps be a consultative-cum-recommending body, rather than an executive-cum-controlling body. But it is not easy to visualise the perfect formula for such a body. If it were merely representative of all the interests concerned—Government, law, finance, investment, labour and the general public—it might be too ponderous as well as too complaisant. This might be a field, however, where the "Three Wise Men" method could be made to work, by giving a small body of independent but interested people the continuing job of looking at the development of company organisation and law, reporting regularly about these questions and acting as keeper of the public interest in them. It would also conceivably allay many public misconceptions about companies and the way they are run. Such a body would hardly dispense with the need to have a closer look at company law at longer intervals, though its work would help not least in this direction too.

For various reasons, "company" has become a bad word. The ignorant public thinks that the company that earns good profits must be a greedy monopolist. Or that the average company director is a tax-dodging caterpillar feeding on corporate enterprise. Or that the ordinary shareholder has no natural right to a satisfactory return on his investment or to the sometimes provocative increase in its market value to correspond with its true worth. Much of this envy arises from two facts: post-war inflation and the distortion of values that it caused—only fairly recently overtaken by prices on the Stock Exchange; and secondly the expanding character of the modern economy which, on the face of it, has taken a good deal of the risk out of risk investment. In the process of adjustment to these two major facts, company profits and share prices have often responded sharply, while the take-over bid has often developed in public clamour between contending interests. None of this is other than an economic response to economic forces. It is not wicked, anti-social, a deprivation of the workers, or an enrichment of the investing class beyond the enrichment of others. But it is during such periods of major change that the shareholder, wielding the ultimate sanction of his vote, is of crucial importance. It is then that directors have to admit that they govern by consent and that they owe shareholders the double duty of information and consultation. The British company system is not perfect and our tax laws sometimes make it look odder than it need be; but it is still far better than anything that has been proposed to replace it.

Company Law

Some Questions for Review

The 1948 Companies Act righted much that was wrong and it is still working satisfactorily after twelve years. The present task, in contrast to 1948, does not seem to involve a radical revision of company law so much as more modest amendments

in the same general direction and enlisting the support of law for the best in modern business practice. It is possible, as the following paragraphs show, to comment in this sense without being confident in every case that useful positive recommendations can be made for changes in the law.

Incorporation and Partnership

Limited liability, secured through the act of incorporation, was originally taken to be a privilege. As the ever increasing number of companies shows, it has become a matter of automatic convenience for the majority and, for a few, a means of evading the responsibilities of the best business practice. The "one man" company is a familiar product of heavy taxes falling upon the individual, and the "accommodation" company has been known to exploit defects in other branches of the law. Whether measured by the advantages to the well conducted business or by the risks of misuse by the ill conducted business, incorporation is too easy and too cheap.

It would be invidious, to put it no higher, to distinguish between what is worthy and what is unworthy among companies. More specific or restricted definitions of the objects of a company as set out in the memorandum of association could easily frustrate the creation and growth of new trading enterprises which need the protection of limited liability, and it would hardly be possible, even if it were desirable, to impose new limitations on nearly 400,000 existing companies. But the privilege of limited liability should be made less of a bargain by two changes: first, to increase the fees payable by existing companies for the services of the Companies Registration Department; and secondly by increasing the fees payable on incorporation of new companies and the capital duty for all companies.

Incorporation of a company with one shareholder should be introduced. A company must now have at least two members, but often one of these members has a purely nominal interest to comply with the law, as in the case of a holding company which needs a "dummy" shareholder.

Where by custom or by non-statutory regulation, it is the practice to trade with unlimited liability, the law against partnerships of more than twenty members can press heavily upon enterprise and it is avoided by the clumsy device of associate partnerships. There seems no reason for any upper limit, and the Registration of Business Names Act, 1916, provides a means of identifying the partners.

Private Companies

One advantage for a private company is that it may take power in its articles of association to regulate and to restrict the transfer of its shares. The Lyle and Scott case showed that this privilege needs to be zealously guarded. But is there any need then to preserve the distinction between "exempt" companies (which are not required to file copies of their accounts) and "non exempt" companies? For "exempt" private companies, the law is concerned with a proper measure of protection for creditors rather than protection for a limited number of shareholders. It would be possible to dispense with the distinction and require all companies to file accounts. But if this is (probably rightly) regarded as too drastic, some protection would be afforded to creditors if the directors of an "exempt" company were required to certify that proper books of account had been kept, that annual accounts had been prepared in accordance with the Companies Act and that these accounts had been audited by a fully qualified person (as defined by the Act). Such a provision would have the incidental advantage of exacting a public *quid pro quo* from those who adopt limited liability as a personal convenience.

Any "exempt" company should be prohibited absolutely from appealing to the public for deposits and loans or from accepting them. This question is discussed in some detail later.

No Par Value Shares

The arguments for and against the issue of no par value shares were examined by the Gedge Committee and the Government has in principle accepted the majority

recommendation of that committee that the issue of NPV shares should be permitted. Such an enactment is long overdue.

Directors and Shareholders

The duties of directors in a public company and their relations with shareholders are complex and were broadly discussed in the introductory article. It is difficult and it may be undesirable to attempt to frame comprehensive rules to govern them. At certain key points, however, the accountability of directors to shareholders could be made more apparent and direct.

1. In buying assets, the directors can fundamentally alter the character and activities of a company, though still keeping these within the bounds of a widely drawn memorandum of association. In such cases, the ideal arrangement is for the directors to secure a prior mandate from shareholders. The disadvantages, however, have to be weighed. Disclosure might be commercially imprudent and tie the hands of directors too tightly in negotiation, conceivably with harm to the shareholders' interests. Directors elected by shareholders have the right to a reasonably wide area of decision and probably should be allowed to continue to exercise their discretion in such cases—subject to the recommendation on the issue of shares discussed below and to the proviso that shareholders must be fully informed as soon as the transaction is completed.

Difficulties may arise because in the heat of a take-over struggle the directors may pay too high a price for assets and so dilute the existing equity. Precipitate and occasionally rash actions associated with some "shell" and industrial holding companies provide examples, though bad buying is not confined to these alone. Ultimately, however, shareholders must be presumed to know the kind of company they have invested money in and to what sort of men they have entrusted its management and the law can hardly be expected to protect their equity from the risks of enterprise. It is for shareholders to insist on good direction and on full information about it; the law can help here by insisting on information at least *post hoc*.

2. Similar arguments can be advanced to cover the sale of part of a company's assets. But there does seem need here for some limit to the directors' discretion. Where the sale is of a substantial proportion of the assets (say, 50 per cent., by current valuation) shareholders should have the final say whether the sale should go through. By analogy, the law should make it quite explicit that directors may not place assets beyond the voting control of shareholders without their consent.

Disposal of any considerable proportion of trading assets usually leaves a company with an abnormal volume of cash. In such circumstances, the directors should be made to seek a mandate from shareholders for their proposals—for example, whether the whole or part of it should be distributed. Shareholders should be asked to approve the broad outlines of any policy the directors intend to pursue in re-investing the money.

3. The articles often permit the directors to issue further shares (where the authorised capital exceeds the issued capital) for cash or in satisfaction of a take-over bid without first consulting shareholders. The issue of 25 per cent. of the equity of United Dominions Trust to Barclays Bank and the frustrated attempt by British Aluminium to issue shares to Alcoa, are cases of this kind which have caused resentment. Issues of shares for cash, or other consideration, carrying present voting rights (or prospective votes in the instance of convertible loans) and which represent more than, say, one-eighth of the paid up share capital should be made subject to the shareholders' prior approval.

4. Power to make donations for charitable or political purposes (subject to the general conditions that these are in the interests of the company) is usually vested in the board of directors. They should be competent to judge what is in the interests of the company, its shareholders, its employees and the industries of which it forms part; and there would seem to be little point of imposing on the law the making of

distinctions between acceptable or undesirable patronage. But there are arguments (both in terms of excessive charity and also possibly of too little) for expecting them to make some disclosure each year of the donations they have made.

5. It is important that minority shareholders, especially shareholders in a private company, should be able to seek remedies in the courts if they have reason to believe that they are being oppressed by the majority shareholders. One difficulty here is that oppression is so defined as to be linked with the need to prove that the facts would in normal circumstances warrant a winding up order. If that limitation is likely to block the access of minority shareholders to the Courts, another definition of oppression is obviously needed.

Take-over Bids

In the past the clash of interests between directors and shareholders has been most vividly revealed in take-over struggles. It would be regrettable if any changes were made to hamper a process that can have beneficial effects for the economy; but the law should have some say on the procedures to be adopted. Consideration should be given to the following matters, as it has already been given in large measure in the Board of Trade regulations for licensed dealers:

- (a) The directors of the company approached should be given prior notice of an intention to make a bid to its shareholders, though they should not expect unduly long notice.
- (b) A time limit should be fixed for which the offer can remain open.
- (c) The date when an offer can be declared unconditional should be announced. When the offer is declared unconditional the bidder should reveal the number of shares which he then holds or for which acceptances have been received.
- (d) In the first public announcement of the terms of the offer, the name of the principal and the number of shares he has already acquired should be disclosed.
- (e) Where the bid is for part of the capital, acceptances should not be treated on a "first come, first served" basis but should be scaled down proportionately.
- (f) Payments for loss of office or any other conditional benefits or agreements should be disclosed.
- (g) Where a bid is wholly or partly in cash, some evidence should be presented (such as a letter from a clearing bank) to show that the money is there to meet the bid.
- (h) Where a bid is in shares, in whole or in part, some indication of the recent value of the shares should be given.
- (i) The directors of the company for which the bid is made should tell shareholders whether they recommend the bid or not and their reasons. They should reveal and describe any material change in the company's financial and trading position since the last published accounts or any material change in prospect.
- (j) The bidder should give some broad outline of the policies he intends to pursue if he gains control and, in particular, if he intends to dispose of any of the company's assets so as to provide eventual finance for his bid.

Non-voting Ordinary Shares

The ultimate power of ordinary shareholders to control the affairs of the company and the activities of its directors lies in the right that their shares usually (though not invariably) give them to vote at meetings. Any argument that directors should be made more accountable for their actions leads to the presumption that all ordinary shareholders should have equal voting rights.

Practical facts, however, get in the way of this logic. One involves the case where a company needs to finance itself largely by risk capital but from reasonable fear of intervention from outside wishes to restrict the control. This is typical of some new and growing companies whose enterprise is founded on a family or a small group of associates. Secondly, when investors buy shares they must be presumed to know whether the shares carry votes or not and to have measured the price they pay accordingly. Thirdly, a number of big and well managed companies have issued non-voting shares in considerable volume and these have not lacked popular appeal.

To insist that all non-voting ordinary shares now in existence should be given equal voting rights with the voting shares or to put a statutory ban on any further issue of non-voting or restricted-voting ordinary shares would go too far. Indeed, it might not even eliminate the creature that it was trying to kill: would it be possible or equitable to ban the issue of participating preferred shares which had equal rights with the ordinary shares except in the matter of a vote? The law could at least insist that non-voting ordinary shares are clearly designated as such, instead of being described as, say, "A" shares. Beyond that, the law might leave it to the pressures of the market (and these are not insignificant in the City) to resist the wider introduction of non-voting ordinary shares and to encourage the giving of votes on acceptable terms to ordinary shares that now lack them.

Nominee Shareholdings

The Cohen Committee recognised the practical convenience of registering shares in the name of nominees. It also framed recommendations to make it possible to see who the beneficial owners were. These recommendations were not adopted, except that an inspector appointed by the Board of Trade has the power to trace the beneficial owners of shares in nominee names.

The principles here should be that directors should be able to discover for whom they are acting and that shareholders should know who their fellows are. In particular, they ought to have the right to know who effectively controls the company. General regulations to ban nominees altogether or to allow them for holdings within a defined proportion of the capital might do away with the practical conveniences of registering shares in the name of nominees without closing all the avenues open to abuse. The law jealously preserves the rights of the registered holder and refuses any recognition of trusts on the register. But equitable rights in a holding can be pursued by the real owners as against the registered holder and it could hardly weaken the established doctrine if the names of beneficial owners of shares could be entered as a memorandum on the company's share register. This would require some procedure for establishing the beneficial owners of existing shareholders and of future ones. If that were thought to be burdensome in the case of existing nominee holdings, as distinct from the case of new ones, a general power could be given to directors to inquire into the identity of beneficial owners and to publish their findings. Shareholders could also be given the right, by passing a resolution, to require the directors to make such an enquiry and to publish its findings. In both cases, the enquiry should be at the company's expense.

Accounts

The best practice in accounting has already outpaced the formal requirements of the 1948 Companies Act but the question whether the law should be brought more in line with modern practice is not absolutely clear.

Turnover

A growing number, but not the majority, of companies publish figures of annual turnover. These figures are useful in serious study of a company's business and in judging how well its affairs are being conducted. For some companies, however, turnover figures would be meaningless—for instance in the case of the banks and finance companies; for others they would be misleading—for instance, companies whose sales and profits are considerably affected by the timing of the completion of

big contracts. Some companies would also contend that the publication of turnover figures would be harmful to industry, but this objection deserves to be treated with some reserve.

If the publication of figures of turnover were enforced, "turnover" would need to be carefully defined. It could be applied to public companies only. Exemption would be needed on good grounds being shown that information would be meaningless or grossly misleading; and there would be pressure for exemption on the ground that the information would be harmful to the company. An appellate body, which would almost certainly have to be the Board of Trade (which would merely mean some already over-burdened officials), would have to be called in as a referee. If figures were published, they would have to be clearly defined to ensure, for instance, that inter-group transactions had been eliminated or that the influence of changes in indirect taxation had been made clear.

These are serious practical difficulties that reformers ought to recognise. Increased recognition should certainly be given to turnover but perhaps the best way of securing it is not by laying down in detail what figures should appear in the accounts or directors' report, but by requiring that some reference must be made to turnover, with suitable figures if possible. If the directors see some objection to this, they should be required to explain precisely why they do not choose to give any information under this head.

Interim Accounts

Half yearly or quarterly accounts can be as useful to shareholders and investors as turnover figures, but this matter seems to belong to the wider field of company and stock exchange practice rather than to the field of the law.

Diversity of Interests

Many company accounts fail to show how the company's assets and profits are divided, whether by geographical area or by industry, and usually shareholders have to be content with general information under these heads which may not be very meaningful. The least that shareholders should expect is a list of a company's main fields of activity and the principal areas of the world in which it trades. The most that might be done would be to require a company to give quantitative details of all businesses including indications of size and profits that accounted for, say, more than one fifth of the net assets attributable to shareholders. Even so, compulsory publication of such information would be open to the same reservations as might be applied to turnover figures.

Exemption Orders

The use of exemption orders has enabled the banks, the discount companies, the insurance companies and the shipping companies to create and maintain hidden reserves. They conceal from their shareholders information that other companies are required to publish.

1. Why shipping companies, alone of the trading concerns, have continued to enjoy this privilege is difficult to see. No one's confidence was shaken when P and O brought its consolidated accounts fully into the open. Indeed, the reverse seems to have been the case. The shipping industry, moreover, is one that has enjoyed considerable favour from the Government through the investment allowances, which are tantamount to subsidies to new investment from public funds. That might be taken to strengthen the argument that shareholders (and through them the public) should know at least in group accounts what the state of their finance is.

2. With the banks and the discount houses, the grounds for exemption rest on the premise that hidden reserves are needed to retain the confidence of depositors and the public at large. Their investment assets are occasionally subject to sharp fluctuations and it is held that confidence in these institutions would be endangered either at home or abroad if their financial state were revealed in full. In recent years,

however, most banks and some discount houses have had to give an indication of the effect that fluctuations in the value of their investments has had upon their resources: this does not seem to have qualified the confidence that depositors have in them—though in one or two cases it may have put shareholders on guard. The banks usually maintain that full disclosure would have an adverse effect on confidence abroad, particularly as foreign banks themselves do not usually give a full and fair view of their finances. This argument should not be decisive; financial opinion internationally as well as at home has become better informed. The banks and discount houses should be forced to show their true current earnings; the one concession might be to allow them to modify this principle by valuing their investments in such a way as to avoid any artificial swelling of profits for a period of rising bond values and to avoid any extreme fall in profits when bond prices are falling. But there should be disclosure of any practice that values a portfolio in the balance sheet above market values.

3. Arguments similar to these can be applied to insurance companies' accounts, on the ground that the interest of the policy holder is paramount to that of the shareholder. But would anyone be less confident in the insurance companies if they disclosed their resources in full?

In all, any claims for exemption need to be put through a much finer sieve than was the case in the Cohen report.

This article has not dealt with all aspects of the law that are before the Jenkins Committee. It has not, for example, commented on prospectus requirements—which are broadly satisfactory. Nor upon the transfer system—which must be made simpler. Nor upon the powers of the Board of Trade to initiate an inspection—which may need strengthening. Nor upon particulars in a company's accounts such as the designation of reserves and the definition of depreciation. Its intention has been rather to focus attention on broader topics, particularly where it is possible to make the role of the shareholder more central in the conduct of a company's affairs. The more shareholders are told and consulted the more the community will know about the way in which companies conduct themselves and the readier the public should be to let companies use their economic and social power without prejudice to their need to live competitively.

Protection for Depositors

The terms of reference of the Jenkins Committee ask for review of the Prevention of Fraud (Investments) Act, 1958, except so far as it relates to friendly societies; but the Government made it clear when the Committee was appointed last November that legislation to regulate the soliciting of unsecured loans and deposits need not await its report. Such legislation has been foreshadowed for next session.

The lack of statutory control over the soliciting of deposits is largely a legal accident. Existing legislation was enacted before advertising for deposits became widespread (banks have traditionally preferred their "tombstone" advertisements to direct appeals for money). When, a few years ago, hire purchase firms started to advertise for deposits it was still open to question whether they were within the law. But the point has never been tested in the courts and soliciting for deposits has been exposed as a major loophole. Few people dispute that it should be brought under direct control, as are other forms of appeal to the public for money by stock issues or by unit trusts and now, under the new act, by building societies. The question is what form regulation should take.

One minimum regulation seems to be called for—that no exempt private company should be allowed to seek deposits from the public; and, by extension, that balance sheets should be given to depositors as well as shareholders. Beyond this minimum, the possible instruments of control seem to be three.

1. *A system of registration* as used for building societies. Finance companies (or possibly only those that advertise for deposits) would be required to register with the

Board of Trade. The registrar would lay down minimum conditions for the ratio of liquid assets to deposits and of risk capital to borrowings. The difficulty here is that hire purchase companies are not friendly societies but profit-making institutions, whose natural path is not so straight and narrow as that of most building societies. Moreover, they vary greatly in size and it might be unreasonable to insist on uniform balance sheet requirements for all.

2. *Informal influence* by the Bank of England, on the lines that the Bank has developed with the older City institutions. The difficulty here is that the hire purchase companies are widespread and have not so far been amenable to voluntary restraint.

3. *Provision of full information.* A substantial measure of protection would be provided if all deposit-seeking companies were required to publish at regular intervals (at least half-yearly, and preferably quarterly) particulars of the amount and nature of goods financed, period of contracts, and provisions for bad debts and deferred finance charges. There should also be provision that the key figures are included in any advertisement or circular.

Perhaps the best means of control would combine these requirements for full information with a general watch by the Bank of England. Hire purchase finance has become an integral part of the nation's credit, and it is anomalous that it should not be fully within the purview of the central bank both from the standpoint of protection of depositors and also of broad economic policy. At first glance, the task of control might seem unmanageable; but the main purpose would be served if the Bank concentrated its interest on those companies that seek deposits from the public—probably twenty or thirty out of the total of 1,300 hire purchase firms counted by the Board of Trade.

All hire purchase finance companies might be required to submit their figures to the Bank of England at regular intervals (say, two months), and renewal of their licences to seek deposits could be made dependent on the Bank being satisfied that they were proceeding with due prudence. In this way, control might be exercised more effectively and more flexibly than under rigid statutory rules.

Proposals for Unit Trusts

Rising share values in 1958 and 1959 aroused new interest in unit trusts, after nearly twenty years during which they were cramped by controls. In the middle of 1958, the unit trusts were administering funds worth about £60 million. Today their portfolios are around £200 million. This reawakening of interest has prompted the view that the code governing the conduct of unit trusts needs re-consideration. The Board of Trade is now re-drafting its regulations in consultation with members of the movement. An Association of Unit Trust Managers has been formed, to which all the management groups except the Municipal and General belong, and this body is now framing its rules.

Unit trusts are governed by the Prevention of Fraud (Investments) Act, 1939, as re-enacted but not substantially revised in 1958. This act empowers the Board of Trade to make regulations on management charges, on the calculation of bid and offer prices and of yields, on trustees, on advertising and on the disclosure of management accounts. Major fraud on the part of a unit trust is impossible, because no unit can be issued unless the trustees hold cash or securities to back it. The worst that can befall the unit holder is (i) some prejudice (though limited) in the price he may pay or receive for a unit; (ii) some prejudice from any inadequacies or faults in unit trust administration, which an association should help to correct and (iii) any consequences of mismanagement of the investments, which will be reflected directly in the price of the unit.

It seems invidious that unit trusts should be governed by an act with the title "Prevention of Fraud (Investments) Act". This was designed primarily to hamper share pushers. Unit trusts are not share pushers (though they sell securities) and their inclusion in the act was something of an after-thought. Nor are they companies

(though the management groups are) and they would not obviously fall within the compass of the Companies Acts. It seems desirable to have a separate act governing their general affairs and giving the Board of Trade power to make regulations controlling them to correct any failure of good practice and competition to secure the public good.

It has been suggested that such an act should contain a specimen trust deed, just as the Companies Act contains specimen Articles of Association. This has much to commend it. But what should the trust deed say? The question gives fresh currency to an interminable debate: once it was conducted in terms of "cash" versus "appropriation" funds; now it is more generally expressed in terms of "agents" versus "principals".

There are two schools of thought here. One argues that in the creation of new units the managers should always be in the position of agents and should never deal in or hold securities or units for their own account. If managers buy securities and appropriate them to the fund in advance of the public issue of new units then, according to this view, they act as principals. So again if they appropriate their own cash to the fund and hold the units created pending their sale to investors. In the first case, the managers stand to make a dealing profit or loss on the securities and in the second on the units. In whose interests, the purists then ask, are the managers acting—in their own or those of new and existing unit holders?

Again, the Board of Trade regulations require managers to buy units offered to them. But since the sale of securities to match the cancellation of units can be awkward and costly, management groups commonly act as principals in maintaining a revolving fund of uncanceled units held on their own account. This is a service that is generally conceded to be desirable; but in providing it the managers are inescapably acting as jobbers. Nor is it clear that a stock market quotation for units would avoid this dilemma, for one remove behind the jobbers the managers must stand ready to buy back units. It has been suggested that any profit (and presumably any loss?) from the operation of a revolving fund ought to be passed on to the trust fund. This seems like using a pile driver to crack a not very formidable nut.

In theory, where the managers act as principals they stand to make a profit—though it does not follow that this profit must be at the expense of unit holders. Where the market in some of the underlying securities is restricted, managers are likely to appreciate reasonable freedom in choosing the moment to invest, and not necessarily to the disadvantage of the investor in units. Whether the market is narrow or wide, their profit from assuming any position as principals is not likely to be a large one, for managers with limited resources are not likely to run undue risks in the value of securities or units. In any case, the old type of "appropriation" fund is on the way out and a rule that securities should be appropriated to the fund at cost or current market value, whichever is the lower, would be generally acceptable. This self-denying ordinance, which prevents the managers from making a dealing profit on securities but still exposes them to a dealing loss, has already been adopted by some trusts. There is also general agreement that the managers should not be allowed to re-purchase units below the price calculated by the Board of Trade (that is, below their net realisable value). The unit holder is entitled to demand this price and when he does so the managers must give it to him; but present regulations do not compel the managers to offer this price to him. If these matters were attended to, what else needs to be done? Preventing the managers from jobbing in their units would impair a practical convenience; add to costs; and come close to penalising unit trusts for the successes they have scored in the past. There seems to be no reason why the managers should be prevented from running some risks in jobbing if they chose.

* If managers are to act as principals, however, unit holders should have a right to know what profit they have made. Management accounts at present are practically unintelligible. A simplified account is needed, distinguishing between the running fees of the management and their additional profits from jobbing in units. A specimen management account would seem as much to the point as a specimen trust deed.

Another suggestion is that the trust form used by mutual funds in this country should be replaced by the company form used widely in the United States. This argument has been advanced not because it is thought that the trust form has failed (which clearly it has not) but because the company form would enshrine the "agency" principle. But the company and "agency" form in the United States has not prevented managers earning extra fees as investment consultants to the fund which they themselves manage. Trustees acting for unit trusts in this country have held the balance fairly between unit holders and managers and they should not be lightly discarded. But it is worth considering whether the regulations should be revised, so that trustees could become more than depository custodians and take a more active supervisory part. All the trustees have been of the highest calibre. But this fact owes nothing to the regulation that a trustee must be a corporation with an issued capital of £500,000 (of which £250,000 is paid up). It might be better to recognise in law what is already an established fact, and confine trusteeship to banks and insurance companies above a certain size.

Those who dislike managers acting as principals also frown upon block offers. These offers, akin to a prospectus issue of shares, put on sale an apparently fixed number of units at what purports to be a fixed price. In fact, units are always on tap at prices governed by the value of the underlying securities. The block offer made on terms that ensure a roaring success can create serious investment problems. It puts the managers at risk. If they act as principals, they stand to lose if the market falls. If they act as agents they may have to abandon or curtail the offer, at the stated price, if the market rises, and then they will lose the advantage of heavy advertising expenses. But block offers have one overriding practical advantage: they bring in applications on a scale that the same sum of money spent on day-to-day advertising does not. Without them it is difficult to see how a new unit trust appealing to the general body of investors could be launched successfully.

Are present management charges high enough? Normally the maximum charge is 13½ per cent. over twenty years, of which the initial charge is usually restricted to 5 per cent. Costs have risen since these scales were introduced and thrift plans for regular investment add to these costs. Given competition between management groups and freedom of entry by newcomers, charges would not be likely to rise excessively even if there were no formal limit to them. The remuneration of unit trust managers has to be judged in terms of their skill and of the capital they employ (which is not very much) and not in terms of the funds they manage (which can be very large). But the best way might be to continue to insist on some limit to charges, provided that the initial charge is not fixed so low as to frustrate the creation of new trusts.

Higher charges presume some continuing control over advertisements. But given certain minimum regulations, these matters could with reasonable safety be left to the good sense of the managers and trustees. One source of new unit trust business is the agent, usually a broker or a bank, who gets a commission. The unit holder in fact pays the commission, wrapped up in the price of the unit. Some would ban commissions to agents on the ground that the potential buyer does not get unprejudiced advice. This seems extreme—it would certainly hamper the growth of unit trust investment (and in particular the development of "over the counter" sales in banks). It does seem desirable, however, to distinguish the commission paid to the agent from the net price, so that the investor can see what the agent makes.

Legislation for unit trusts should seek a balance between adequate safeguards for the public and regulations which pinion the movement in too strait a jacket. It should recognise that the managers are in business; but it should not be based on the assumption that they are under irresistible temptation to do the unit holders down.

APPENDIX XII

Memorandum by E. V. Morgan, Professor of Economics,
University of Nottingham4. *Donations by Companies for Charitable and Political Purposes*

It seems necessary to distinguish between charitable and political donations. In the case of the former, the grounds for possible objection are that the donations rarely if ever serve the direct interest of the companies concerned, and that there may be a conflict of interest between directors (who often gain considerable kudos from such donations) and shareholders, who gain nothing.

Though there is undoubted force in these arguments, there are also important considerations on the other side. First, the firms concerned or their employees may gain considerable indirect benefit, e.g. from the development of educational, recreational and cultural facilities in their localities. Contributions to charities of this type can be viewed as no more than an extension of the cultural and recreational facilities which many firms provide for their employees, and from which, again, they can hope to gain only an indirect benefit. With the decline of private patronage, contributions from companies are very important for many charities, including universities. It may be argued that activities that are generally regarded as desirable, but which cannot be financed by the actions of individuals, ought to be undertaken by the state rather than by contributions from companies. The state does, of course, play a large and often dominant rôle in many of the activities concerned, but there are great advantages in keeping some part of them outside official hands. Among them are room for experiments, the possibility of diversities to meet special local needs, and the fostering of interest by industrialists in the social life of their localities.

The case against political donations is different. They serve, or are believed to serve, the interests of the companies making them, and the objections to them are that some shareholders may hold different political opinions from their directors, and that (when directors are heavily concentrated in one political party) that party may gain an undue advantage. To the first argument, it may be replied that the company, as an institution, has an interest that is distinct from that of individual shareholders, and that it is reasonable that directors should be free to further the interest of the company, as they see it, even though some shareholders may hold different views. To the second point there is the answer that the trade union movement makes large contributions to the funds of one party and that, if companies were not allowed to make donations, the interests of companies and their shareholders would be placed at a grave political disadvantage.

On balance, it seems definitely undesirable to restrict the right of companies to make charitable donations, and their freedom to make political donations should also continue at least so long as the law with regard to the "political levy" by trade unions remains as it is. It might, however, be desirable that lists of both kinds of donations should be included in the annual report to shareholders.

11. *Disclosure of Ownership and Control*

The practice of concealing ownership by the use of nominees is contrary to the spirit (though not, of course, the letter) of company legislation, and it is difficult to find any real justification for it. The shareholder in a company has a right to know who are his fellow shareholders and how large are their holdings, and it is generally regarded as desirable that this information should be accessible to others as well; this is, presumably, the reason why the law provides that copies of registers of shareholders should be open to inspection by the public. It may be argued that in many cases, the use of nominees does little harm, particularly if the holdings are small, but

it is equally true that, in such cases, it does little good. There is always, however, the possibility of serious abuse; nominee holdings can be used as a screen behind which to build up a controlling interest—or at least a holding large enough to form the foundation for a bid for control—without the knowledge of other shareholders.

A point of secondary importance is that the use of nominees prevents shareholders' registers being used as a source of information about matters of property ownership (such as the extent to which the holding of shares is spread through the community) which are important from the point of view of economic and social policy.

Though it is easy to see how private individuals may benefit from the use of nominees, the system does not make any contribution to the public interest to balance the disadvantages mentioned above. It therefore seems desirable that the law should be changed so as to require registers to disclose the ownership of all shares.

21a. *Accounts. Revaluation of Fixed Assets*

The object of attaching a value to fixed assets in a balance-sheet is to enable those who are directing or investing in a firm to compare the return on their capital with that which is obtainable elsewhere. There are three possible criteria on which such a valuation could be based:—

- Historical cost less depreciation,
- Replacement cost, and
- Capitalised prospective earnings.

The third is, theoretically, the best measure of present value but, unfortunately, it is the most difficult to apply in practice. A capital asset is desired for the income it produces and, however much it may have cost originally or however much it would cost to replace, it has no present value except insofar as it is likely to go on producing income in the future. Thus, the prospective purchaser of any existing capital asset must have regard to the best estimate he can form of its prospective earnings, and also to the relevant rate of discount at which to capitalise them. This principle is, of course, used in the valuation of certain types of businesses and professional practices, where a conventional (and usually rather arbitrary) number of years' purchase is applied to the earnings of a past period. The difficulties about applying the principle to industrial and commercial capital generally are, first, the problem of choosing a relevant rate of discount and, secondly, the fact that past earnings often form only a very imperfect guide to future prospects. These difficulties are least where earnings are fairly stable and where there are regular dealings, so that the relevant rate of discount can be assessed by the consensus of opinion in a market. Clearly, however, there is a wide range of industrial assets for which neither of these conditions obtain, assets which are highly specific, which seldom change hands and whose earnings are liable to considerable fluctuation. In such conditions, this criterion cannot be applied satisfactorily.

The criterion of replacement cost sets a limit (apart from short-run scarcities) to the price of existing assets. It is also very important as a general guide to the adequacy or otherwise of depreciation allowances at times of rapidly changing prices. Again, however, it is not very useful in making an exact estimate of present values. The ordinary course of technical change ensures that very few assets are replaced, when they are replaced, by one identical with the original. In some cases, of course, the change is so great that new capital is of an entirely different kind from that which it replaces, and in others an asset that has failed to justify its existence during its lifetime may not be replaced at all. The cost of replacing something that no-one wants to replace is a very academic notion.

The criterion of historical cost less depreciation has the big advantage (which accounts for its being so generally used) of starting from the only "hard fact" in the situation—the price actually paid for an asset by its purchaser. It may, however, fail to give a true indication of present value (in the sense of what a new purchaser would find it worthwhile to pay) for several reasons. Depreciation allowances may

have been incorrectly calculated. Changes in technology, in the demand for the goods or service produced, or in the supply of co-operant factors may have affected earning capacity; and present value may have been influenced by a change in replacement cost due to a change in the value of money.

Though the three criteria of value are very different, they are not unrelated. Their relationship can be seen most clearly if we assume a "model" economy in which technological change was affecting the form of capital only slowly, in which prices were constant, and in which there was sufficient competition to justify the use of the concept of a "normal" return to capital. It would then be unnecessary to distinguish between historical cost and replacement cost. Any type of capital could earn more or less than the "normal" rate of return for a time, but when any type was earning more than the "normal" rate there would be a tendency for new capital of this type to be created, and so for average earnings for the type to be reduced. Similarly, if any type of asset failed to earn the "normal" rate, units would not be replaced as they wore out, the total supply would be reduced, and the earnings of surviving units would be raised. There would thus be a tendency for earnings to approximate to normal and, hence, a tendency for value based on capitalised earnings to approximate to value based on cost. At a time of changing prices this argument would apply not to historical cost, but to replacement cost.

The only rational object in putting a value figure for fixed assets in a balance-sheet is to give an index of performance for the guidance of the firm itself and of the public who may be investing in it. Such an index would be given by comparing the earnings (as a percentage of capital) of the firm in question with others. The comparison, however, is only valid if capital is valued on a uniform basis, and the relevant one is clearly the price which a new purchaser would find it worthwhile to pay, i.e. capitalised earning capacity. For reasons discussed above, the normal method of valuation based on historical cost less depreciation may differ from this for a number of reasons, and the differences will vary in an arbitrary manner. Any practicable measure to reduce these discrepancies would, therefore, serve a useful purpose.

In practice it is probably necessary to distinguish between land and buildings on the one hand, and plant and machinery on the other. For plant and machinery, the difficulties of using any method of valuation other than historical cost less depreciation appear almost insuperable. Moreover, the fact that many items of plant and machinery have a comparatively short life, limits the divergence between values based on historical cost and those based on other criteria. Except at times of very rapidly changing prices, historical cost gives as good an indication of value as could be obtained by using any other criterion and there is, therefore, nothing to be gained by re-valuation.

The situation with regard to land and buildings is very different. Their lives are much longer so that their value is more liable to be affected by changes in general prices. In a developing community, there is also a tendency for property values to appreciate relatively to general prices. This does not mean, of course, that values may not fall temporarily during a slump, or that the value of particular pieces of property may not decline owing to changes in circumstances peculiar to themselves. The upward trend of property values in general is, however, a matter of undoubted historical fact. As a result of this upward trend and of the more general fall in the value of money, land and buildings often stand in balance-sheets at a small fraction of the price for which they could be sold.

This misrepresentation has several disadvantages. It is misleading to shareholders and prevents them from making a true comparison between firms. Where property is under-valued in balance-sheets, this is usually reflected in the price of the shares, and there is thus a temptation to other firms to make a take-over bid, even though there is little economic justification for it. Finally, when a revaluation is made, there is usually a sharp and arbitrary jump in share prices.

The difficulties which beset re-valuation of plant and machinery do not apply with nearly the same force to land and buildings. They are less specific, dealings in them

are frequent, and valuations are regularly made (for a variety of purposes) on the basis of the price that could be expected to be reached in the market between a willing buyer and a willing seller. The estimates of two qualified valuers may sometimes differ quite widely, but there is no doubt that this method gives a far more accurate indication of value than the history (often ancient) that is generally used in balance-sheets. It would, therefore, seem desirable that the law should require regular re-valuations, perhaps at five-yearly intervals, of land and buildings.

29. *Any other matters*

The existence of a healthy capital market requires that investors should have the fullest possible information about companies in which they hold, or may acquire, shares. There has been considerable progress in the techniques of investment analysis during recent years, and increasing attention is being paid to it by institutional investors, stockbrokers and the financial press. Progress is still hampered, however, by lack of information on several important points. For obvious reasons, no single indicator gives a complete picture of a company's performance, and it is desirable to use a considerable number. One very relevant one is earnings as a proportion of capital, and the suggested change in the valuation of land and buildings would make this much more satisfactory.

Two other important indicators are the growth of sales and the behaviour of profit margins, and both of these require turnover figures, which are at present given only by a small (though growing) number of firms. It is very desirable that all public companies should provide these figures. Ideally they should show sales by the parent company to subsidiaries and to outsiders and consolidated sales by the group to outsiders, though the last figure is the most important. In the case of multi-product firms, the figures should show sales of each product separately. The publication of such figures would not only make possible the analysis of profit margins, but would also give an indication of the rate at which a firm was growing, and its vulnerability to various kinds of economic fluctuation.

Since the various components of cost often behave very differently, a breakdown of costs would also be very helpful in assessing the position and prospects of a firm. A simple breakdown, which would nevertheless be very useful would be:—

Purchases of fuel and power.

Purchases of other raw materials: from subsidiaries and from other sources.

Wages.

Salaries.

Again, this sort of information is already provided by a number of companies.

Other very widely used indicators are dividend yields and earnings yields, calculated on the current market price of the shares. At present, these are very out-of-date, as they have to be based on the last published figures and, for most companies, earnings figures are available only once a year. It would probably not be desirable to change the present practice with regard to dividends, but there is no reason why profit and loss accounts, together with the figures of sales and costs mentioned above, should not be provided at more frequent intervals. A few companies already provide quarterly figures of sales and earnings, and this practice should be made general. Such figures would be particularly valuable in comparing companies in the same type of business, but whose financial years end at different dates.

Finally, there is need for more information about certain financial items in balance-sheets. The items, "cash" and "investments" are too general, and apparently cover up a number of differences in practice between different companies. A minimum desirable breakdown would be:—

Cash in hand and at bank.

Deposits and short-loans with other financial institutions.

Treasury bills.

Tax reserve certificates.
Quoted British government and guaranteed securities.
Securities and mortgages of local authorities.
Securities of other British companies.
Other British securities.
Overseas securities.

Figures should be given for market value as well as book value. This information would not only be useful to the investor, but would also promote a better understanding of the working of the monetary system.

It should be emphasised that this information is not asked for in order to gratify the curiosity of the economist, but in order to safeguard the legitimate interests of the investor, and to promote the efficient working of the capital market. The investor should obviously be in a position to estimate, as accurately as possible, the value of the share that he is buying, and the information mentioned above is required primarily for that purpose. Furthermore, the capital market can only fulfil its general function of helping to direct the capital of the country into the most productive uses, if share prices give an accurate reflection of the position and prospects of the firms concerned. At present, there are far too many arbitrary fluctuations in prices due to ignorance, and these both distort the working of the market and cause injustice to individual investors; it is only through the publication of more information and its more scientific study that this type of harmful fluctuation can be removed.

APPENDIX XIII

Memorandum by Trade Indemnity Company Limited

The Trade Indemnity Company Limited annually underwrites the credit risk on about £980 million of goods sold in Great Britain. In 1958 it thereby became involved in the failure of about 530 companies in Great Britain, and in 1959 in the failure of about 410 companies.

As a result of its experience in dealing with companies from the point of view of creditors and suppliers, the Trade Indemnity Company Limited wishes to submit the evidence on the following points to the Committee.

3. Classification of Companies

(b) Nature and merits of distinction between exempt and non-exempt private companies

One of the striking features of the British economy since the war has been the increase in the number of private companies, and the increasing percentage of those companies, which are exempt private companies. For the last few years the percentage has remained more or less constant around 80 per cent.

In 1950 there were 235,307 private companies, representing £2,198 million of issued capital, of which 140,658 (or 59.7 per cent.) were exempt private companies.

In 1954 there were 269,355 private companies, representing £2,433 million of issued capital, of which 213,714 (or 79.7 per cent.) were exempt private companies.

In 1958 there were 318,800 private companies, representing £2,623 million of issued capital of which 249,684 (or about 78 per cent.) were exempt private companies. In the same year there were 10,933 public companies representing £4,608 million of issued capital.

There are now, therefore, a very large number of companies indeed, representing a substantial proportion of the issued capital of all companies, which do not have to file accounts. Moreover Trade Indemnity Company Limited firmly holds, that, provided annual accounts are filed within a reasonable time after the end of the financial year, these accounts are of very real value in assessing the credit worthiness of the company in question. On the same count it is often very difficult to assess accurately how much credit should be allowed to a company, which does not have to file accounts.

It is no doubt true to say, that by and large the standard of ethics of trading in this country is relatively very high, and the vast proportion of companies would not buy on credit, if they were not fully capable of paying. On the other hand, it is contended that, especially in certain trades the privilege, that an exempt private company has at present, in not having to file accounts is being sufficiently abused, for the present law in this respect to be reconsidered.

Abuses normally occur in trades where there is normally a buyers market, where little capital is required to set up in business and where there are speculative elements in the trading, such as marked fluctuations in demand. It is not uncommon to find cases of companies, with an issued capital of £2, having a deficiency of over £20,000, and paying a small dividend in the £. The methods of trading in such companies naturally often give rise to many queries as to the responsibility of the manner of trading. Often their accounts have not been audited for two or three years prior to failure, and may not even have been made up for such a period.

It is not possible to deal statistically with the cases in which we consider the privilege of not having to file accounts is being abused, but there are many instances in our files, which in our view bears out this contention.

The obvious remedy of such abuses might seem to be to increase the efficiency of the legal deterrent against such irresponsible or even dishonest trading. It is, however, very difficult to draw the line between legitimate speculative trading and reckless or fraudulent practices, and the small number of convictions obtained annually by the Board of Trade for material breaches of the Companies Acts is illuminating in this respect. Although it might be possible to strengthen the penal clauses in some respects, such as barring any director of a company, which became insolvent, from being a director of a company for, say, three years, it is considered it would not be possible to increase the legal deterrent against irresponsible or dishonest practices effectively, without offending the spirit of enterprise in trading, which demands an element of speculation.

It is suggested a more practicable remedy would be to allow any prospective seller to be able to assess the credit worthiness of a company as accurately as possible, by withdrawing the privilege of any private company of not having to file accounts annually with the Board of Trade. It is believed this would have the immediate effect of reducing the number of cases of unsatisfactory trading, and would, of course, place more feeling of responsibility on the seller, if the buying company was unable to pay.

When the Cohen Committee discussed this particular problem, it re-affirmed the principle that the fullest information practicable about the affairs of companies should be available to the shareholders and the public, but at the same time the Committee considered that the fact that many small private companies have to compete with partnerships and individuals was sufficient ground to allow the exemption of private companies from the obligation to file accounts to continue, subject to certain conditions being fulfilled. To discriminate between the small family business type of private company, and the other types of private companies was deemed impracticable.

Although in 1945 it was no doubt correct to make this exemption to the principle that the fullest information should be made available to shareholders and the public, but it is contended that it is no longer so.

It is averred that the advantages that would accrue to partnerships and individuals, from small private companies having to file their accounts would not be particularly great, but even if they were of moment, partnerships and individuals would still not be in such a generally advantageous position as private companies.

In the case of a partnership, or an individual, where a prospective seller can obtain an appropriate assessment of the buyers credit worthiness, by making the necessary enquiries, there is a real deterrent against irresponsible trading. Should a partnership or an individual default, bankruptcy with all its penalties can ensue. Being made a bankrupt, quite apart from its material consequences, and the disqualifications from holding public office or being a company director, involves a stigma, which can be the most effective deterrent of all, against irresponsible trading. In fact it has been reported that the views of the Committee reviewing the legal penalties of bankruptcy, are that they are in some instances too severe.

The position of an exempt private company, however, is quite different; the prospective seller can very easily be the victim of irresponsible or dishonest buyers, through lack of knowledge, and the penalties attaching to directors of exempt private companies, only exist if fraud can be proved, which is very seldom. There is no penalty, but little stigma, for reckless or irresponsible trading.

It is not uncommon for new companies to start up just before insolvency to carry on where the insolvent company left off, dealing with those of its suppliers who had not suffered losses. Small exempt private companies can start and fail, with many creditors suffering losses, and the directors responsible for the company, losing only £2 issued capital. Although this state of affairs no doubt existed when the Cohen Committee considered the matter, the impression has been gaining in recent years, that if some companies handled their affairs as well throughout their history as they do when they are failing, there would be considerably fewer failures.

Although about 1,200-1,300 exempt private companies are wound up every year as a result of insolvency this figure does not give the whole picture, as a very considerable number of such companies make a composition offer to their creditors each year. As there is a ready market for a company's tax losses, which are, of course, not so practicable to use in the case of an individual, an offer can normally be made substantially greater than any anticipated dividend. The incentive for creditors to press for liquidation in order that the debtor companies' can be properly investigated has been progressively weakened over the years owing to the absence of results in law from such investigations, through no fault of the liquidator, and the greater amount received by way of offers. So reckless and irresponsible directors can feel there is a good chance of not even having to go into liquidation on their company failing.

In a nutshell it is not considered that an unfair advantage would be given to a partnership or an individual, if all private companies had to file their accounts, when the law as it stands gives the exempt private company a much more privileged position as compared with a partnership or an individual.

Bearing in mind the great advantages that would accrue to creditors if they could peruse the annual accounts of all private companies, it is suggested that the principle that the fullest information practicable about the affairs of companies should be available to the shareholders and the public, should be affirmed in law without exemption.

21. Accounts

In general the requirements of the Companies Act, 1948, do not involve the production of accounts designed to give all the information which a creditor wishes to have in making an intelligent assessment of the credit worthiness of a debtor company.

The conventions which regulate the drawing-up of company accounts in this country, are based on the idea that directors should give an account of their stewardship to existing shareholders. The emphasis, is not, on giving the public full and fair information on which to assess the stability, prospects and management of the company in question. It is considered that the requirements of the Securities and Exchange Commission in U.S.A. would result in the necessary information being given to suppliers, since the requirements of would-be suppliers are similar to those of intending or existing shareholders, in whose interests the Securities and Exchange Commission act.

In general at present the greatest difficulty facing a supplier in assessing the credit worthiness of a company is the lack of disclosure of sales and purchases. Without these figures a rational assessment is not easy. It is understood that it is usual for public companies in the U.S.A. to show their sales figures.

Regarding the specific points mentioned in the annex to the Committee's letter, there are no matters under (a), (b), (c), (d) and (f) which merit discussion particularly from the point of view of suppliers.

With regard to the definition of profits, however, one very important point affects suppliers. The net profits disclosed by many companies depend to a large extent on two items which are the subject of estimates, and these estimates may in each particular case be based on several different principles. The two items in question are stock and work-in-progress, valuation, and depreciation, and unless the basis is given as to how these estimates are made, the disclosed net profit figure is not so indicative as it might otherwise be. It is common practice for public companies in the U.S.A. for a full disclosure to be made of the methods used for stock valuation and the calculation of depreciation, and it would be most helpful in assessing the credit worthiness of companies in this country, if a similar practice was followed here.

23. Provisions as to Returns

Section 131(2) of the Companies Act, 1948, lays down that if default is made in holding an annual general meeting of the company, the Board of Trade may, on the

application of any member of the company call or direct the calling of a general meeting of the company.

A result of this provision is that, should a non-exempt private company not hold an annual general meeting, and should no member apply for a meeting to be held, a creditor cannot obtain up-to-date particulars of the financial position of the company.

It is suggested that the Board of Trade be empowered to instruct a non-exempt private company to hold an annual general meeting, should it not do so, in the interests of would-be suppliers. It is contended that in every case the corollary of limited liability should be full disclosure.

27. Winding-up

Members' Voluntary Liquidation

The effect of Section 283 of the Companies Act, 1948, is that when a company goes into members' voluntary liquidation, the liquidator has twelve months in which to pay the creditors.

Large sums of money can be at stake, and creditors seriously inconvenienced by having to wait so long for payment, through no fault of their own, but merely because the shareholders have decided to wind-up the company.

As a declaration of solvency has been lodged, if the creditors cannot be paid out immediately on liquidation, owing to the company's assets not being sufficiently liquid, what is to prevent the liquidator raising the necessary funds from a bank on security, in order that creditors' position may not be prejudiced? Under the law at present there is no incentive for a liquidator to pursue this course of action.

It is suggested that in a members' voluntary liquidation all creditors should be paid within a period, at the most, of six months.

29. Other Matters within the Terms of Reference

Judicial Management

When a company finds it is in financial difficulties, it is common for it to call its creditors together informally, to apprise them of the position. It may well be that at that stage it is impracticable for creditors to decide on the best course of action, because the company's overall financial position may not be clear, or because it is not known whether a purchaser can be found for the company. A moratorium may be granted, or the company may continue to trade under the guidance of a committee of creditors.

These informal arrangements can give rise to difficulties, as to the incurring of fresh liabilities, and their relation to existing ones, and there is an argument for considering whether there should not be a legal procedure, whereby in such cases the Court could appoint a Judicial Manager, with properly defined rights and duties, to ascertain the true financial position of the company, and to advise the creditors on the best course of action to take.

This procedure is followed in the Union of South Africa, Kenya, Tanganyika and Rhodesia.

(Signed) R. C. STEVEN.

Writer to the Signet

for TRADE INDEMNITY COMPANY LIMITED.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
FIFTH DAY

Friday, 28th October, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT (*Questions 1338 to 1502
only*)

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. REGISTRAR BERKELEY *called and examined*

1338. *Chairman:* Mr. Registrar Berkeley, you hold the appointment of Registrar in the Companies Court, and you have been good enough to come here to help us besides providing a very interesting memorandum. I understand you have held your present appointment since 1957, and before that you were for many years in practice in the Chancery Division and a substantial part of your practice was concerned with company matters.—That is so, the period was 30 years in fact.

1339. And during those 30 years you drafted all manner of documents, conducted company cases in Court and advised on company matters?—That is so.

1340. And now you are looking at matters from a different point of view, and I understand that your present duties include dealing with all company matters which are going to the Court, various matters which you decide yourself and others which are adjourned to the Court after you have given the appropriate directions to ensure that the application is in order?—Yes.

1341. I would like to ask a very general question. Do you think the present

division of responsibility between the Registrar and the Court or the Judge is satisfactory or not? Would you take the view that more matters ought to be decided in your department, or that there are some which ought to go to the Court which are now dealt with by you?—No, I think the present division works very well. There are certain matters which have to go to the Judge, and I think it is right that they should all go to the Judge—petitions to wind up, petitions for reduction of capital, petitions to sanction schemes of arrangement, and other petitions and motions. As regards all other matters, in practice what happens is this. They are dealt with by me unless cross-examination of witnesses, or some difficult point of law, or a point of construction is involved. The majority of applications are therefore dealt with by me, and it is only the more difficult matters that go to the Judge.

1342. Do the parties have a right to require an adjournment to the Judge?—I have never been quite sure whether that is so, but if both parties want the application to go to the Judge in any event, I am inclined to adjourn it to the Judge. What

ordinarily happens is that I give my decision and then one of the parties can go to the Judge on appeal.

1343. It seems that for present purposes you have a very comprehensive knowledge of the subjects which the Committee is considering. You deal towards the end of your memorandum with various relatively minor matters concerning winding-up. I do not propose to ask you questions, or at all events not many questions, on that aspect of your memorandum because these matters are matters of comparative detail and probably best left to be dealt with on the next revision of the winding-up rules.—Since I have sat in my present seat as Registrar I have noticed anomalies in the rules that I had not noticed at the bar, chiefly in matters which do not come before counsel, and every time I have seen something that seemed to me rather odd I have made a note of it. I have now taken this opportunity of raising all those matters.

1344. It is a valuable collection of discrepancies and so forth.—As you will have seen from some of them, orders are made in practice which technically it may be the Court has not power to make; but they simply must be made as a matter of common sense.

1345. Justice tempered by common sense?—Yes.

1346. Passing to the more general matters with which you have been good enough to deal, you say that there is much to be said for the view that a company should have all the powers of a natural person *vis-à-vis* third parties.—That is my view. That would really mean putting a company *vis-à-vis* third parties on the same footing as a company formed by royal charter.

1347. Of course if the company were to be endowed with such absolute powers that would accentuate the need for a proper degree of control by the shareholders, would it not?—I think that is probably a fair statement, but in any event the directors' powers are sometimes limited by the articles, and I would have thought that that was the proper place to limit them. I doubt very much whether in practice the control over the directors effected by an objects clause under the

ultra vires rule would be stricter than control effected by articles. I suppose there is this difference, that under the present rule you can attack the unfortunate people who have dealt with the company without having ascertained what the true position is and recover something from them; whereas under my suggestion the company would only have a right of action against the directors for misfeasance, which may not be worth a great deal.

1348. This proposal was in fact mooted in the Cohen Report; I do not know if you recollect the passage?—No, I have not looked at it recently.

1349. Some critical observations were made about the very wide terms in which objects clauses are couched, and that Committee came to the conclusion that the resulting position as regards *ultra vires* was really not very sensible and operated very unfairly on the third party whom it may have been designed at one time to protect.—That was the way it struck me.

1350. But then the practical difficulties seem to me to be not negligible. One floats a company that can do everything that a natural person can do; that company goes out and deals with the public. Surely there must be recorded somewhere some information as to the kind of business the company proposes to carry on. As a natural person it could do anything.—I was contemplating that the objects of the company would be set out, but as regards third parties dealing with the company, the third party would not be concerned to see whether on the true construction of the objects clause the company had power to do this or that. The shareholders could attack the directors, or a liquidator of the company in liquidation could attack the directors, if the latter went outside the objects described in the memorandum of association.

1351. But, in order to protect the third party effectively, one would have to provide, would one not, that he was not to be affected in any circumstances whatsoever with notice of any arrangements made internally by the company as to the extent of the powers exercisable by the directors?—Yes, I can see the dangers of it.

1352. Might that not lead to difficulty? Supposing the third party knew perfectly well that some limitation had been put on the powers of the company, as a matter of internal management as between the shareholders and the directors, would it be right that the third party should be able to go on dealing with the directors, get some of the company's property and have a good title to it?—It may be that I was too sweeping in my suggestion, and that the rule ought to be altered so that third parties with actual notice, not constructive notice, of something which was *ultra vires* would be affected by it.

1353. One might leave the existing memorandum with all its faults and enact that notwithstanding anything contained in or omitted from the memorandum of association any person dealing with the company for value in good faith should have a good contract.—Yes, that would be effective, but of course, as you have really got at the back of your mind, that would simply mean everybody would be very careful not to look to see what the objects or regulations of the company were. I do see difficulties there certainly.

1354. I do not know that one can carry this much further, but it is clear from the discussions that we have had so far that there is a considerable demand for something of this sort which would get rid of the trap provided by the doctrine of *ultra vires*.—There have not been, have there, great difficulties in connection with companies incorporated by royal charter on this point? They have existed for years and years and the *ultra vires* rule never applied to them.

1355. But if they did anything too outrageous they could have their charter revoked.—Yes.

1356. I do not know if anyone would like to import that possibility into the law of limited liability companies of the statutory kind. But your view is in the direction of giving the company all the powers of a natural person, although you agree that the way of working that out may need further consideration. Would that fairly state your view on that?—Yes, it would.

1357. The next point in order concerns shares of no par value, and you point out

in your memorandum the necessity for a safeguard to avoid a reduction of capital to which the present restrictions on the reduction of capital would not apply. As you know, this was made the subject of a very thorough consideration by the Gedge Committee on shares of no par value, and they dealt with this point in paragraphs 46 and 47 of their Report.—They take a stated capital account, which would be the equivalent of the issued capital account and the share premium account; I think that, as you say, it is implied in paragraph 47 of the Gedge Report that you would have to go to the Court to reduce the stated capital account in the same way that you do now to reduce the capital.

1358. And in the concluding lines of paragraph 47 they say:—
“and that the stated capital should in this and in all other respects be treated as identical with the paid up share capital of a company having shares of a nominal value.”.

—I think that would cover the point which I raise, except that I think I was also concerned with something more—the doubt which there has always been among certain practitioners as to whether you can make a distribution by way of a capital distribution of anything other than a realised capital profit. Some people take the view that you can revalue the assets of the company and distribute the difference as a capital profit. Other practitioners think that you should never make a distribution otherwise than by a bonus issue in a case like that and that you should only distribute in the form of cash something which is a realised capital profit from the sale of a particular asset. I was rather seeking indirectly to introduce that into my proposal by saying that there should be a prohibition of the distribution by the company of anything by way of capital without the leave of the Court other than realised capital profit. Of course there may be difficulties in defining that.

1359. Would that apply to all cases? —Yes, it could prevent a distribution of capital in respect of shares of par value, and the directors would have to think very carefully before they got the company to pass a resolution for the distribution of a capital profit without going to the Court.

1360. But you think that a provision like paragraph 47 would meet the case?—I think that would certainly cover the case of repayment of the capital which was paid in respect of shares of no par value.

1361. I suppose one could regard each no par value share as having attached to it its due proportion of the stated capital, and that would stand in the place of the capital paid up in the case of an ordinary share of nominal value?—Yes, plus the share premium account where the shares are issued above par.

1362. As to the distribution in cash of an unrealised capital profit, the same objection does not apply if the distribution is made by a capitalisation issue?—No, because no money goes out of the company; the creditors are not affected.

1363. In my young days I used to see cases where distribution of an unrealised capital profit was made by debentures, which might be paid off the next day?—Of course one did not know what happened afterwards; but I agree that the present system is open to abuse. More generally distributions nowadays are by way of bonus shares, and that is unobjectionable.

1364. Under heading 5, which concerns the powers given to the directors and the degree of control retained by the shareholders, your view expressed in your memorandum is that the several matters mentioned under this head (in the annex to the letter originally circulated by the Committee) are matters on which the sanction of the shareholders should be obtained?—Yes, I think particularly (a), (b) and (c).

1365. (a) is fundamental changes in the company's activities; (b) is the disposal of undertaking and assets; and (c) is lending money otherwise than in the ordinary course of business. You do say there is something in the view that these three should be dealt with by a resolution requiring a three-quarters majority of votes, is that right?—Yes, and a bare majority as regards the other two, (c) and (d)—the issue of shares and borrowing money.

1366. What we have been asking over and over again, and what we have not yet

I think got an answer to, is this. The necessity for sanction would have to be limited, would it not, to what one might call major instances of the various operations, e.g. *fundamental* changes in the company's activities. But then what is *fundamental*?—The difficulty of definition always arises, does it not, in any statute? Whatever you say there are bound to be borderline cases. Prudent directors will take the precaution of protecting themselves and imprudent directors will take a chance. But I would not have thought the difficulty of definition would be a reason for not attempting to introduce legislation. I would have thought that on (a) one might say "make any fundamental alteration in the nature of the company's business", which is reasonably clear. If you are carrying on a particular type of business and then you carry on a totally different type of business you are making a fundamental alteration.

1367. One can say, if it is a change from confectionery to goldmining, that it is a fundamental change, but I suppose the nature of one set of objects may fade into the nature of another at some point?—It may, but then I suppose the Courts would say it was not a fundamental change in the nature. I would have thought, however wide your objects clause might be—and they are very wide now—if a company had been a trading company in Malaya and suddenly wanted to become an investment company, even if it had power on the true construction of its objects clause to do that, it ought to go to its shareholders before it did it.

1368. For the purposes of legislation you would use the word "fundamental", would you, and let the meaning ultimately be decided by the Court?—Sir, I have great faith in our Bench. I do not think it would be beyond their powers if you used as strong a word as "fundamental" to give a decision as to whether the change was a minor change or a fundamental change.

1369. Would there be any merit, do you think, in providing that the directors must consider the matter and must record a formal resolution as to their decision whether or not to have a meeting of the shareholders, and giving their reasons if they decide against a meeting?—I think

that is a very valuable suggestion, if I may respectfully say so, because that would ensure that they do consider the matter.

1370. It would ensure they apply their minds to it?—Yes, and they could not afterwards, if they turned out to be wrong, say—“We did not think there was any difficulty about it; we thought we had power to do it.”.

1371. If the proposed provision was effective to prevent the more outrageous cases, it would I suppose serve a useful purpose although some might get by?—I would have thought so. I think it is really only the fundamental changes that matter. That is an easier one to deal with than disposal of undertaking and assets. As regards the latter, I was thinking of a section something like this:—

“A company shall not without the sanction of an extraordinary resolution—

(a) make any fundamental alteration in the nature of the company's business;

(b) dispose of the whole of its undertaking;

(c) dispose of any part of its undertaking or assets otherwise than in the ordinary course of business.”.

Those words have been used for years and years in injunctions and undertakings; it might be difficult to interpret them but they have been used and presumably they have worked. Such a section would allow a disposition of assets in the ordinary course of business in any shape or form, and nobody objects to that. But it would rule out an extraordinary transaction, on which the shareholders ought to have an opportunity of expressing their views, although it would not prevent an extraordinary transaction being negotiated by the directors before the shareholders were consulted. All the negotiations could take place in secret as they would now but, in order to make any arrangement reached binding on the company, it would have to be sanctioned by the company by extraordinary resolution; and even if so sanctioned, it could be brought before the Court if any shareholder thought there was a valid objection to it.

1372. Then if the plan was adopted of giving the company all the powers of a

natural person, how would the matter then stand?—With respect, I do not see that that would have anything to do with it, because what one is considering is the decision of the company *vis-à-vis* the shareholders, not *vis-à-vis* the public.

1373. The assets would have been made over, I suppose?—No, there would be a conditional agreement pending sanction by extraordinary resolution. But you are asking what would be the position if the directors had disregarded the new section?

1374. I was imagining a case where the directors disposed of the whole undertaking and assets without reference to the shareholders. The third party would get a good title, would he?—I think not, if you make it a provision by statute that it has got to have the sanction of the company by extraordinary resolution: any more than an increase of capital without a resolution, or reduction of capital without the confirmation of the court, would be valid at the present time.

1375. I think that must be the answer to that. Then there is (c) the issue of shares.—I do not feel very strongly about (c), but there would be no difficulty in the drafting of it anyway. It would be —“The company shall not, without the sanction of an ordinary resolution, issue any shares”.

1376. Then would you measure the importance of the transaction by expressing the new shares as a percentage of the previously existing capital, or something of that sort?—I do not know that it would be necessary to try to do anything by reference to a proportion. Sometimes, although it is invalid, the majorities have been altered by the issue of shares by a board to its friends, and sometimes they have got away with it because I think the other shareholders were not aware that, on the case law, that could be stopped. I think it would be difficult to try to limit the issue of shares by reference to a proportion.

1377. Supposing you had a new director in and the articles said he should have one qualification share?—You say “other than qualification shares” then. You could either do that or you could leave it for the resolution to be framed when the shares are created. The company could then authorise the directors if

they thought fit to issue qualification shares. Otherwise they would have to call a meeting.

1378. We have had the suggestion made, and I think this really underlies much of the discussion on this point, that the shareholders ought to be protected from having their ordinary capital watered down, as it were, by the issue of a lot more shares to somebody outside the company. It has been suggested that to meet that the company or the directors ought to be put under a duty to offer any new shares *pro rata* in the form of a rights offer to existing shareholders.—That would not always necessarily be desirable, but *prima facie* it may be that that is the right course to adopt, and that is what one would normally advise directors to do if they wanted to issue shares simply to raise money. But there are cases in which it may be proper to issue otherwise than *pro rata* to existing shareholders, and if the directors had to go to the company in general meeting for this sanction then they could get it if it was a proper case for issue otherwise than *pro rata*.

1379. But if they had to go to the shareholders in respect of the issue of these shares then the whole matter would be before the meeting; they could say whether they were in favour of *pro rata* distribution or of some other distribution.—For example, there might be a case where a company took over another business and issued shares in satisfaction of the purchase price. In that sort of case it would be quite right that the shares should be issued in return for the business, but the members ought to have the opportunity of considering the matter.

1380. Yes, I think that really covers that point. Are there any other matters that have occurred to you?—There is borrowing money and charging property. That again is a difficult one because I feel it is essential that the directors should be able to borrow money sometimes at short notice, and they could not go to the company every time for permission. But if the words "other than in the ordinary course of business" were added that ought to cover the cases where they have to borrow money in a hurry, and would make it necessary for them to go to the company only in the extraordinary cases where

they were going to do something the members might object to.

1381. I think I am right in saying that the view provisionally held by members of the Committee is that so far as borrowing money is concerned the standard clause which I think is demanded by the Stock Exchange would probably give sufficient protection.—Yes, limiting it by reference to the paid-up capital. Lending money otherwise than in the ordinary course of business would, I think, be covered by my proposal about disposing of any part of a company's undertaking or assets otherwise than in the ordinary course of business. But if it were not so covered it might be desirable to bring some separate paragraph into the proposed new section about it.

1382. Then, turning to voteless ordinary shares, you say you cannot see any objection to these. No one is under any compulsion to acquire them, and you point out their advantages in certain circumstances. This is a point on which our witnesses have shown a fairly sharp division of opinion. Some think that voteless shares are so objectionable they ought to be abolished, even retrospectively.—I have read a great deal in the press about it, but I do not agree with those views myself; it is a matter of opinion. It depends on whether you think it is best to run everything by so many votes per head however ignorant the voters may be, or whether you think it is better to have the company run by someone you know is running it well. You do not have to buy the voteless shares.

1383. It has been pointed out to us by some of our witnesses that if they are so undesirable in the end there will be no market for them and such shares will die out.—The fact remains that the prices of such shares are very high on the Stock Exchange, if they are shares in good companies. I do not suppose anybody would be anxious to invest in a company where there were no voting rights unless it was a company which was being run very successfully. But perhaps my views on this should not be taken into account seeing that I am one of the people who has invested in "A" ordinary shares in companies that appear to be doing well. I am quite happy not to have votes and I should very much dislike the rights to be

altered because there would have to be some *quid pro quo* for the people that have the shares that carry votes, and that *quid pro quo* would come out of my money.

1384. Yes, I see your point there. A suggestion has been made to us that voteless shares might by statute be given a limited right of voting comparable to that quite usually attached to preference shares. That is to say, for example, if a dividend has been passed for a year or more, where a fundamental change is proposed, or where winding-up is proposed, and perhaps some other limited but important matters of that general kind; what would you say to that?—I think that is an admirable suggestion.

1385. You think that would be worth trying?—I should have thought so, yes. I cannot see that the controllers of those companies could have any proper objection to that.

1386. Then there is the difficult question of the minority and section 210. On that you express the view that this section was a dead letter until the cases of *Scottish Co-operative Wholesale Ltd. v. Meyer* and *Re H. R. Harmer Ltd.*—There was a general feeling that it was not going to be much use. One put in a claim under it and claimed winding-up in the alternative, but at first the Judges seemed rather reluctant to operate it. The Harmer case is a very extreme case indeed, and if you can do what was done in the Harmer case you could do almost anything under the section. I should have thought it was now clear that the section is meant to be operated widely (and it was quite plain I thought from the wording of it originally that wide powers were intended to be conferred by it). One of the Judges took that view, and he used the powers very widely but in cases which were not in fact contested. The petition would be brought under the section and perhaps there would be argument for a day or two and witnesses would be called, and then it would be fairly clear to everybody that it was a case where something ought to be done for the petitioner. The usual difficulty would be in buying the petitioner out, because the other shareholders would not have the money with which to buy him out. Then some settlement would be reached which involved the company pro-

viding the requisite money, which it could not do without the sanction of the Court, and the section would then be used to enable the settlement to be operated. In one case, the order authorised the company to lend money to the personal respondents, the other shareholders, to enable them to buy out the petitioner in a subsidiary company, which would have been contrary to section 54 of the Companies Act if it had not been authorised under section 210. Quite a number of consent orders have been made under the section. I can provide you with some statistics.

1387. Yes, I was going to ask you; I do not know if you can distinguish between the pre Meyer/Harmer era and the post Meyer/Harmer era?—I can do that, the Harmer case did not get into the Law Reports until late in 1959. There have been altogether since the 1948 Act 58 petitions under section 210 of which two are still pending; 2 of those were struck out; 10 were dismissed otherwise than by consent, 7 with costs. They can be assumed to have failed I suppose. In 3 a compulsory winding-up order was made which was claimed in the alternative. 31 were dismissed by consent; 3 were stayed by consent on agreed terms. Now a settlement may be assumed in all those 34 cases, which means that the section was of use and operated in all those cases. 7 orders were made under section 210; 5 by consent; 1 by default, and 1 on a contested petition. The only order in a contested case was the Harmer one. If section 210 had not existed it is very likely the petitioner in all the 34 cases which were settled would not have had any remedy and would not have been satisfied by a compromise; and no doubt there is a number of cases which never have got to the Court, the threat of the section having been enough, and that number should increase as the result of the Harmer case. The other thing I was going to give you on this was the number of petitions per year, in case that is of any value. 1948, 2; 1949, 5; 1950, 5; 1951, 3; 1952, 9; 1953, 7; 1954, 3; 1955, 4; 1956, 3; 1957, 3; 1958, 4; 1959, 4; 1960, 6. So although we are only three-quarters through 1960, there has been an increase as compared with 1954 to 1959.

1388. So that one can say with justification that the section has served a useful purpose even though orders were actually made in relatively few cases: there have been 34 settlements?—Yes, and it is of course only since the Meyer and Harmer cases were reported that there have been useful decisions on the section available to the practitioner.

1389. I understand it to be your view that, although these decisions have made the orders perhaps easier to obtain, the section would be improved by omitting the criterion of winding-up?—I think myself that that is a limitation on the use of the section which tends to make its operation difficult. I think that was particularly so before those two cases, but even so I think that, as the section stands, one has still got to go back to the old cases under the just and equitable rule first, to see whether a case could have been made out under those rules; and it was only in very extreme cases that a minority shareholder could get a winding-up order. I would have thought that section 210 ought to cover cases where a petitioner might not have got a winding-up order under the just and equitable rule but where, as the Law Society suggests, he is not really getting a fair share of the profits, or where he ought to have his shares purchased. I doubt whether a petitioner could go to the Court and ask for a winding-up order on the ground that the respondents would not purchase his shares yet it might be unfair that he should be unable to be bought out. I do not like the word "hardship" which the Law Society suggests in this context. That brings in notions of National Assistance or a means test or something of that kind and I do not think it is the right criterion. You might, for example, be suffering hardship because you did not get any income from your shares, but it might be quite proper in all the circumstances for the company not to pay a dividend on the shares. I would prefer the ground for relief to be that the business was being conducted "unfairly" to the minority shareholders.

1390. Do you remember the revenue legislation which was to apply in its first form to companies which failed to distribute a reasonable proportion of their profits? There, for the purpose of taxing

the subject, the Court managed to find out what was reasonable, and they looked at all the circumstances of the case. Might one, do you think, import something of that kind into section 210?—I think that is, as I would have expected, a much better word than mine.

1391. "Reasonable" is always a good word because it has been used so often that the Judges just cannot refuse to consider what it means.—Yes, I would certainly accept that.

1392. Then I think you have indicated the sort of lines on which you think oppression could be measured for the purposes of this section?—The Law Society did suggest that there should be another section, as I understand their recommendation in paragraph 65 of their memorandum. They say that the scope of section 210 should be extended to afford protection to minority shareholders in private companies who neither receive reasonable dividends nor are able to sell their shares at a reasonable price. But I would have thought no extension was necessary for that; if you remove the criterion of winding-up from section 210, the Law Society's cases would be covered by the section as it stands (they are the usual cases that minority shareholders come with now). Then, in order to implement their proposals, the Law Society suggest that "a new section be incorporated in the Act to provide that any member of a private company who complains that the affairs of the company are being conducted in a manner which causes or is likely to cause hardship to him for which neither the provisions of this Act nor the Articles of Association of the company afford him any remedy, may make an application to the Court for relief". I think it is dangerous to have two sections, one dealing with oppression and another dealing with relief where you are not covered by the previous section. I would have thought it was much better to widen the scope of section 210 so far as is thought necessary to enable it to cover cases where the business is being conducted in a way which is unfair to the petitioner, or under which he does not obtain a reasonable income from his shares.

1393. Do you think there would be any merit in saying in any revised form of section 210 that for the purpose of this section "oppression" should be taken as including certain things?—I think it is dangerous. I suppose it could be done just as it is done in the case of reduction of capital. You can include as many cases as you can think of but say it can be done in any other case too; but the danger of setting out a string of particular things is that the section tends to be applied only to those.

1394. You would prefer to leave it as "oppression"?—I think "oppression" is a bit too limited; I prefer "unfairness" or if you can introduce unreasonableness in some way, better still.

1395. I think the Northern Ireland Committee on Company Law has suggested that unfairness should be used.—I did not know that but I am glad to hear it. The last part of paragraph 65 of the Law Society's report appears to me to suggest the provision of powers which already exist and have in fact been exercised. The Court has got power "to make such order as it thinks fit for securing to the petitioner a reasonable share of the profits of the company or the purchase of his shares by other members of the company, or by the company". That is just what has been done. If I may say something more on this, the Association of British Chambers of Commerce has suggested that one of the difficulties under the section is in drafting the relief that is wanted by the petitioner because there are no precedents. I think they very much underestimate the ingenuity of counsel, and it might be useful if I were to state some of the reliefs which have been claimed in the cases of which I have a note.

1396. Yes.—I will include even the ones that have been dismissed. Appointment of a receiver and manager and a declaration that a lease was held in trust for the company (that was dismissed); purchase by the personal respondent of the petitioner's shares at £4 each or at a price to be fixed by the Court; sale of one share to the petitioner which gave him control (that was successful); sale of shares to the petitioner at a price and

on terms to be fixed by the court (successful); rectification of the register, appointment of directors and removal of a director (an order was made there rectifying the register and convening a meeting with one as a quorum); directors or the company to purchase shares and in the latter case a reduction of capital; an order for the purchase by the company or another member of the petitioner's shares at a price to be fixed by the Court; purchase of shares by the company and reduction of capital; one-third of the net profits before charging directors' remuneration to the date of order, and the purchase of the petitioner's shares by the co-shareholders at a price to be fixed by the auditors; purchase by the company of the petitioner's shares; purchase by the company or a member of shares of the petitioner; alteration of voting rights or, alternatively, sale by the respondent of his shares to the petitioners; removal of the respondent from the board on a pension to himself and his wife to be fixed by the Court (that was Harmer). Then there are two more purchases of shares by the company and reduction of capital. I think those indicate that the sort of cases which the Law Society has in mind in its suggested new section are in fact the sort of cases which are usually brought under section 210; and also that the fact that there are not many precedents as yet does not prevent counsel in a proper case from petitioning for whatever relief would seem to be fair to the petitioner.

1397. Of course that will develop as time goes on?—Yes.

1398. I think it was also the Association of British Chambers of Commerce who suggested that this Committee's report might set out various kinds of conduct which should be regarded as reprehensible and within the spirit at all events of section 210?—They said it had been very useful in the case of the Cohen report, that the question of excessive remuneration of directors had been mentioned, and that that was useful behind the scenes. I doubt if I should express any view on this; it is a matter for the Jenkins Committee. But I would have thought that it was rather difficult for the Committee, in effect, to give suggestions to the Judges as to what they

are to do under the section; and it would not bind them anyway. I do not think that is very desirable.

1399. It would not bind anyone at all. There is just one other point on section 210. A common complaint is that the minority shareholders do not get adequate information as to the company's affairs. Section 165(b)(iii) enables an inspector to be appointed in a case where the members have not had sufficient information.—I think the Board of Trade are very reluctant, are they not, to exercise their powers under that section because they have got enough to do as it is without being expected to make an inspection of every private company where a minority shareholder feels himself to be getting insufficient information. It would be quite impracticable for them to investigate every case.

1400. And they might well think it wrong to investigate without some sort of *prima facie* case. It has, therefore, been suggested to us that a prescribed minority should have a statutory right of access to the company's books. I suppose they would be allowed then to make an application to the Court on the question of inspection, or else bring it into the claim for relief under section 210.—That might be a good idea.

1401. The Court could put them on terms not to divulge the contents to anyone else.—Would they have right of access to all the books? I suppose the views of the City are more important than those of the lawyers on this sort of question. I do not know how far it is desirable as a matter of practice that shareholders should be looking through the company's books. They are only entitled at present to look at certain specified books of the company.

1402. You think there would be difficulty in applying such a provision?—I think there would be no difficulty in applying it, but I do not know whether it is desirable from a business point of view.

1403. I should think it would not be very desirable from the business point of view; that is why I suggested the Court might put the applicant on terms not to pass on the information

without the leave of the Court.—Yes, but thinking of those cases where people have made a profession of opposing schemes of arrangement, I think this kind of rule might lead to certain chartered accountants or solicitors making a business out of investigating the affairs of companies. They would make applications to do that and cause chaos in the administration of the company. Would you not have to alter the law generally as regards shareholders' rights of inspection of books? At the moment they are only allowed to see a very limited number of books. What you were suggesting is this: that if you get a certain proportion, say one-tenth or one-quarter, they can see everything?

1404. Yes.—I think that would require a lot of consideration.

1405. Reverting to our earlier discussion on section 210, reading the passages of the Cohen Report dealing with this minority question, one feels that originally this was conceived as a procedure to be adopted in the case of private companies, but of course as enacted it is quite general.—Yes, I could not give you statistics as to that, but I would apprehend that all the cases have been cases in private companies, though I would not have thought in practice it was necessary to impose any limitation as regards that.

1406. I was thinking of the well-known case *Re Yenidje Tobacco Co.* where it was said that a small private company was to be likened to a partnership. One might apply the idea of the "just and faithful" clause in partnership articles, but of course that has no room in a general provision referring to all kinds of companies because many of them do not resemble partnerships in the very least.—That is already taken into account by the Court, in the case of a private company, as an additional reason for granting relief.

1407. Have you anything to suggest on section 225(2) which is the existing "just and equitable" provision?—No.

1408. We have had a suggestion that, for instance, on a reconstruction the Court could protect minorities more effectively if it adopted the Scottish

practice of referring the scheme for investigation and report by an independent expert.

Mr. Lumsden: I do act as reporter in a number of such cases. The procedure is that on such things as reductions of capital and schemes of arrangement, after the complete procedure of holding the meetings and advertising has been carried out, the whole process is remitted to a reporter, who is normally a solicitor in Scotland, to report on whether the procedural steps have been carried out and to raise any points which he sees fit with regard to the protection of creditors and so on. His report goes before the Court when they consider whether or not to grant the petition.

Chairman: I see.—*Mr. Registrar Berkeley:* But that sounds like work which is done in the chambers of the Companies Court at the moment. As I understand it, the reporter does not question the merits of the scheme; that is left to be argued by anyone who wants to oppose it and the person who is applying for the scheme to be sanctioned. Would that be right?

Mr. Lumsden: That is so, except that it is open to the reporter to draw attention to any points where he thinks creditors may be prejudiced, but then it is argued in open Court.

1409. *Chairman:* It would not greatly differ from our existing procedure.—

Mr. Registrar Berkeley: I think not, because one of the things which is considered is whether creditors would be affected by a scheme. If when it comes before me it is a scheme which affects creditors and there has not been any meeting of the creditors then I have to consider whether there should be an inquiry as to creditors, or make sure that they are protected, for example, by money being held sufficient to pay all their debts in full.

1410. *Mr. Mackinnon:* In Scotland the reporter, as I understand it, will deal with the aspects of law that he may consider relevant to whether the relief should or should not be granted. In other words, he is acting as a sort of *amicus curiae*. As I understand it, we in fact do the same thing in our Courts. The Registrar or his

department will make a corresponding note—and you will correct me if I am wrong—and does in fact give the same service, in the way of *amicus curiae* as the reporter appears to give in Scotland.—If there seems to me to be a point of law on the scheme I raise it in my notes, or the principal clerk raises it in his notes, and the Judge's attention is drawn to it and then he would ask counsel to deal with it. We have no system whereby an accountant is instructed to consider a scheme or the merits of a scheme. It is really up to anyone who wants to to oppose it, to get the scheme investigated by an accountant, file evidence and come and oppose it. I rather understand that it is not from the accountancy point of view that the Scottish people have a report and an investigation, but from the legal point of view.

Mr. Mackinnon: That is quite correct.

1411. *Chairman:* Then under heading 15 you make various observations as to the penalty for failing to file charges. That is a minor matter, but I mention it because an allied minor matter was mentioned by one of our contributors of evidence, under section 100, which is the section dealing with charges which are taken off the register. The suggestion was that there should be a duty on the company to file the necessary evidence within 21 days of the charge being discharged. I do not know if there is any merit in that suggestion?—I think logically that may be right, but I do not know that it matters very much. It is very important to have a charge on the register so that creditors know what they are doing when they are dealing with the company; they must know what money is secured in priority to the credit they are giving, but the discharge of a charge makes their position all the better. It does not really matter if they do not know it is discharged. They deal with the company in that case on the assumption that there is so much secured indebtedness. They would be pleased when they found out later that there was no secured indebtedness. Registration of the discharge of a charge is not very important.

1412. Then the company will hasten to see that the notice of satisfaction is put on the file?—Yes.

1413. Then the next matter is section 209 and take-over bids. On that, Mr. Registrar, a curious position seems to have developed because it seems the Board of Trade think that sections 206 to 208 of the Companies Act are now obsolescent in relation to section 209 transactions, since nowadays even agreed amalgamations are generally put through by means of the take-over bid. You are rather inclined to take the opposite view, are you not?—I would not have agreed that section 206 was obsolescent; section 209 is not used much but it is used. I have had cases during my time as Registrar where a minority shareholder has applied under section 209(1) for a declaration that he is not bound to sell his shares at the price offered by the transferee company. Usually they are disposed of amicably in the end, but one or two have been fought. There are very few cases under section 209(2); I think there has only been one in fact where a minority shareholder has made an application to have his shares purchased at the price which had been paid for the other nine-tenths in value which had been taken over. My only point on section 209 really was that it seemed to me inconsistent to have a nine-tenths majority required there if you could achieve the same result under section 206 with a three-quarters majority of *those present and voting*, which is a very much smaller majority. The effect of that, it seems to me, is that section 209 will be used less and less, because there you have got to get nine-tenths in value of the shares or the class of shares with which the take-over is concerned.

1414. This section was originally introduced in the 1929 Act, and it is rather interesting I think to look at the passage in the Greene Report dealing with that. This is what it says:—

“It has been represented to us that holders of a small number of shares of the company which is being taken over (either from a desire to exact better terms than their fellow shareholders are content to accept or from lack of real interest in the matter) frequently fail to come into an arrangement which commends itself to the vast majority of their fellow shareholders, with the result that the transaction fails to materialise. In our opinion this position—which is in

effect an oppression of the majority by a minority—should be met”.

So that the principle underlying section 209 is that if you can get 90 per cent. of the shareholders to agree to a transaction as fair and reasonable then *prima facie* the 10 per cent. who are standing out are behaving unreasonably; if they want to make out that a scheme is in some respect or other unfair to them then the onus is on them to make out their case. That was the philosophy there, and of course from that point of view it was essential that there should be a vast majority, and I think that also accounts for the position as regards onus of proof.—Yes.

1415. So that I should not have thought that it was unfair to a minority of only 10 per cent. to say to them—“Very well, you are holding up this scheme; you differ from everybody else; now just prove to us that the scheme is unreasonable”. Of course, on the other side of the matter, the scheme of arrangement method of dealing with these cases is different because that is started by the proposer of the scheme going and asking leave to convene meetings. If he convenes the meeting and he gets the prescribed majority the Court will sanction the scheme if they are satisfied that it is fair?—Yes.

1416. But even then—and I used to appear in some of these cases—I seldom if ever succeeded in getting the Court to listen to my opposition in a case in which the meetings were well attended and the statutory majority was achieved.—The Court generally takes the view that it is a domestic matter for the shareholders, but there have been cases where the Court has considered that there has not been sufficient disclosure and the scheme has been rejected.

1417. I remember the Dorman Long case in which that happened. What this is leading up to really is your suggestion that section 209 might with advantage be repealed.—That was on the footing that you had something to take its place which involved every take-over bid being submitted to the Court for approval before it could be finally given effect to. It sounds a formidable thing and people might say how could the business ever

be got on with if you had to go to the Court, but I cannot see that it would really make any great difference. There has got to be an arrangement reached by the directors in secret first anyway, and those negotiations would take place whether you ultimately had to go to the Court or not. Then a time would come when a circular had to be sent out to the shareholders to find out whether they were prepared to sell their shares at the price offered. I would have thought no harm would be done to anyone if at that stage the matter had to go to the Court and the Court could control the circular which was sent out. The agreement would provisionally have been made or the terms would have been provisionally fixed. I cannot see that it really would upset the business world if the circular was sent out under the direction of the Court and it was a term that every such offer and acceptance was conditional on the Court's sanction.

1418. I think it might impose a little excess of work on the Court. But you say that company draftsmen would be concerned in settling the documents anyhow?—Yes, and the companies concerned have to circularise the shareholders anyhow; and there would not be any more publicity if the matter were dealt with in that way than at the moment. The news is bound to break the moment the shareholders are circularised. The offer is conditional in any event on the acceptance of a percentage of the shareholders; sometimes it is 51 per cent., sometimes 75 per cent., sometimes nine-tenths. I cannot see that my suggestion would result in any very great hold-up and not really an enormous expense.

1419. It is really that the Court would be asked to approve the circular?—Sometimes section 206 is now used and the minority interests are acquired under a scheme of arrangement. But there could be another section in place of section 209 which would say in effect that any scheme for the purchase of the shares of a company, or any transfer of the shares or any class of shares from one company to another company would require the sanction of the Court.

If it was thought desirable such a scheme could provide for the transfer of say 51 per cent. or 75 per cent. of the shares

instead of all the shares being transferred, as would be the case under section 206—where it is all or nothing. The minority could be given the right of having their shares taken over at the price approved in the scheme, in the same way as is done in section 209. I do not think the news of a scheme of arrangement breaks any quicker than the news of a take-over bid. The fact that it would have to go to the Court would not involve any earlier publicity, and I cannot see any disadvantage in it other than the relatively small expense which would be involved. The delay really would not be substantially any greater, it seems to me, than the delay there must be anyway in getting the assents of the shareholders when the circular is sent out. You would avoid the battle of circulars which goes on at the moment without any kind of control over it at all. There would be a controlled opposition here, evidence would be filed and so on, before the case was adjourned to the Judge for sanction.

1420. Would the application in such a case be for leave to make proposals to the shareholders?—I think it would be to sanction the transfer of the shares at the price provisionally agreed by the directors. It would be called a scheme for transfer, or something of that sort. It would have to be passed by the requisite majority—51 per cent. or 75 per cent. as the case may be.

1421. And the directors would have to make full disclosure in the circular they sent out, which would be approved in chambers, or something of that sort?—Yes.

1422. I think that suggestion is well worth looking at, but there is always resistance when it is suggested there should be an application to the Court in these matters.—This procedure would ensure full disclosure. And it is followed now when the parties choose to use section 206. It is difficult to see why, if they are prepared to make full disclosure to their shareholders, they should object to the matter coming to the Court. It would not prevent a conditional agreement being entered into by the directors of the transferor and transferee companies—conditional on the sanction of the scheme by the Court. There would be a short delay while the application went through.

1423. Yes, I think that seems to deal with that point quite successfully. Then, to go back to *npv* shares, we have I think already discussed the question of reduction of capital, but I think the view is held in some quarters that one would have to look rather carefully at the stated capital provisions to make sure that *Trevor v. Whitworth* was not disturbed? —Yes, but if the Gedge Committee's proposals were adopted I do not see how *Trevor v. Whitworth* would be disturbed. Of course, in the case where shares are issued for a consideration other than cash it is bound to depend on the valuation put on the consideration by the directors, and I suppose there are dangers there, where you have shares of no par value. But there are similar dangers at the present time, where the consideration is obviously something greater than the nominal value of the shares which are issued.

1424. Thank you. Then there is your very useful comment on various discrepancies in the winding-up procedure. We need not trouble you with those, but there are just two or three points we would like your help on in the winding-up heading, and the first is whether you think winding-up subject to supervision serves any useful purpose now?—No. I cannot give any accurate figures, but I think there has only been one since 1948 anyway.

1425. Then there is a suggestion by the Board of Trade that a special procedure should be provided with a view to striking off summarily companies who are persistently in default but who are not worth prosecuting. Apparently they have in mind cases coming within the category of failure to make returns, which under section 353 affords a ground for striking off.—They are perhaps thinking more of those cases where, after persistent prosecutions, returns are ultimately filed and so there is no case under section 353. A procedure has been adopted within the last month or so, which I think may bear fruit on this question of returns. Previously in the few cases in which the Board of Trade had time to bring any proceedings, the prosecution resulted in directors being fined but they did not result in any returns being filed. Now the Registrar of Companies applies for an order of the Court against the directors and against the company to file the returns within fourteen

days after service of the order; and if the directors do not comply with that order they are liable to be committed to prison. I think that will produce results.

1426. What is suggested now, as I understand it, is some additional procedure; the idea being to get rid of such companies without the expense of a petition and without a prosecution, when a prosecution would probably be fruitless? —I do not think my views would be of any value about that. It would not affect the Court in any way. I think it might have a desirable effect on the directors of companies. On the other hand it might result in a number of companies carrying on for years afterwards without any idea that they had been struck off and legal complications might ensue. But they could be wound up, I suppose, after they had been struck off.

1427. Then we did have a complaint, with which I have some sympathy, from a solicitor who said that he had inadvertently failed to file a declaration of solvency within the proper time in a members' voluntary winding-up, so he was irretrievably committed to a creditors' winding-up, although the company was perfectly solvent. He suggested there might be some possibility of getting an extension of time in such cases.—I have these cases constantly. They do not give rise to any difficulty in practice: there is an application for a stay of the winding-up, and if it is perfectly plain that the company is solvent and that there is plenty of money to pay all the creditors in full, I exact an undertaking from a majority of the shareholders to put the company into voluntary winding-up again within, say, four weeks, and I make an order staying the creditors' voluntary winding-up. The fact that that may put the company to some expense does not seem to matter. If the solicitor has made a mistake, then it is fair enough that he should bear the costs of it.

1428. Yes, that seems to answer that point satisfactorily. I have two minor points now: there is a complaint that in a members' voluntary winding-up the creditors are kept too long for their money because twelve months is allowed in which to pay the debts.—If the debts can be paid quicker than that, they should be. I should have thought

it was up to the members to keep prodding the liquidator.

1429. And in contrast to that we have a suggestion that twelve months is too short to allow, and it ought to be three years.—I do not think that either is a desirable alternative. That would simply mean that the liquidators might delay the winding-up until just before the three years expired.

Chairman: Yes. Those are all the questions which as far as I am concerned I have in mind to ask, but I expect other members of the Committee might like to ask you some further questions.

1430. *Mr. Scott:* Do you think sometimes in a simple case of reduction of capital the actual submission to the Judge has become almost a formality? You and your department have the duty of ensuring that the papers are in order; do you think that the delay which is involved in subsequently waiting for the case to go to the Judge could be obviated?—The delay is negligible, I think. The reduction of capital petition comes before me, and I give directions about advertisement, and the evidence is then checked in my chambers, and the delay between that time and the hearing of the petition is not really more than about a fortnight, I would have thought.

1431. In practice it can be longer, sometimes, particularly if the long vacation intervenes and particularly if there happens to be a very full list on the Monday when one would ordinarily hope to have the case before the Court.—I think that is not the result of the matter being adjourned to the Judge, because if it were dealt with in my chambers it still would not be dealt with in the long vacation, because reductions of capital would not be regarded as vacation business.

1432. No, but it can happen that it is dealt with in your chambers just before the long vacation. Then there is a long delay—and one can never advise the client with certainty how much delay—even assuming everything is in order, before it will be heard by the Judge. Do you think there is any means whereby that interval could be obviated?—

Not without altering the rules about the long vacation. It is really only the first Monday of the Michaelmas term that is "out" so far as reductions are concerned, owing to the accumulation of winding-up petitions during the long vacation. Reductions of capital which are pending at the end of July would be heard on the second Monday of the Michaelmas term, I would have thought, for certain. But of course solicitors usually arrange these matters so that they do not get the reduction stuck during the long vacation. They bring them on in time to get them through. There is a terrific spate of reductions of capital at the end of the Summer Term, and my department works very late to get them all before the Judge, if that is at all possible, before the end of July.

1433. My question was not a complaint at all, it was merely wondering whether you thought there was any procedure which could be adopted which would make it unnecessary for simple cases to be heard by the Judge at all. It is because of the delay which sometimes results that I think it would be desirable, if it were possible. Would you see any objection?—If you have still got the vacation problem in mind, in practice it would not help you at all. Such cases would not be heard in the long vacation even if they were not required to go before the Judge. I am the only one of the three Registrars who deals regularly with company matters, and it would not really be fair to the bankruptcy Registrars to land them with cases of reduction of capital in the vacation, for these are highly technical and require specialised knowledge. These cases have never been treated as vacation business. On the general point as to whether I should deal with them instead of their going to the Judge in cases which are not opposed, I should have thought it was desirable that they should continue to be dealt with by the Judge. They always have been, and I think the publicity resulting from their being so dealt with is salutary. It may seem to the solicitors concerned that it is all very much of a formality, because the matter usually goes through in a few minutes before the Judge; but in my view it is the very fact that the matter will come before the Judge in

open Court, with attendant publicity, which ensures that the relevant documents will be very carefully drafted by expert counsel, and very carefully considered by expert solicitors and accountants; so that it is only few cases that give rise to difficulty before the Judge.

1434. I was thinking more of how it occurs to the clients than to the solicitors. On your comments on directors' powers, I think you have suggested that the sale of any asset by a company otherwise than in the course of business should require the consent of the shareholders?—Yes.

1435. Would you suggest that third parties should be affected by notice of that? I think one can draw a distinction between the sale of the whole of an undertaking and of any asset. Might it not be rather difficult for the directors to decide whether the sale of an asset was in the ordinary course of business?—I should have thought third parties, in the position they are now, would be entitled to assume that all matters of internal management had been properly dealt with. It is the directors who would be liable for misfeasance, if there were any loss as a result of this.

1436. What remedy would you suggest if the section were transgressed, if the directors did make a sale without getting the sanction of the shareholders?—I do not think there would be any remedy but to make the directors liable for any damage that was suffered; and also, I suppose, it would be a good stick to beat them with at the next meeting that was held, when the matter came to light; it might be a very good ground for asking for their removal.

1437. It would be very difficult to prove a loss, would it not, if they sold an asset?—I think it might be, but I do not know that the fact that difficulties might arise would really be a reason for not having legislation of that kind. The existence of the legislation might help to keep straight directors who would otherwise be errant.

1438. I think you have suggested it would be possible to extend such a provision to the powers of directors to issue authorised and unissued shares?—I feel that is the most difficult one.

1439. It would really mean that there would be no point in a company ever having any authorised and unissued capital?—I do not think so, because I did say that, when the capital was created, it would be possible to give the directors authority with regard to its issue. Their authority to issue might be limited or they might be authorised to issue all of it as and when they thought fit. The issue would have to be sanctioned by the company in general meeting, but it could be sanctioned in advance. In fact, it would have to be sanctioned in advance at some time, it is only a question of how much in advance. Perhaps the provision would become a dead letter at once, because every time the company increased its authorised capital it would pass a resolution authorising the directors as and when they thought fit to issue it, but that would be the members' own fault.

1440. Mr. Watson: I wanted to ask you if you had had a petition for reduction of capital where the obvious intention was to get rid of high dividend preference shares?—Yes. If the preference shareholders have a priority as to return of capital they are the first to be paid off, and it has now been settled by the House of Lords that the company is entitled to pay them off. I think very often, despite that legal entitlement, the company does sometimes give the preference shareholders something more than their strict entitlement because they think it would be fair to do so. But if you take a preference share with articles of association in those terms, with no special right to anything more than your capital back, the company is entitled to pay it off at par, together with arrears of dividend of course. I make sure that the dividend has been paid up to date, and I raise that question if there has been no provision for that, and I am usually told that it is intended to pay the dividend down to the date of the repayment of capital.

1441. You would not consider that action of this kind might be regarded as unreasonable treatment of a minority?—I should not have thought so myself, because it seems to me that the preference shareholders' rights are defined by the articles, and they take them on those terms for better or worse.

1442. *Chairman*: And of course the situation might work the other way according to the movement of the market?—Exactly. In times when there have been no dividends on ordinary shares the preference shareholder has been in a much stronger position.

1443. *Mr. Watson*: I had in mind the circumstances where a prosperous company with high dividend preference shares carrying 8 per cent. or 10 per cent., with redemption rights at par, petitioned for a capital reduction using the sale of assets for the purpose of deliberately paying these preference shares off.—The shareholder in question can always oppose the scheme on the grounds that it is illegal or improper or unfair, and the Court will hear what he has to say; but if the proposal is in accordance with his legal rights he has not got anything to complain about. He may wish he had not bought the preference shares originally, but that is really nothing to do with the Court. I do not think it would be right to give the Court power to confer some different right on the shareholder than that for which he bargained.

1444. *Professor Gower*: It does mean, does it not, that today there is really no difference at all between an irredeemable preference share and a redeemable preference share? Would you not say a shareholder might fairly expect, if he had bought an irredeemable preference share, he could not be bought off so long as the company remained in existence?—No, he could not possibly think that. Redeemable preference shares are a modern invention. In the old days every preference shareholder knew that, on a reduction of capital involving return of capital, his share, if he had priority on return of capital, would be paid off first. That he might regard as an advantage. In the present day it proves to be a disadvantage, but the difference between a redeemable preference share and an irredeemable preference share is that an irredeemable preference share can only be paid off with the sanction of the Court; a redeemable preference share can be paid off at any time, subject to the terms on which it is issued, without going to the Court. That is the only difference between them. But an irredeemable preference share could

always be paid off with the sanction of the Court on a reduction of capital.

1445. On section 210, the wording of the section and the interpretation put upon it by the Courts—particularly in the Scottish cases—suggests that you can only invoke it where there is a course of oppression, and that you cannot use it where you are complaining of one specific oppressive act. It has been suggested that the wording of the section should be widened to cover that. Have you any comments on that?—Yes. It is difficult to talk about oppression if it is one isolated act, and it is probably the use of the word "oppression" which has led to one having to look for a course of conduct. That point would be met, I think, if some word like "unfairness" or "unreasonableness" were used, which would enable application to be made at a much earlier stage.

1446. In your memorandum, when you were talking about take-over bids and sections 206, 208 and 209, I understood that what you suggested was that section 206 should be amended so as to require a larger majority; in other words that whereas it is a three-fourth's majority of those voting at a meeting, it might be in future a three-fourth's majority in value of the shares concerned. But I gather from your evidence today that you were rather advocating instead that the Court should have some control over take-over bids?—The point I was making in my memorandum was that at the moment you could take over all the shares or the whole of a class of shares under section 206 with a relatively small majority, but you could take them over under section 209 only with the assent of nine-tenths of the shareholders or of the class. I was suggesting that there should be some consistency here—either make it nine-tenths on every take-over or three-quarters on every take-over, but do not let us have two different majorities.

1447. In connection with your suggestion that the Court should control the contents of circulars put out on take-over bids, the situation at the moment surely is that some control over the contents of those is exercised by the Board of Trade. They lay down in some detail what these circulars must contain, and unless the deal

goes through a licensed dealer or an exempted dealer such as a member of the Stock Exchange they will have to approve the circular before it goes out. As I understand it you are suggesting that instead of the Board of Trade approving those circulars, this should be done by the Court instead?—Yes.

1448. Do you think the Court is really in a better position to control this kind of thing than the Board of Trade? Do you think that the Court has greater expertise than the Board of Trade in seeing what are the business considerations which should be stressed?—What I thought was that the battle between the opposing sides—the members and the directors if you like—could be better conducted if it was done in Court than if it was done in a free-for-all by means of circulars. At the moment the Board of Trade insists on certain information being given, but there can be several different opposing elements all sending out circulars, and there is really no control over this at all. I would not claim for the Court any expertise from the business point of view nor would I suggest that the circulars should not continue to have included in them what ever the Board of Trade requires.

1449. There would be certain difficulties again with the long vacation, would there not?—There would, yes.

1450. *Chairman:* As regards the long vacation I did myself as vacation Judge deal with a highly complicated scheme, and as far as I know if urgency is shown that can always be done.—That is so, if there is real urgency, but I think Mr. Scott had in mind the general run of the cases. I too have dealt with the convening of meetings for schemes of arrangement and so on, in the vacation, and I am always ready in fact to do that if it is going to help the solicitors, but I do not feel it is fair to put that class of work on my brother Registrars. It does not always follow that a Registrar in bankruptcy would have had experience in company matters, he is not really appointed to do company work in term time, and his company work, in the absence of the Registrar of the Companies Court on vacation, is limited to very urgent matters and minor routine matters like the

extension of time for registration of charges, and so on, which have to go on in the vacation. The vacation Registrar only sits as Registrar of the Companies Court on one day a week; the other days are all devoted to bankruptcy work, and it would be impracticable to allow the company work to continue just the same as in term time.

Chairman: I follow that.

1451. *Professor Gower:* You have drawn our attention to a very important point, if I may say so, because as you point out a take-over bid can either be effected under section 206 or section 209, and the economic results may be identical. If it is done under section 206 the Courts control it completely and the Board of Trade have nothing to do with it; if it is done under section 209 the control is by the Board of Trade and the Courts have nothing to do with it unless and until there is an application to buy up the minority dissenting shareholders.—And of course there are at present no doubt take-over bids that come under neither section. Very often a transferee company would be content with a working majority, it might not even need a 75 per cent. majority, and I suppose those cases would not come under either section.

1452. *Mr. Mackinnon:* Can I move back to quite a different point we were discussing earlier, when you were giving your views on the *ultra vires* rule. I think I am right in saying you took the view that the company should be given all the powers of a natural person *vis-à-vis* third parties, but the shareholders should be able to limit the activities which the directors—or rather the company—could carry on. That would involve setting out in the constitution of the company certain powers, in the same way in which it is done in the memorandum. Then we left that point and we went on to consider whether certain matters should not be made automatically subject to the approval of the shareholders, and one of the matters we discussed was the question of changing fundamental activities. I would like to be quite clear to what your evidence is going on that. Are you proposing that if the

powers, as set out in the constitution, are to be changed then that should be subject to the approval of the shareholders? Or are you proposing that where, for example, there are ten possible businesses which a company can carry on under its existing powers, and in fact it is only carrying on one of them, it should then be required to seek the consent of the members before embarking on one of the other nine?—I am proposing the latter. As matters now stand, companies have such comprehensive objects clauses that they cover all sorts of things that they have no intention of doing—such as running railways and tramways when the company is, in fact, a trading company. It would not be enough, it seems to me, to attempt to limit companies' powers to pursue new activities by the objects clause, because they would always have a very comprehensive objects clause which let them do everything. I think therefore that there should be a limitation on their powers to change from one of the objects specified in the objects clause to another activity, which may also be specified in the objects clause but which they have never hitherto carried on.

1453. *Mr. Lumsden*: If you are going to legislate that whenever a company wishes to change its activities—not merely its powers but its activities—it must go to the shareholders, will you not then come back to the difficulty of what is a change of activities? You may have a case where a brewing company wishes to take on some ancillary activity—something like soft drinks or bottling. Again, supposing it had been carrying on one activity in a very small way and another activity in a large way, and it decided to expand the activity it had been carrying on in a small way so that it became the greater part of its activities; would it not be very difficult to legislate on these matters?—I do not think it would be so difficult to legislate. It might be difficult on occasion for the Judge to interpret the effect of the legislation. You are putting borderline cases. I would not like to predict what the Court would decide, but I would have thought that if you were simply extending a business which you were already carrying on, or starting an ancillary business, it would not involve a fundamental change

of business. But if you stopped carrying on whatever you were carrying on, or even started up something which was not related in any way to the business you had been carrying on, that would be a fundamental change. I should not have thought the fact that the Courts might have borderline cases before them would be an objection to legislation of this kind.

1454. I was thinking more of the directors having to decide.—The sensible and cautious director would take the precaution of getting himself protected by getting a resolution through; and if it was a proper case, why should he not? It is only in the cases which one wants to guard against that the director might take a risk, and then he would be very unwise to do it.

1455. If I could come to your suggestion regarding take-over bids and that the Courts should have control of the circulars, let us accept that that might have some benefit in those public battles where there are large numbers of shareholders involved. But if this was going to be made a matter of legislation it would also affect the far more numerous cases which involve the take-over of a small company where, say, five or six shareholders have all agreed amongst themselves to sell.—It would affect such a small company in exactly the same way as a reduction of capital does now. It does not affect it very seriously. It puts it to a little more expense, but there is usually a lot of money floating about on such occasions or there would not be a take-over bid.

1456. Your proposition is that even a company with two shareholders would require to go to the Court for approval?—It would be open to you gentlemen to recommend some limitation on the general rule, but I do not think there would be a great deal of hardship if it applied throughout. You could limit it to public companies, I suppose.

1457. I assume that your evidence on procedural matters is limited to the English courts?—Yes, I know nothing about the Scottish courts.

1458. *Sir George Erskine*: I was interested in your references to the extent to which shareholders should have a right to approve the issue of shares, and I quite see that there are circumstances where

that might be highly desirable—for instance, if you are changing the control or the nature of a business—but from the point of view of practical convenience I see difficulty if you want to apply it to cases where shares are to be offered for cash *pro rata* to the existing shareholders. In conditions today when a great majority of public companies have authorised but unissued shares, it is a great practical convenience that the directors can go ahead and make a rights issue without having to convene a meeting of shareholders.—My recommendation would have covered the authorisation, by the company in general meeting when the shares were originally created, to the directors to issue them in the future. For instance, the company could, when the authorised capital is increased, authorise the directors to issue the unissued shares at any time they thought fit; or they could require that they should not be issued, otherwise than by a rights issue, without the sanction of the company in general meeting. It is difficult to see how anybody could be prejudiced by a rights issue.

1459. My experience is that in a great majority of cases where there are authorised unissued shares they are in fact at the disposal of the directors, who can go ahead and make a rights issue.—The articles usually so provide. My suggestion is that any issue should have to have the sanction of the company in general meeting, but such sanction could be given at the general meeting at which the shares are originally created. At present either the articles of association say that all unissued shares should be at the disposal of the directors, or the resolution creating the shares says that. It may well be that in the future, if my proposal were adopted, the position would continue as at present, but there would be a statutory requirement of the sanction of the company in general meeting. If the company in general meeting gave the directors *carte blanche*, no one could stop them doing that, but they would have had their opportunity of controlling the matter. So that what goes on at the moment might still go on, but there would be something in the Act drawing everybody's attention to the power of the members to control the directors as regards the issue of shares. You cannot force the company to exercise

the power. I think it would be inconvenient to insist that every time a share was issued there had got to be a general meeting—especially in the case of a very large company, where a considerable cost would be involved.

1460. With reference to section 210, is it your experience that that section has been of any value where you have the case of one class of shareholder complaining as regards the action of another class? I have particularly in mind where you may have the case of the whole of the ordinary capital having changed hands and the company having preference shareholders who are still left there, and it may be that their rights are being prejudiced.—I do not know of a case where it has been used in the circumstances you mention, but the section would certainly cover such a case. There is, of course, also what is called the fraud on the minority action. There would be nothing to stop a class of shareholders—or a member of a class of shareholders—applying under section 210 if it could be shown that the company was being run in the interests of the other class and not in the interests of the company as a whole.

1461. Could I just refer again to takeover bids under sections 209 and 206: is it quite correct to say you have your choice of proceeding under section 209 or section 206? As I understand the position, if you proceed under section 206 you have got to do so *ab initio*. Could I compare that with the situation under section 209? If a bid is being made you may want at a later stage to have recourse to section 209 in order to bring in a dissenting minority, but you do not invoke section 209 until the offer has been made unconditional.—There may be no procedure under section 209 at all, you are quite right.

1462. Where you are proceeding under section 206, then you have to start from the beginning?—Yes, once the negotiations between the boards of the two companies have been concluded, they then start right away under section 206.

1463. It seems to me that section 209 has got rather a different function than section 206. Section 209 in my experience is a very valuable section that you may want to have recourse to—you do not

need to use it, you may be quite happy to take 75 per cent., or 51 per cent., but section 209 is there in the background and you can use it if you want to. Whereas section 206 is for a different situation and if you are proceeding under that section you do so from the beginning. Are you advocating that, even if you are going to be content to get a bare majority, proceedings under section 206 should in future be necessary?—Not under section 206 but under a section substituted for section 209. My suggestion is that every offer for transfer of shares which will give control of a company should be done under supervision of the Court. At the moment, sections 206 and 209 can each be used if you want to obtain complete control—every single share. They are two alternative procedures for getting every single share—not just 51 per cent. or 75 per cent.—but every share of the particular class. Under section 206 you go to the Court and you only need three-quarters of the members of the class who attend the meeting and vote, or to the exact a bare majority holding three-quarters in value of the members of the class who attend and vote. Under section 209, you have got to get nine-tenths of the class to assent. The case where you only want 51 per cent. or 75 per cent., or only a portion of the shares of the class, does not come under either section. My suggestion really was to introduce instead of section 209, which seems to me a dead letter now, a section which would involve the control of every take-over bid, if you can define a take-over hid.

1464. Do you think it is reasonable that if a majority of shareholders are willing to sell their shares you should put them in a situation in which, because you have got to go to the Courts, a minority might prevent them from disposing of the shares at what they might think was quite an attractive price?—That is really a matter of policy, which is not for me. I say if you want to control that situation this is a way of doing it. It may well be as a matter of policy that it is thought better to let the majority do what they like regardless of how it affects the minority; but the complaint about take-over bids is surely that the minority are adversely affected in some way.

1465. I could not quite follow. If you have competing offers, and everything has got to go through the Courts, then has each bidder got to proceed with his separate scheme of arrangement? How do you deal with, say, three competing bids, if they have all got to be approved by the Courts?—Every competing bid would be subject to the Court's sanction, and I suppose if there were three competing bids the one that offered the most would be likely to succeed. They might involve three sets of proceedings and three sets of circulars, but probably the result would be that long before it ever got to the Court one or the other of them would be discontinued.

1466. Is the Court going to determine which is the best bid?—No, it is going to consider the one which gets the requisite majority, whichever it may be.

1467. But there would be three proceedings going through the Courts at the same time?—I am not quite clear what these three bids would be; each bid (within my proposal) would involve taking over at least 51 per cent. of the shares.

1468. Yes, but suppose that you have two or three competing bids, which may be quite different and it is not easy to determine which one is the better. There may be offers not for cash but for shares. If you provide by legislation that no take-over bid could pass without some procedure through the Court, presumably you would have the same type of procedure for each separate bid, or how do you bring all the different bids which are made by different people into one process through the Courts?—I imagine that it would not get to the Court until one or other of the three had been more or less accepted as the right one, just as, where you are going to have a scheme of arrangement altering the rights of shareholders, there has to be a great deal of preliminary negotiation before an approach to the various big holders of shares of the class to discover which is going to be acceptable to them as a whole. It might not prevent a preliminary battle.

1469. But we have had cases where the definite offers have gone out from more than one quarter, two quarters or three quarters, so I have difficulty in seeing from a practical point of view how the

Courts can control a matter of that kind. —It depends whether the legislation should insist on every offer being sent out under the control of the Court, or merely on any transfer as a result of such a scheme being sanctioned by the Court, and I would have thought it was the latter that one should insist on. It is inconceivable that there would be an application to sanction three different schemes, because only one could obtain the requisite minimum of 51 per cent. But if the Court considered every circular sent out, I agree it might have several submitted to it simultaneously.

1470. On your suggestion, the court would not really be approving a scheme, they would simply be sanctioning it, because they had received evidence that it had been accepted by a certain percentage?—Yes, and it would give an opportunity to those who still thought it was unfair, to air their grievances in public and file evidence about it if they wanted to.

1471. *Mr. Brown*: I think I understood you earlier to imply that the Court would in fact vet the fairness and the accuracy of the information in the circulars making the bid?—It does not do that now, it insists on certain information. If there are Board of Trade requirements, or Stock Exchange requirements, it insists on the information under those requirements being given. There could even be a new schedule to the Act saying what had to be stated in the circular. All the Court does at the moment is to insist that any statutory requirement as to the circular must be complied with. In the case of a scheme of arrangement it is merely that the interests of the directors should be disclosed. The Court does in fact look at the circular, and if there is something in it which is obviously nonsense or wrong it suggests that counsel might consider altering it, but it never is responsible for the contents of the circular. That would be very dangerous, because if the circular was misleading someone would say: "But the Court approved it". The person who sends out the circular would be responsible for the fairness of it, but anyone who thought it was unfair would have an opportunity of coming to the Court and opposing the scheme on that ground.

1472. *Chairman*: But is there not something in this: supposing you had

competing schemes of arrangement, would there not come a time when the Court had to decide which of the applicants was to have the carriage of the matter?—Yes, if competing schemes of arrangement actually got to the Court. It seems difficult to me to envisage that happening, because any take-over bid would require the acceptance of a particular majority—that would be involved in my suggestion. But I suppose it is possible that three schemes requiring different majorities could be pursued. But the result must be that either they would all fail or only one of them would achieve the requisite majority, and it would only be that one which would ultimately go through as far as the Judge. It might involve starting a whole series of proceedings, initiating three sets of proceedings, if there were three conflicting schemes, but only one would go through to fruition.

1473. *Mr. Brown*: But the matter could only come to the Courts after the shareholders had indicated their views?—No, it would come to the Court before the shareholders' meeting was called to consider it. The circular would be submitted to the Court, who would direct that it should be sent out. But the Court could not and would not make itself responsible for representations of fact in the circular.

1474. The Court would ensure, for example, that a circular did contain answers to questions which ought to be answered, whether they were correct or not?—Yes, if you laid down a code as to what should be included in the circular, the Court would see it was included and that would be the place to provide, if it was thought right to provide it, that the name of the person who is seeking to take over should be disclosed; and it might be right to provide that the Courts should be satisfied that the money for the take-over was going to be available.

1475. At the present moment, under section 206, surely the only people who could apply to the Courts for a scheme of arrangement of any sort are the present directors, company, or members?—Under the present schemes of arrangement it is the company whose shares are to be taken over that applies, under the present section 206.

1476. Are you visualising that any other company or individual, at present having

no interest in the company, can go to the Courts and ask for a scheme of arrangement with regard to that company which he is not concerned with? That is what happens with a take-over bid.—I had not thought this out in detail, but I envisaged that it would be the transferor company or the transferee company which applied.

1477. Assuming the transferor company objected, as often happens, you would then visualise that some other party, company or individual could go to the Courts for a scheme in connection with the company in which at that moment he has no interest at all—he only wants to acquire interest; would that not be a new concept?—Yes, I think it would—you mean the transferee company would have a right to apply in such a case? I suppose that is fair enough though, is it not? If the offer is an offer which presumably the transferee company thinks that the shareholders of the transferor company would want to accept, it would not be right that the board of the transferor company should prevent the shareholders hearing of the offer. On the other hand, the expense of going to the Court would fall on the transferee company and it would not be worth its while to embark on such a procedure if it was not fairly confident that it would get the requisite majority. If the transferor company considered the proposal unfair they could come and oppose it.

1478. Of course, you might get the sort of position where the directors might consider it unfair and the shareholders might think it quite fair.—Yes, exactly, and that would seem just the sort of case where there should be an opportunity for both sides to air their views before the Court.

1479. I am very interested in this general discussion on this question of minorities under section 209, where you say a majority of 90 per cent. has to be achieved. Under section 206 it is sufficient for 25 per cent. of those voting to object, to stop it?—Yes, and a large number of people of course may not attend the meeting at all.

1480. I think you suggest in fact that the two percentages should be made the same one way or the other?—Yes. If sections 206 and 209 are to be retained

in their present form then the majority in section 209, I think, should be changed, say, to three-quarters rather than nine-tenths.

1481. Insurance company investors have to think about this particular point frequently. We are always concerned, where we happen to be large holders in any scheme of arrangement, that we do not impose our views on the minorities; and I would have thought minorities even as low as 10 per cent. have a right to their views. Surely it would be unreasonable, particularly in a take-over bid, that 24 per cent. of a company might not want to be taken over by somebody outside, and yet be compelled to hand over their shares?—But under section 209 they have got a right to apply to the Court for an order varying the terms that have been offered, if they can show they are unfair.

1482. Yes, but is it not true that unless the minority have something new to bring up the Court would normally hold that if 90 per cent. (or 75 per cent.) have accepted then the views of the majority should prevail. I suggest that if a minority of 10 per cent. or more exists, with different views than the majority, it is entitled to have its views respected and not to be interfered with.—There may be something to be said for that view. I do not think section 209 is used very much at all. The alternative might be to alter section 206 so that it cannot be used for take-overs or, so far as it is used for take-overs, to require a majority of nine-tenths. My point is that the nine-tenths provision of section 209 seems to be somewhat anomalous. You can achieve the same results by a scheme under section 206, once you have got into the position of having control of the company—holding, say 51 per cent.—you could bring in a scheme under section 206 to acquire the minority shareholdings. And if you do that you can force the minority, even though it is 25 per cent., to toe the line, unless they can show that there is some unfairness in the scheme.

1483. A particular case I am thinking of, and which I think fits your complaint, is a company which wholly controls a subsidiary, some of whose preference shares are held by outsiders. It may well be that the parent company owns 20 per cent., or 30 per cent., or even 70

per cent. of the preference shares, and I suggest that it would be hardship that the parent company, owning 75 per cent. of the preference shares, should be able to force through a scheme against the wishes of the minority.—That is what is constantly done at the moment.

1484. Would it be fair to require in a case like that that the parent company should not be able to vote in respect of its shares and that a majority should be required of the remaining shares?—That is what happens in practice now. I am confident that the Court would not sanction a scheme where the vote was carried by the votes of the parent company. Usually the class of meeting which is convened is of the holders of the preference shares of the subsidiary other than the parent company; so it is only if three-quarters of those people assent to the scheme that it is forced on the minority. But it is forced on the minority, even though the minority may be considerably greater than one-tenth.

1485. Are you saying that if in fact a meeting were called of all the preference shareholders, and the parent company used its controlling votes, the Court would not allow it even if there were no objection?—No, I think if nobody objected the Court would pass it. But in practice that is one of the functions which falls on me; the scheme is brought in, and the company asks that a meeting of its preference shareholders be called to sanction the scheme, and discloses the facts in evidence, and if it is plain on the evidence that the parent company already holds a large proportion of the preference shares, I suggest to the company's legal advisers that the class they want to call together is not the preference shareholders, but the preference shareholders other than the parent company.

1486. *Mr. Bingen*: There has been a lot of discussion about sections 206, 207 and 208. Those sections deal mainly with schemes of arrangement, between a company and its creditors or a company and its shareholders, and it is probably only rarely that you find those sections used in connection with what is commonly called a take-over?—Yes, it is only where another company already has a large stake in the company.

1487. Where there has been some difficulty to start with, and a scheme has been devised by agreement between the one company and its creditors or its shareholders—or the two companies—then you have a long complicated procedure; and am I right in saying that if everything on the face of it appears to be in order then the Court would probably say: "Business men are the best judges of business affairs; the meetings have been properly held"? In the absence of any manifest fraud the Court is not really judging the fairness of the scheme, even though they may be hearing evidence from accountants and so on?—That is quite correct.

1488. And the case which Lord Jenkins referred to in, *Re Dorman Long & Co.*, was a case where directors had not disclosed their interest, or something of that kind. This sort of procedure, under section 206, would not, I think, be applicable to the sort of timing which is involved when Company A wants to take over the shares of Company B; it is a slow procedure?—I would not agree it is a slow procedure, but I agree it is not adapted at all at present to the ordinary take-over bid.

1489. Would you say, from a general point of view, that you think the circumstances of various take-over bids—or the generality of them—have been such that any purpose would be served by asking the Court either to approve the circulars before they go out or to approve the scheme when it has been approved by the necessary majority? Would you think that that sort of procedure would be necessary or desirable to deal with any mischief which has arisen in the past?—That I would not know, that is a matter which the City would know much more about than I should. But if it is desired to have control over take-over bids, this is a possible method of doing it which is worth considering.

1490. Of course there is some form of control at the moment. The Board of Trade rules for licensed dealers require circulars to contain certain valuable information. Others have to go to the Board of Trade and get their circulars approved, and I am sure the Board of Trade require the same information to be disclosed in those cases as licensed dealers

are required to give. Would you think that if the Board of Trade rules were made applicable generally to any company or individual wanting to make an offer for shares in another company, that might in itself at least bring out all the relevant facts. Thus the shareholders, without going to the Court, would have the information with which they could make up their minds?—I should think really that is entirely a matter for you gentlemen. It is only matters that might be controlled by the Court that come within my ambit.

1491. Perhaps my approach is slightly different, but I was trying to ask you why you thought the Court should do these things, or might take on this additional jurisdiction?—Only because there seems to have been such an outcry about takeover bids, in the press and elsewhere, and it seemed to me that if it is thought desirable that they should be controlled, they could be controlled by the Court just as well as schemes of arrangement can be controlled by the Court.

1492. But of course the schemes of arrangement involve either a state of difficulty—inability to pay your creditors—or something which is already cut and dried between two groups, involving dealing with various shareholders and different rights in various ways. That is the difference between that and an ordinary direct offer for shares, is it not?—I would agree that that was the function of schemes of arrangement until relatively recently, but they have been used recently to effect take-over bids of a minority of shares, where a company has obtained control of the equity in another company.

1493. Could I now ask you a question on section 210? Would I be summarising your evidence correctly if I said you would like to see the section redrafted on the following lines: "Any member who complains that the affairs of the company are being conducted unfairly or improperly or in a manner oppressive to some part of the members, can apply, etc. . . .", and you would remove the existing requirement that the facts must be such as to justify a winding-up order?—Yes.

1494. Then I would like to have your views about a suggestion, which many

witnesses have made to us, that there is no need to have extraordinary and special resolutions on the statute book any more, the only difference between them being the length of notice required to be given? Would you agree with that?—I think I would, yes.

1495. Finally, I would like to ask you about a fundamental change in objects. You say that there may be borderline cases but if such a case comes before the court it will determine it one way or the other and so a body of case law will grow up. Then you were asked, I think by Mr. Lumsden, what the directors should do in the borderline case, and you said prudent directors would err on the side of safety and get their shareholders' approval.—Yes.

1496. That sounds very easy. But if you take the case of large companies—many of them with hundreds of thousands of shareholders—you say that, on what might be a matter of no importance, they would have to go to the expense of setting up and printing hundreds of thousands of circulars?—If the company could not time it for the next annual general meeting it would be a very expensive procedure, but then the larger the company the less likely that there will be a fundamental change in its activities.

1497. I am not sure I necessarily agree with that. Again, it comes to a question of definition. As regards the sale of the whole of the undertaking and assets, I would assume already that prudent directors would not sell the whole of the company, lock, stock and barrel, without getting approval of their shareholders in the first instance; would you not agree that is so?—I would agree, and I would agree that prudent directors, if they are going to make a fundamental change in the company's activities, would take the precaution of getting the approval of their shareholders.

1498. One further question: in your capacity of Registrar of the Companies Court, have you seen any real mischief arising from companies changing their fundamental objects without the shareholders having given their approval? Have you ever come across cases where there has been some mischief?—I should not come across that kind of case unless

the company went into liquidation, and I cannot say offhand whether many of the misfeasance summonses which have come before me have involved such cases; but I do not think so as a general rule.

1499. *Mr. Scott*: I wonder if I could ask one more question, which arises out of take-over bids. We often have cases where Company A makes a bid for the shares of Company B, the conditions being satisfied by shares in Company A. If Company A, when making the offer, likes to say to the shareholders of Company B: "If you do not like our shares you can sell them, and some banking house is ready to buy them from you (at a price which is stated in the offer)". Of course that price is usually linked to the price of Company A's shares at the time the offer goes out, but there can of course be changes during the period in which the offer is open, and it is very nice for Company A to be able to underwrite and pay a commission to the banking house, or whatever it may be, for agreeing to make such purchases. But at present that is not permissible under section 54, because it would clearly amount to giving financial assistance for the purchase of its own shares. Would you see any objection in principle to section 54 being amended

to permit such underwriting commissions?—I should not have thought so, but it does not really come within my functions as Registrar of the Companies Court.

1500. Have any schemes submitted to you under section 206 involved the payment of such commission?—I do not think they could. I think that would be something which would be illegal.

1501. It is illegal, but presumably it could be sanctioned by the Court?—I do not know that it could. Section 210 gives such wide powers to the Court that it can do anything, but I doubt whether section 206 would enable the Court to sanction something which is prohibited by section 54, though I do not think the question has arisen.

1502. *Chairman*: Mr. Registrar Berkeley, we are all very much obliged indeed for the help which you have given us this morning. I do not think anyone can think of further questions to put, so that concludes the matter, and no doubt you would be able to come and see us again if the occasion arises that we should like to call on your knowledge and experience in such matters?—Certainly, my lord.

Chairman: Thank you very much indeed.

(The witness withdrew.)

(Adjourned until 2 p.m.)

MR. P. J. MORTLOCK, MR. J. W. STEVENSON and MR. P. P. RUSSELL
called and examined.

1503. *Chairman*: Gentlemen, we are very much obliged to you for your memorandum and for coming here to give evidence today. Mr. Mortlock, I understand that you are a member of the Board of Management of the National Chamber of Trade?—*Mr. Mortlock*: Yes.

1504. And you, Mr. Stevenson, are the General Secretary?—*Mr. Stevenson*: Yes, Sir.

1505. And you, Mr. Russell, are a chartered accountant and a member of the firm of accountants who act as the National Chamber of Trade's auditors?—*Mr. Russell*: Yes, Sir.

1506. As to the constitution of your Chamber, I understand it is a body representative of the retail and distributive trades in the United Kingdom, and it would seem from your articles of association that your members consist of three classes—representative members who are nominated by affiliated bodies; ordinary members who are engaged in an appropriate trade or profession, and persons specially nominated by the Board of Management. Is that right?—*Mr. Stevenson*: Yes, Sir.

1507. Including the membership of those bodies who have nominated representative members, could you give some

rough idea of what is your total membership?—Approximately 450,000.

1508. And would it be right to say that your membership includes a representative cross-section of the retail trade of this country from the small individual retailer to the multiple and chain stores?—Yes, Sir.

1509. You have, I think, few criticisms to make of the existing Companies' Act. You make various points, of course, in your memorandum, but you would not say there is anything fundamentally wrong with it?—*Mr. Mortlock*: No, they are only individual points which we have made. We have had merely the concern of the main body of our members in mind who are in the main independent retailers, and we have not tried to look technically at the Act.

1510. Yes, I see. Turning to the various points raised in your memorandum, you say that you think the adoption of a universal objects clause should be allowed in the case of exempt private companies; and that implies that you would not allow it in the case of non-exempt private or public companies. Could you explain that?—*Our feeling*, I think, when we made this submission was that the exempt private company has usually been formed from a family business. There is a natural development very often from a sole trader into a partnership possibly, and then into an exempt private company. In those circumstances we considered that a universal objects clause would not in any way harm the public. There is not the same measure of protection needed so far as the public is concerned as there is with public companies, which we feel should not be allowed a universal objects clause in order to protect the investing public.

1511. Yes. To make sure we are talking of the same thing, by "universal objects clause" you mean one which allows the company to do anything which a natural person can do?—We would suggest in the case of exempt private companies their power to trade should be in effect the same as it would be with a partnership.

1512. Yes. Then I think the next point I need to raise is this. You seem to object

to the use of no par value shares by private companies?—What we have suggested by implication is that it should not be allowed in the case of exempt private companies, but that there is no reason why there should be any restriction so far as public companies are concerned. I think that in this we had in mind that it is only possibly with companies that are likely to obtain their capital from the public that this question would arise.

1513. Yes. Perhaps one might say you would regard it as an unnecessary complication in the case of a small family company.—That is the position, Sir.

1514. Then about the different kinds of company. I gather that you favour the continuance of the existing division of companies into public, non-exempt private and exempt private companies, and of the existing conditions for inclusion in the exempt and non-exempt categories of private companies. Is that your view? That is to say you would like to keep the position as it is at present?—Yes. We do not propose any change there at all. We feel particularly that there should be a class of exempt private companies. There must be a distinction made between the exempt private company as it is known at present and those companies which are public companies and obtain their capital from the public.

1515. You would wish to retain a distinction between the public one, the exempt private one and the non-exempt private one?—Yes, we would retain that distinction as well.

1516. And you think that exempt private companies should continue to enjoy the privileges they enjoy at present?—Yes, Sir.

1517. But I think you seem to qualify that later on in your memorandum as regards the requirements in regard to audit. What is your view about that?—With regard to audit, Sir, we do feel that the regulations appertaining to the audit and the preparation of accounts of limited companies—all limited companies—should make it necessary for all companies of whatever class—all companies registered under the Act—to have properly qualified auditors. We are therefore

suggesting the withdrawal of that privilege so far as exempt private companies are concerned.

1518. That is the privilege of having accounts audited by someone other than an auditor qualified under the Act?—That is right, Sir.

1519. It has been put to us by one witness that it is really in the best interests of the smaller companies that they should be compelled to have qualified auditors, if only for the reason that tax provisions and so forth are now so complicated that it is probably well worth their while to have the best assistance they can get. Would you agree to that?—I would agree it is worth their while to have the best assistance they can get.

1520. Of course there are two sides to every question, and other witnesses object to the privileges accorded to exempt private companies, and as you no doubt know that question is not entirely free from controversy. They say that the benefit of limited liability should carry with it the duty of making full disclosure as to the company's financial position; and they say further that, with the absence of public accounts, there may be a source of embarrassment and inconvenience to creditors or persons having dealings with the company. What do you say about that? First of all they do get the benefit of limited liability, do they not?—*Mr. Stevenson*: Yes.

1521. Would it be unreasonable that they should pay—or give up something—for the sake of that advantage in the shape of being required to make full disclosure in due statutory form to the public?—*Mr. Mortlock*: If I could make a point here, Sir, I think the question of administration would present a very big problem if all exempt private companies had to submit accounts to the Registrar. I think that there are so many of them that it would increase the tasks of administration. But I also feel that in the main the exempt private companies are family businesses and there seems to be no reason why you should ask more from them than you do from a partnership or from individuals. I do agree that privileges are accorded to them by the Companies Act, and I also agree that the ideal position

would be that they should submit accounts, but I think that the submission of the accounts of a small business to the Registrar for open inspection by the public would mean in some cases much more hardship to the firm concerned than it would in the case of a large public company. The information would be more private with a private company—a small family business—than it would be with a public company.

1522. Be more private?—The information contained in the accounts would relate more, I think, to individuals in the case of a private company than it would in the case of a public company. It would mean in many cases individuals revealing their private affairs to the public—more so than it does with public companies—because so many of these exempt private companies consist of possibly husband and wife and son and daughter; and by an examination of those accounts it would be possible for the public to tell exactly what the income of those individuals was. I am speaking, I must say, on this matter on the spur of the moment, but from that aspect alone I think that the submission of accounts to be open for inspection by the public would not be in the interests of exempt private companies.

1523. But of course if one wants to keep everything private one can be a sole trader or a partnership. Then one does not have to disclose anything to anybody. It is only when one begins trading as a limited company that the question arises whether that degree of privacy can be kept consistently with limited liability.—I agree with that point, Sir. I am making my submissions now of course as representing our members within the National Chamber of Trade, and I do agree that if the point is conceded—the point that you are making—then it does strengthen the case for the employment of qualified people as auditors of the company.

1524. That incidentally must involve the expense of producing accounts which probably a qualified auditor would pass as sufficient accounts.—That is so.

1525. I do not know if you have ever looked at the report of the Cohen Committee whose recommendations led to the

Companies Act, 1948? I refer you to that for the reason that one of the reasons why this exemption was allowed by that Committee was that if exempt private companies were required to file accounts, the information they made public would expose them to competition against other small companies and partnerships.—The Cohen Committee has put it much more clearly than I did—that is the point I was trying to make earlier with regard to throwing open to the public the results of these private companies. It would be a relatively greater hardship to them than to the large public companies.

1526. Then there is this point from the Report. The members of the Committee, I think, really intended, according to what they said, to allow this exemption for the purpose of protecting private companies with a small number of members carrying on business of no great size, and in which no other company was the beneficial owner of any of the shares. That was the original conception of the class of company which ought to be exempt.—Yes.

1527. But this is how the thing has worked out in practice. This is from the General Annual Report of the Board of Trade for the year 1959: it shows that out of a total of some 340,000 private companies in existence at the end of 1959, no fewer than 265,000 or 78 per cent. had qualified as exempt private companies within the meaning of the Act. That is an enormously high proportion of all private companies which have in fact been exempted.—Yes, Sir, I agree, but I think that that indicates the number of small businesses that are turning themselves into limited companies. I do not think that the companies who are receiving the benefits of exemption have gone outside—to any great extent—the class envisaged by the Cohen Committee. My own experience is that it is becoming a more and more popular form of business organisation, and more and more small firms are turning themselves into limited exempt private companies, and would, I should have thought, come within the class referred to by the Cohen Committee. I do not think that the increase or the proportion that is mentioned there necessarily reveals that there was a different

position arising from that envisaged by the Cohen Committee.

1528. You are saying in effect that the attractions afforded by the exemption lead a lot of small businesses to incorporate themselves?—Mr. Stevenson: Yes.

Mr. Mortlock: Partly, but I think this would have happened without the privileges of exemption.

1529. I do not propose to mention any names, but my information is that many very large companies in fact qualify as exempt private companies. Of course that is not within your knowledge?—No. But it is within my knowledge, as an accountant in a provincial practice, that a large number of the companies that we have to deal with are small private family affairs, and we very rarely come across cases where an exempt private company would be termed a large company. When the business develops into a large company, it is usually necessary then for it to turn into a public company in order to obtain capital for expansion.

1530. So you would not share the inference that for the sake of argument I am seeking to draw, namely that in the result the class of company qualifying as exempt private companies was wider and larger than anything contemplated by the Cohen Committee when they framed their exemption?—Not from my experience.

Mr. Stevenson: Out of the 650,000 businesses in retail distribution, there are at least 350,000 with a turnover of less than £5,000 per annum. That does show the enormous number of very, very small businesses among those falling within our membership, and I mention that to illustrate Mr. Mortlock's point.

1531. You would probably subscribe to the suggestion made that if the exemption is not preserved *in toto*, it might at all events be possible to qualify the production of certified accounts in the case of exempt companies by making them file with the Registrar a statement that the accounts had been properly audited by a qualified auditor, together with the certificate of the auditor to that effect?—I do not think we would quarrel with that.

Mr. Mortlock: I think that would cover the position.

1532. That is one of the alternatives—I am not saying it is right or wrong, but it would fit in with your notion of requiring fully qualified auditors in all cases?—Yes.

1533. I think I can now pass to heading 7 in your memorandum. That concerns voteless shares, and the view you express is that no voteless shares should be allowed except where there is a minimum fixed interest yield and a pre-determined date of redemption. Or in other words except in the case of redeemable preference shares. Would you care to give your reasons for your objection to other classes of shares being made voteless or restricted in point of voting power?—I do not think that we have submitted formally there should not be any restriction of voting rights, but when we made this submission we had in mind that the public who invested in any concern, if they had no definite right of a fixed yield on their investment and no definite right as to repayment of the capital invested, then they should have some right of regulation of the affairs of that company. And what we are suggesting is that if they have to take the risk involved in investing in a public company, then that risk should be matched with some degree of voting or power over the affairs of the company.

1534. Of course the difficulty there would be to equate your share of the risk with your voting power or, to put it the other way round, to match the various equitable interests which shareholders have with the right of voting, so as to divide it up equitably, as it were, amongst a whole body of shareholders. That surely presents some difficulty, does it not?—It certainly does, Sir, but this submission was made merely as a matter of principle. We did not go—when we considered our submission—into the mechanics of how to provide this right, but we felt that this should be accepted as a kind of directing principle: that if the public invested in a concern and they had no definite right to a fixed interest or to the repayment of the capital they had invested, they should have some right of exercising some measure of control.

1535. Yes.—I do not think we went so far as to suggest that there should not

be some restriction of voting rights—that the right should not differ for different classes of shares.

1536. What you said was shares with no voting rights should only be allowed where there was a minimum fixed interest yield and a pre-determined date of redemption. In those cases you said that there need be no voting rights, but in other cases there must be.—Yes, Sir.

1537. Your redeemable preference share, I suppose you would say, is for this purpose rather like loan capital?—That is so, Sir. We viewed redeemable preference shares and any capital invested which had a definite date of redemption rather in the nature of loan capital; and it seemed reasonable to us that their voting power could only be exercised in particular circumstances.

1538. We have had evidence in support of both views before us, and the question really lies between the conception of an equity split up amongst a lot of shareholders, each of whom ought to have proportionate voting powers as a matter of fairness—that is broadly your view, is it not?—and then there is the opposing view that there is no reason why a company should not create shares of any kind it pleases, and there is no reason why a man should not bind himself to accept shares on whatever terms he chooses or buy whatever shares he likes in the market; and on this view it would be an unwarrantable interference if such shares were prohibited altogether.—I can understand that point of view, Sir, but I do not fully understand why anybody should put that point to a committee that is dealing with company law, because the whole purpose of company law and the Companies Act is to regulate and to control companies; the very existence of the law, one might argue, was an infringement of the liberty of businessmen to trade as they wished. But it is with the public that we thought this Committee was concerned, and that is why we made that submission. We agree that the method of implementing the principle that we have enunciated is difficult, but we think that it is something which should be seriously considered by the Committee and if possible some ways and means should be devised to bring it into operation.

1539. And you say the Committee that is set up to recommend reform of the law ought not to be frightened by anything in the law as it stands today? You say now is the time to alter it if it is wrong? —Yes, Sir, that is our view as well.

1540. Then the next thing is have you any view as to the use of the words "Chamber of Commerce" in the names of associations? The Association of British Chambers of Commerce have made a recommendation to us on this subject.

—*Mr. Stevenson*: It is a point of confusion between our two organisations. Its effect is not completely national, inasmuch as from the Midlands northwards at any rate the two organisations are quite definitely divided in both function and in name. Further south there is a tendency for organisations irrespective of their function to call themselves Chambers of Commerce. It has often meant, in connection with committees similar to this one, that the National Chamber of Trade has been left out, and upon enquiry we have been told that our interests are already being catered for by the Chamber of Commerce. The National Chamber of Trade is incorporated under the Companies Act as a company limited by guarantee, and an organisation wishing to use the name "Chamber of Trade" must be associated with us. I think that would equally apply with the Chamber of Commerce. We feel that if the Chamber of Commerce want to insist on what I might term "closed shop rights" for their own name, that is a matter for them; we do not wish to interfere with it.

1541. So you say that if an organisation chooses to describe itself as a Chamber of Commerce, it is quite free to do so as far as you are concerned?—With respect, not quite, Sir. We would much prefer it to use "Chamber of Trade" if it is preponderantly a traders' organisation, but with regard to denying it the right to use "Chamber of Commerce", we feel it is not within our province.

1542. The next thing concerns the Registration of Business Names Act. Do your members make much use of the provisions under the Act?—Our advice in reply to any questions put to us is that compliance with the Act is essential.

We notice from correspondence many cases where there is an apparent breach. We always call it to the notice of the people concerned and advise them to comply.

1543. Looking at it the other way, the interests of your members as traders—how much use do they make of the Registration of Business Names Act? When they get a strange firm name they have never heard of, or something like that, do they go and search the Register? —To answer that I must rely on the volume of correspondence that reaches me, and I would say no.

1544. I am putting this question for this reason; this Register is an extraordinarily voluminous and cumbersome affair, and it presents almost impossible problems, I think, of indexing and so forth, and we would like to know from the various people who have experience of these things how far the service provided is worth while. —If I can use the case of the National Chamber of Trade as an example, we frequently search the Register for particular cases.

1545. Would it meet your requirements in any degree supposing the Register were abolished but there were provisions corresponding to the existing ones—with any necessary modifications—which require true names of the proprietors to be exhibited in their places of business, and which require them to put their true names on business letters?—In other words abolish the need for actual registration under the Act?

1546. Yes, but put them under a direct obligation to display these things?—I think, Sir—speaking without authority, having an opinion on various cases which have been raised—that the Chamber would raise no objection to the abolition of the Register providing the other conditions which you have mentioned were still imposed upon the people concerned.

Mr. Mortlock: May I express an opinion on that point? With regard to the Register of Business Names, I would certainly welcome its abolition, and I think regulations such as you have suggested would be much more useful not only to traders but to the general public,

to know with whom they are dealing. Because the general public will not take the time or the trouble to search the Register of Business Names, and in my experience the Register of Business Names is becoming rather a farce. The small traders generally do not realise they have got to register if they are trading in a name other than their own, and it is probably brought to their notice years afterwards, and then there is a long correspondence perhaps between their banks or their accountants and the Registrar as to why this name was not registered ten years ago when they first commenced trading.

1547. Then you get changes in the composition of the firm and so on which are not registered?—Yes, Sir.

1548. And you get people trading in their own name and people trading in the same name, who are in fact not of that name, so the information to be got from the Register as it were defies any reliable analysis?—I agree with you there, Sir.

Chairman: Those are all the questions I personally thought of asking you, but I will see whether any of my colleagues would like to put any questions to you.

1549. *Mr. Bingen:* I gather, Mr. Mortlock, your suggestion is that exempt private companies should not be required to file balance sheets and profit and loss accounts. On the other hand you would not oppose the suggestion that the accounts should be audited by properly qualified auditors and that a certificate by the auditor should be filed in lieu of balance sheet and profit and loss account. That certificate, of course, would not show to anybody who searched the file whether it had been qualified in any way by the auditors?—I would suggest, Sir, that the certificate might be required to state whether or not there was a qualification, and what the qualification was.

1550. It would not show, of course, even then whether the company was trading at a profit or loss, or what its asset position was?—No. As I tried to explain, that is what I think might be most harmful to exempt private companies trading as small family businesses—to reveal exactly what their trading position was to the public.

1551. Do you object to exempt private companies having to disclose their balance sheet and profit and loss account figures on the ground that people in the neighbourhood would know what Mr. X's income was, or because it would give additional knowledge to some competitor who might want to plant a business next door?—On both counts you have mentioned.

1552. What about the question of those who give credit to exempt private companies? Your members as retailers are buyers on credit and sellers for cash, so you may look at it in a somewhat different way than the suppliers?—Yes, but it would surprise me if suppliers of these smaller companies are going to go to the trouble, even if the information is provided, of finding out what their last balance sheet showed according to the returns made to the Board of Trade. I think that suppliers allow credit purely on experience. That is one of the risks of trade I would say, and if there is not any question of protecting the public, then I do not think there is any need to worry very much about the suppliers of goods to these retailers.

1553. That is one view. I may say it is in conflict with evidence we have had so far from one other group which was to the effect that, in insuring credit risks, it would assist them if they could see the accounts of companies concerned.—It would also be helpful, in giving credit to individuals, if they knew all about their private affairs, but there has been no suggestion that that burden should be placed on an individual.

Mr. Stevenson: The supporters of the last point of view you mention are trying to get done for them by Act of Parliament something which they themselves should undertake by means of commercial enquiries.

Mr. Bingen: I am sure commercial enquiries are made anyhow; this would be a reinforcement. There is the question of public interest; which way that balance lies is a matter which this Committee has to decide in due course, I was merely trying to probe.

1554. *Mr. Brown:* May I refer to the comment just made by Mr. Mortlock.

Surely there is a difference between the private individual trading who has unlimited personal liability—his credit can reasonably be judged—and the same private individual whose credit is good but who may be trading through a company whose credit may not be good? There is quite a difference.—*Mr. Mortlock*: I agree that certainly in law there is a difference; whether in practice it is so great as has been suggested I am very doubtful.

1555. In the majority of cases it is not different; but you have to deal with the exceptional case.—Yes, but whether or not it is a good thing to bring in legislation to cover the exceptions I do not know—I have not got a legal mind.

1556. Dealing with the question of the exempt private companies, you emphasised that the bulk of them are small companies, and I think you mentioned most retailers having a turnover not exceeding £5,000. Would it be acceptable, from your point of view, if the larger company were drawn into the net by limiting the exemption to small companies?—That figure of £5,000 referred to all types of small retail trading establishments, not limited companies. We have not considered this, but I think I would say that if a workable dividing line could be drawn, then that would be a fair proposal. If an exempt private company became overgrown, then it would lose its exemption. If a method of measuring that could be devised, I am sure that there would be no opposition from the National Chamber of Trade, but I think it would be extremely difficult—I believe this has been considered in the past.

1557. *Mr. Lumsden*: May I ask you about two points from your memorandum? One is on directors' duties. You say:—

"Directors' duties should be more clearly defined in respect of their fiduciary responsibility to shareholders and creditors."

How would you envisage that could be done?—This is a difficult question to answer. We quite frankly felt that directors over a large field do not appreciate all the fiduciary responsibilities that directorship incurs. How to make them

understand them is very difficult unless it would be possible so to recast the Companies Act to set out in one section—even if it meant repetition of other sections—the responsibilities of directors quite clearly. It might also be possible, whenever notification of a directorship is made to the Registrar, for the Registrar to send to the private address of the director concerned an understandable letter pointing out that there are responsibilities attached to directorship, and perhaps calling his attention to the relevant sections of the Act. I think it is quite possible that the reaction to that would be that many directors would not understand what it was all about but they would go to their advisers to find out, and then they would have explained to them their responsibilities under the Act. I would not have thought it a difficult matter for the Registrar, whenever directorships are notified to him, to send automatically to the address of the director some kind of notification of the kind I have mentioned.

1558. It would be difficult to be comprehensive, would it not?—It would when changes in directorships take place. But at least it might be done whenever a new company was formed. Here again our main concern is with the smaller companies. When a new company is formed that is an exempt private company, very often the individuals concerned do not appreciate the responsibilities involved in directorship.

1559. It would be difficult to be comprehensive in setting out all their duties.—I would not suggest that that should be done, but I envisage a general letter dealing with responsibilities, and in that letter reference being made to the relevant sections of the Companies Act—merely the numbers of the sections, not detailing them, so that the persons concerned if they had no knowledge of the Companies Act would possibly go to legal advisers and say, "What is all this about?", and it could be explained to them. Not an ideal solution by any means, but just one suggestion.

1560. Under disclosure of ownership and control you say:—

"In the case of public companies beneficial ownership of shares should be

disclosed in the annual return submitted to the Registrar."

I am not quite clear how the company itself would get the information to put in the annual return. Do you envisage that every shareholder would inform the company as to the beneficial ownership?—I think we mainly had in mind directors, and you will see we have made another submission with regard to directors' shareholdings, that they should be disclosed in the annual report of the company, and that information would then obviously become available. In our original submission we did not restrict our suggestion about disclosure of beneficial ownership to directors' shareholdings, but obviously from an administrative point of view it would have to be restricted to directors.

1561. *Mr. Mackinnon*: There is one privilege which an exempt private company enjoys—being able to lend money to its directors. Has the National Chamber of Trade any observations to offer on whether that is a privilege which should or should not be preserved if it were decided to preserve exempt private companies?—I think we have not really any comment to make, but I do not think there would be any objection if that privilege were retained.

1562. May I just put one other matter to you? You said that if the privilege of exemption from lodging accounts was withdrawn, it would not, in practice, be of much assistance to creditors, because no trader would bother to go and look at the file at Bush House to look up his customers?—I was referring rather to the public.

1563. Would it not be fair comment on that that the trade protection societies would be able to set up a body which would make examinations and be in a position to circulate cases of what appeared to be bad credit worthiness to their own members in a particular trade?—I think that is a point, but I think it is outweighed by the other points I have been making.

1564. *Professor Gower*: In the memorandum of evidence of the Association of British Chambers of Commerce they

suggested there was at the moment confusion between what was a Chamber of Commerce and what was a Chamber of Trade, and this was aggravated because associations were allowed to register with the name of "Association of Trade and Commerce" or "Association of Commerce and Trade". They have suggested that that should be banned and that such organisations should be required to be either "Chambers of Commerce" or "Chambers of Trade", and the decision as to which they were should depend upon whether or not they were basically controlled by retailers. Have you any views on that?—*Mr. Stevenson*: You say that the Association of British Chambers of Commerce object to registrations in the dual name. I do not know of any that are registered under the Companies Act. There are many organisations, but they are mostly unincorporated organisations, trading under the dual name. From our own point of view we would quite naturally prefer clarity, but we do not feel that we can object to someone using someone else's name.

1565. That is the problem. If they were not registered under the Companies Act would they have to register under the Business Names Act?—No, Sir, they are non-profit making.

1566. So no registration is required and there is no control whatever over the name at the moment?—That is the position at the moment. If the use of the word "Commerce" were to be controlled, could it be controlled—I ask a question, Sir—outside of the scope of the Companies Act? We would like clarity. But we are not of the opinion that it should be made a matter for compulsion under the Companies Act for unincorporated organisations.

1567. *Mr. Watson*: You have talked about the benefit of limited liability so far as the exempt private company is concerned. Are you prepared to admit there is a benefit there?—*Mr. Mortlock*: Yes.

1568. And I gather that your principal objection to the filing of returns by exempt private companies centres round the disclosure of private information concerning the remuneration of the proprietors?—I think that that is an

objection certainly; I do not think it is the only objection there is.

1569. I thought you attached considerable importance to it.—Yes, I do.

1570. I was interested in your proposal that all exempt private companies should have qualified auditors, and I wondered whether there was some possible area of compromise between your views and those of the other witnesses who claim that this exemption should be removed. Supposing it were enacted that an exempt private company were required to file its balance sheet—without the accompanying notes concerning directors' remuneration—and could if it wished also file its profit and loss account. Would you regard that as going some way to meet your objection?—Personally I would say that that proposal would meet the objection in some cases but not in others. It is quite possible that the balance sheet would provide information to private people or competitors that would be unfair to the directors of that company. The balance sheet looked at intelligently should tell anybody inspecting it quite a lot about the year's trading, about the capital position and about the previous year as well if the regulations in the Companies Act are properly complied with. I do not think that merely requiring publication of the balance sheet would overcome our objections.

1571. But the object of doing this would be in order to provide information for those who are dealing with the company as to what its financial position is and how it compared with a year ago. Is there any real objection to that?—I think it has been suggested—perhaps a kind of compromise on this—that the objections I have made would not be valid if the company had grown out of the family business stage and had increased beyond that so that it was a matter of concern to more than the original proprietors. Then I would say that the exemption should be removed. But I think that if you are going to submit a balance sheet you may as well go all the way and submit a profit and loss account as well, because under the regulations in the Companies Act to my mind it is the balance sheet that is the valuable document and not the profit and loss account.

1572. The overriding consideration surely is that the proprietors have put all they have got into their company—or nearly all—and at the same time are able to trade with limited liability.—Yes, but surely if they have put all they have got into it their liability is not limited because it would mean that a large amount of the liabilities were represented by loans made to the company by the directors—that is the families themselves. And I think it is wrong to suggest that the only advantage of a limited company is this question of limited liability; and it is wrong, I think, for anybody to suggest that the only reason a person forms one is in order to escape personal liability. I do not think that, in any case that I have dealt with, that has been a consideration.

1573. I see. Of course there are considerations of taxation which enter into a matter of this kind as well.—Yes. But the Inland Revenue are quite able to look after themselves without going to the Registrar of Companies for a copy of the accounts.

1574. *Professor Gower*: If all they want is the advantages of incorporation other than limited liability, they could form an unlimited company. Have you ever known that to happen?—No, I have not, unless you are referring to partnerships, of course.

1575. No, I was not. I was referring to cases where they have incorporated. It is always done with limited liability, is it not?—It would, I think, be not very businesslike if you were forming a limited company and were told of the various advantages, and you said "There is one advantage I do not want". I think it is only natural if there is an advantage attaching to registration or incorporation that a person would take it and not voluntarily throw it away.

1576. But if this Committee were to recommend that if they incorporate with limited liability then they must disclose their profit and loss account and balance sheet, a small company with *unlimited* liability would still be able to maintain its privacy. The latter would get all the other advantages except limited liability which you have said you do not regard as of paramount importance?—I agree.

1577. *Mrs. Naylor*: Some people have suggested it is too easy and too cheap to incorporate. Do you think it is too cheap?—I do not see how you are going to decide whether it is too cheap or not; it is dependent on what services are being rendered. If you mean are the stamp duties too high or too low, I think they are quite high enough. I do not think it is too cheap in that respect. But like any other professional service that is rendered, a person usually receives what he pays for, and if he forms a company cheaply it probably has not been done very well.

1578. The annual maintenance of the company can be done for a few shillings a year, can it not? Then there is an annual return.—I would not say that the annual return is the only expenditure involved in the maintenance of a company. In order to keep a non-trading company alive it is necessary to submit an annual return, and that return can be filled in presumably by the directors or the secretary and submitted to the Registrar for 5s., but I do not think that is "getting things on the cheap" at all. In connection with annual returns, it seemed to us (purely from the administrative point of view) rather unnecessary that exempt private companies, whose directorships and shareholdings change very little from year to year, should have each year to send in a return with all particulars just the same as in the previous year. And we would suggest, in the case of exempt private companies, that where there is no change, a certificate of no change might be accepted instead of an annual return.

(The witnesses withdrew.)

MR. A. F. HULL, MR. C. W. ASTON, SIR JOHN BROCKLEBANK, BT., MR. F. CHARLTON, MR. J. A. MANN, MR. H. E. GORICK, C.B.E., and MR. ROY HILL called and examined

1582. *Chairman*: Gentlemen, we are much obliged to you for coming to help us today. Mr. Hull, Mr. Aston, Sir John Brocklebank, Mr. F. Charlton and Mr. Mann you are all members of the General Council of British Shipping; and Mr. Hull is Chairman of Ellerman Lines Limited. Mr. Aston is a Director of the

It would save everybody a lot of work. It could be incorporated, if the suggestion were adopted, with the proposed certificate from the qualified auditor with regard to the audit of the accounts. That is only a small suggestion, but it seems to me that the files of the Companies Registration Office must be bulging with annual returns. Our proposal would help their storage problem and it would also help, of course, the secretary and directors of the exempt private companies.

1579. Are there any conditions of membership for joining the National Chamber of Trade?—*Mr. Stevenson*: An interest in the subject, a requirement that the person is a principal in trade, but we do not make exhaustive enquiries; we rely upon the information given to us and we require him to be proposed within the membership of the Chamber; the Board of Management has the right of acceptance or refusal.

1580. You would expect them to be respectable people?—We would not apply for an annual renewal fee if they were not.

1581. Would many of your members be companies whose shares were quoted on the Stock Exchange?—No, very, very few.

Chairman: Gentlemen, I think those are all the questions we have to put to you. I repeat we are much obliged to you all for coming here today and helping us with your memorandum and also with your oral evidence. Thank you very much.

Peninsular and Oriental Steam Navigation Company, Sir John Brocklebank is Chairman of Cunard Steam-Ship Company Limited, Mr. Charlton is Chairman of Furness, Withy and Company Limited, and Mr. Mann is a Director of Buries Markes Limited. Also present are the Joint Secretaries of the General Council,

Mr. Gorick and Mr. Hill. Are those particulars right?—*Mr. Hull*: Yes, Sir.

1583. Gentlemen, before we begin our discussion I should tell you the position about publication, which is this: a verbatim record of these proceedings is being taken and a transcript will be sent to you to enable you to verify its accuracy. This record, together with your memorandum, will be published as soon as possible after this meeting. Is that all clear?—*Mr. Hull*: I think possibly your questions may be put in such a way that we would have to give information which we would like regarded as confidential. If we are to give you the fullest assistance we must obviously mention names of countries and possibly other things which we would not like to appear in print. We wonder whether it would be possible, Sir, if we do find ourselves in that position, to look at the evidence we had given, to see whether some of it could be left out of the official report.

1584. There is some difficulty from our point of view. You are interested in a particular accounting exemption and at some stage the Committee will have to decide whether that ought to be continued or not. It is hardly reasonable to expect the Committee to state its view, whether in favour of your Council or not, without stating the evidence on which it is based. That would obviously cause comment and would not be right.

But I do not know if this helps you at all: as far as my questions are concerned, they do not refer to any particular figures, any particular places or any particular ships. They are simply questions on the principles involved. Have you any objection to the publication of those?—None, Sir, at all. I was merely trying to stress the point that some of the evidence we might give would be affecting particular places in the world.

Chairman: I think the Committee should consider this point, and perhaps therefore you would withdraw. I am sorry to put you to that trouble.

The witnesses accordingly withdrew and after the Committee had discussed the matter in private session the witnesses were recalled.

1585. *Chairman*: Gentlemen, the Committee's decision is that your submissions on questions of general principle and the grounds stated in a general way in support of your arguments must be, it seems to us, made public; but we think that supporting figures are in a different position. We fully understand that you want to be able to present your case to the best advantage. Therefore so far as supporting figures or actual details are concerned we are prepared to receive them on the footing that they are to be confidential and not published.—*Mr. Hull*: Thank you very much, Sir. Please understand that we are not trying to be obstructive in any way at all.

1586. May I take it you still rest your case for exempting shipping companies from the obligation to disclose reserves on the sole ground of national interest?—Yes, Sir.

1587. The sole ground—that is how it was put, I think, in 1947?—Yes, Sir.

1588. That is to say, you think that the obligation to disclose would be detrimental to the interests of British shipping, and anything detrimental to British shipping must be contrary to the national interest?—Quite definitely.

1589. Of course there are other forms of undertakings or concerns which are allowed a similar exemption. In particular there are banking and insurance companies; but in those cases, as I understand it, the persons interested in the question of disclosure or non-disclosure are not merely shareholders, but they include customers, that is to say depositors at the banks, and policy holders, so far as insurance companies are concerned, and it is for the protection of those, it may be said, that the privilege of non-disclosure was given to bodies such as those. Can you point to anyone interested in the shipping industry to whom similar considerations can be applied?—We would say, Sir, that any company which is engaged in foreign trade would need this protection because some foreign countries, having shipping of their own, try to prevent us from having any share of the trade that can be taken away from us. They are always anxious to find out how

we stand and they are very anxious indeed to know our strength.

The Order was regarded as being essential, Sir, in 1948, and it is even more essential now when competition from all over the world has grown very considerably indeed; and indeed certain countries now have a mercantile marine of their own which they did not possess in 1948. Whatever reasons were judged adequate for granting this exemption in 1948 must be stronger now, because we are in a much more vulnerable position than ever before.

1590. How does it help you? I fully appreciate your difficulties and the importance of the work you do. But how does it help your business to stand up against foreign competition, to have these secret reserves?—To give you an example, we are fighting two foreign companies, neither of which is aided by the State directly but each of which has indirect State aid. They are doing their very best to deprive us of any share of their trade that they can take, and it would be most important to them and indeed extremely helpful if they were able to study our profit and loss accounts—not necessarily our balance sheets, but our profit and loss accounts—and see how successful we were, firstly in making a profit; and secondly in how we dispose of that profit, as to whether we are writing down our ships or indeed putting sums to reserve which could be used as, shall we call it, a fighting fund to prevent other countries making too many inroads in our trade, which is of course quite vital for Britain. It is a matter of such importance, Sir—in the case of my own Company we trade all over the world—that I would regard it as quite disastrous if we had to make such disclosures as would give these foreign companies information about how successful we were in our trade.

1591. Or how unsuccessful?—Quite, Sir.

1592. Then to take up the other side of the argument, one finds various professional bodies and individuals concerned with the protection of investors claiming that as a result of this exemption shareholders are prevented from ascertaining the true financial status of the company at the date of the balance sheet and from

receiving a true statement each year of the profits earned, prepared on a consistent basis. The shareholders in other words are prevented from having a proper account—or so it is put.—I am afraid I cannot agree with that at all, Sir. An Exemption Order does not mean that you produce accounts which do not show the true state of affairs of your company at a certain date. They may not show them in as great detail as some shareholders would desire: if that is so, a shareholder has only to attend the annual meeting and ask questions, which have to be answered by the chairman. I do not think it is a valid reason at all. This is a matter of national interest, Sir, not of the investing public.

1593. You say in effect, the shareholders do get true and fair accounts?—Certainly, Sir.

1594. Even with this non-disclosure, and you say also, I suppose, that in any case the considerations of national interest should outweigh any deprivation of the shareholders in that respect?—Certainly, Sir.

1595. That is how you put it, is it? How far would you be prepared to carry this? Would you say that for the purposes of, for example, a take-over bid, the concealment of reserves might not produce an unfair result?—I imagine, Sir, in a take-over bid the company doing the taking over would demand the fullest information before it made any bid of any sort. If the bid was insufficient then clearly it would be the duty of the board of the company being taken over to tell their shareholders the truth.

1596. You would say that was a special case, I suppose?—I have never been the subject of a take-over, Sir, so I really do not know the machinery. Might I ask Mr. Aston here, Sir?

Mr. Aston: I have never been the subject of a take-over bid either, Sir, nor do I intend making one, so I cannot speak from experience. I imagine full disclosure would have to be made.

1597. The point wrapped up in that question is this: it is clear, is it not, that the effect of having a secret reserve is to

make the company appear to be rather worse off than it really is?—I agree.

1598. Would not that facilitate an incursion by speculators into the shipping share market with a good chance of buying shares below their true value because the shareholder does not find out their true value from accounts?—*Mr. Hull*: As far as that is concerned, Sir, surely it is not our function to consider the speculator? As far as shipping companies are concerned they want to attract the type of shareholder who stays with the company because he thinks it is a good one, well managed and sound. I feel the question of the speculator wishing to make a quick profit should not be really discussed in connection with the Exemption Order which, as I have said, is a matter of national interest.

1599. Yes, but it is not unknown in other markets at all events for somebody to find a line of shares where it appears to him likely that the balance sheet value, and probably the market value, will be lower than it ought to be.—I suppose that is quite true, Sir.

1600. It is analogous to the case where a company has some land or buildings, which have appreciated enormously in value but are still carried in the company's books at a quite inadequate price—pre-1914 or something of that kind. I am not saying it is a good argument but one of the arguments put forward is that that state of affairs, which has an analogy in your case I should have thought, would assist an operator of that kind in getting the shares cheaply.—*Surely, Sir*, there is a perfectly good safeguard for any shareholder because the board of the company is in duty bound to give its shareholders correct advice on the value of their capital; and indeed in a case like that to which you have referred the board would disclose the hidden assets, if there were any. This would enable the existing shareholders either to resist or accept a take-over bid. It is a matter for the individual surely, Sir.

1601. You say, supposing an individual received an offer for his shares and he wrote and asked the advice of the directors as to what he should do, the directors

would give him their view as to the value of the shares and that view of course would take account of any secret reserves?—*Indeed, Sir*.

1602. Then there is a point about the Peninsular and Oriental Company which I would like to hear about. I am not sure we have our facts right, but it has been suggested to us that the Peninsular and Oriental line has in fact disclosed its reserves in its consolidated accounts and that this has had no adverse effect.—*Mr. Aston*: That is correct, Sir. I think perhaps it would help this Committee if I briefly recounted our experience of the working of the Exemption Order. For the first few years after the Order was made we made full use of it. We disclosed our profits only after making provision for deferred repairs and transfers to contingency reserves, and we included contingency reserves with the sums owing to creditors.

Then there came a period when we were under attack in this country because our critics said the management was inefficient because we could not earn a reasonable rate of profit on the capital employed. On the other hand we were in trouble in Australia, being criticised for making too much profit out of the Australians. Clearly, both of those criticisms could not be true, and we felt it was probably better to disclose the whole position, which we did, and have done for the last five years. In doing that, obviously we gave very careful consideration to the question of foreign competition and we concluded that, with figures of our size covering the operations of over three hundred ships trading to all parts of the world, our figures could convey no valuable information to our foreign competitors.

It is quite wrong to conclude from that, that we do not value the Order. If you go to the files at Bush House and turn up the accounts of some of our subsidiary companies trading on particular routes, you will find there that full use is made of the Order, and I should be very sorry indeed if we had to disclose the full profits or losses of some of our subsidiaries which trade on specialised routes where the foreigner is only too anxious to know what our results are.

1603. So that you apply the exemption or not, according to local conditions?—Yes.

1604. I am much obliged. I think that clears that point up. The Cohen Committee, on whose report the Companies Act, 1948, was founded, considered the question of disclosure of reserves. They suggested that one reason for requiring such disclosure was to help to dissipate any suggestion that hidden profits were being accumulated by industrial concerns to the detriment of consumers and those who worked for industry. Then one may add to that that the Trade Union Congress have informed this Committee that unions are hampered in their negotiations when they have no financial information on the basis of which they can make a judgment of the company's ability to pay, and they refer to the exemption afforded to shipping companies as a case in point. What would you say about that? Do you think you are the objects of any such criticism?—*Mr. Hull:* First of all may I say that shipping is in a category entirely by itself. We have depressions which are not experienced by other industries. We have them more frequently; and indeed I would probably be right if I said that for every two years of good trading we have about five bad years. For that reason we have to put aside as much as we can to reserve to help us over the bad times. That is peculiar, I suggest, to the ship-owning industry. So far as trade unions are concerned, I would like to point out the Seamen's Union has just made the finest settlement made in Great Britain since the war. They did not question whether we had the ability to pay.

1605. So you do not think anything of that?—I think nothing of it at all, Sir.

1606. Then the next point—nearly all these are against you but you must not regard them as views held by the Committee; we are merely trying to get at the pros and cons. It has been suggested that the exemption, so far from operating in the national interest, has in fact operated to prejudice the national interest. The argument in support of that is that non-disclosure of reserves has fostered inefficiency and wasteful use of assets in the

shipping industry, because it has enabled directors to conceal from their shareholders the low rate of return which has been earned, after proper provision for replacements.—Nobody but a shipowner could make a remark like that, and no shipowner would be so stupid as to do so. It is quite a nonsensical remark. Forgive my saying so, but it is absurd.

1607. It is absurd to suggest non-disclosure of reserves has fostered inefficiency, or is used as a cloak for inefficiency? You of course repel that?—It is quite the reverse, Sir.

1608. You will appreciate that we have had a lot of evidence and views from all quarters, and that point is one of the points we have unearthed from our very considerable supply of contributions of written evidence, so we thought it right to put it.—Indeed, Sir, I am not complaining in any way.

1609. Then I think you would agree to the proposition that a strong, stable shipping industry is vital in the national interest. You would agree to that, would you not?—Certainly, Sir.

1610. Then you distinguish between fair and unfair competition, but I suppose the obligation to disclose would be equally adverse in its effect as regards any competition, would it not, so far as you are concerned?—It is very difficult to distinguish what is fair and what is unfair competition, Sir. We have to meet competition in a great number of forms. There is flag discrimination.

The United States have brought in a ruling that 50 per cent. of all Aid cargoes and any cargo financed in one way or another by the United States Government should be carried in American ships. In some cases the ruling provides that the remaining 50 per cent. will be available to the ships of the aid-receiving country. No British shipowner has any chance at all of any of that cargo. In the case of India these Aid or government-financed cargoes represent a very substantial part of the trade between the United States and India and any of the 50 per cent. which the Indians cannot carry goes back to the American ships, which means the British

shipowner is up against what we consider unfair competition.

1611. And you say you are aided in meeting that competition, as far as you do meet it, by non-disclosure of reserves?—I do not really think so, Sir, because competition is either met or it is not met and I do not think the American government or indeed any other government would alter their laws because they thought one shipping company did not disclose the amount put into reserve. I really do not think the Order itself affects unfair competition. Fair competition is in another category. If a man is able to run a ship better than you can, provide a faster, better service, he takes the cargo away from you. That is fair competition. In that case I would say non-disclosure of reserves definitely helps, when you are up against what is called ordinary fair competition.

1612. Unfair competition encountered abroad by exporting concerns in this country may be of more or less the same order as the expedients of which you complain. Would any exporting company be in the same kind of difficulties as shipping companies?—I really do not think I am competent to answer that question, Sir. I think any company in competition with companies domiciled abroad would naturally not wish to give those companies any information which would make its task more difficult in maintaining the exports of this country. I am not an export expert so I think my remarks cannot be regarded as very accurate. I would have thought they wanted the same thing as we do.

1613. You say there may be exporting companies experiencing difficulties comparable to yours, but do you say, for that reason, there is no reason why they should not have exemption?—None at all, Sir.

1614. Then, as regards discrimination in the shape of foreign legislation ensuring that goods imported into, or exported from a country are carried in ships of that country—that is what I mean by discrimination—how would you be aided in combating that through non-disclosure of reserves?—We could not, Sir. The only way we can be aided is by action of Her Majesty's Government. It is largely a governmental matter, as I mentioned just

now, where in the United States the government passed a decree that 50 per cent. of cargo must be carried in American ships. Disclosure cannot stop that.

1615. Then as regards subsidies, which is another difficulty, the same line of argument I think applies to them, does it not?—Exactly, Sir.

1616. There is only one more matter I want to ask you about and that is about the accounts that British shipping companies have to file in foreign countries. There is apparently some embarrassment occasioned there as to the form of accounts which have to be made out.—*Mr. Aston:* Some countries require foreign companies carrying on business there to file accounts in accordance with the law of the country. In doing that they are following the example of our own Companies Act, but I understand in practice the Board of Trade do not carry out the full measure of the requirements in our Act and do in practice accept the accounts of any foreign company in the form in which they are prepared in the country of incorporation. I think, therefore, it would be a much better example to foreign countries if our Act said that foreign companies shall be required to file the accounts which they prepare for their own domestic purposes and in accordance with their own domestic law with, if you like, such modifications as the Board of Trade may require of them; rather than putting it in the way it is in the Act at present, that they shall comply with our Act, subject to modifications. Section 410 provides that "every overseas company shall . . . make out a balance sheet . . . and if the company is a holding company, group accounts, in such form and containing such particulars and including such documents, as under the provisions of this Act . . . it would, if it had been a company within the meaning of this Act have been required to make out . . .". But this provision is made "subject to any prescribed exceptions".

I think it would be much better if that Section was the other way round and said that every foreign company shall be required to file with the Board of Trade the accounts which it prepares under its own domestic legislation with such modi-

fications as may be prescribed in particular cases.

Chairman: Yes, I follow you.

1617. Then amongst the documents which you have submitted to the Committee there is a memorandum of the 23rd January, 1947, which is your original application for exemption, and I would like to read part of it because it seems to me to summarise your case very well. It is on page 3 of that document, which is an annex to your present memorandum, and it is this:

"The General Council feels convinced that the application to the shipping industry of the requirements of the first schedule relative to 'provisions' is against the competitive interest of the shipping industry and therefore against the national interest. It holds this view most strongly and most sincerely."

This is the passage I think seems to me to put your case very succinctly:

"It believes that such disclosure, especially when compulsorily made at a time of depression when the resources of the shipping companies had been depleted and were attenuated, would be of real help to their foreign competitors who are under no similar obligation to put their cards on the table. It is also undesirable to make such disclosure in a time of strength as in certain circumstances it would indicate to the foreigner profitable trades into which to break, or tonnage of a particular type to develop. The industry asks the Board of Trade to leave it the right to make in its accounts such provision for liabilities and contingencies as it deems necessary, in such a manner that its foreign competitors may be left to guess at the degree of hidden strength and at all events may not have disclosed to them a condition of weakness, if such temporarily exists."

Does that fairly summarise the views you hold today?—*Mr. Hull:* Yes, Sir.

Chairman: It seems to me to put it quite concisely and clearly, if I may say so. Gentlemen, those are all the questions I have in mind to ask you, but I expect some other members of the Committee would like to ask you a question or two.

1618. *Mr. Bingen:* I find it hard to see exactly, if you are not showing voyage accounts or things to that degree of detail, why the disclosure of your full figures should give such valuable information to your foreign competitors. I would have assumed the Americans, the Italians and the Greeks had a pretty good knowledge of which routes were remunerative and which were not, and that you were subjected to this sort of competition in any event.—Some routes, it is quite correct to say, are remunerative, and some are not. But it is very difficult to tell how far that goes. It is very difficult to find the line of demarcation between a remunerative and an unremunerative route. I think it is quite right to say our competitors can get a lot of information from the first item on the debit side of the profit and loss account. You take your net profit and start making your allocations. We are allowed to have an omnibus phrase which says, depreciation of ships, provisions, transfers to reserves—which may be any figure at all. If our competitors realised that a company was able to put a sum to reserve which was very much greater than expected, they would realise that an attack on that particular company could be launched either by way of persuading their own government to grant a subsidy to a domestic shipping company, or indeed some other form of discrimination which might make it extremely difficult for a British company to continue to make a profit.

1619. I can see that, in the case of the company which has very few ships, all sailing on the same line. But take a larger company, P. and O., or Cunard, which has a world trade: would this disclosure of your figures, after seeing the appropriations to reserves, really give much further information about particular voyages?—As to particular voyages, no.

1620. Routes?—*Sir John Brocklebank:* Sir, I think I can answer this very simply by an illustration. In one particular trade we have two companies against us, both private, and we cannot find anything out about them whatever, and I would give my right hand to know what their resources are. It could alter our entire policy. If we thought they were

pretty thin then we might be prepared to have a rate war. It is as simple as that. But we do not know, and they do not show any signs of going off by themselves. Your whole policy can be determined by the resources of the opposition.

1621. Could I ask what the position is in other countries? You are obviously anxious not to disclose more than you have to, to your foreign competitors. Can one go to the accounts of American shipping companies and find out whether they are running successfully?—The answer is that the public companies have to disclose everything, which is a great help to us. It is as simple as that. The passenger conference across the Atlantic is a unanimous conference on alteration of rates and so on—matters have to be agreed by everybody. There are 26 lines in it. If one particular line gets very awkward, the conference, knowing their resources or lack of them, could call their bluff because the only resort that line has is to resign from the conference, and if they know the rest of the conference have any resources it will not do that.

1622. I quite see it would be an advantage to the shipping companies and in the national interest that they should continue on a remunerative basis and not show strength or weakness to competitors. Mind you, all industry has this competition. If it is concerned in overseas trade and has not this protection. Is not the other angle to be considered too, namely the interest of investors who may buy shares in the market (or you may want to make an issue at any time)—does not the public interest then demand sufficient disclosure to enable the investor or potential investor to have a real appreciation of where he is putting his money?—*Mr. Hull*: I think the answer to that, Sir, is that if anybody issues a fraudulent prospectus he goes to jail. If you ask for money you must issue a prospectus giving the state of the company.

1623. I think you misunderstood my question. You would not be publishing anything untrue if you were giving the same figures as appear under the present Exemption Order.—I think you would not persuade the public to invest in your company unless you made a full disc-

losure. It is as simple as that. As far as the public is concerned, before they venture their money in a concern at all they usually demand the fullest knowledge of the resources of that company and the chances of making a profit, and I think that the company making the issue would have a very small chance of raising the money they wanted if the prospectus did not give that information.

Mr. Aston: Sir, I am quite sure the Exemption Order applies only to balance sheets and profit and loss accounts, not to prospectuses.

1624. The prospectus would only refer to the profits as disclosed in the profit and loss account.—I think if the prospectus is issued to the public it has to disclose everything. If it is to shareholders only, I do not think it need be a prospectus in the same sense.

1625. I quite agree. You are quite right on that. I assume by and large the object of the Exemption Order is so that you can set aside provisions to reserve in good years and not disclose your profits. The converse may also apply, but the objective being to build up your strength against competitors. If that were being carried to excess so that shares of shipping companies in the market were standing at a figure below their real value, is there not a possibility—although *Mr. Aston* has said he has never been the subject of a take-over or made a take-over bid—that you might get foreign companies bidding for control of main British lines, which would be contrary to the national interest?—*Mr. Hull*: Surely our accounts, profit and loss or balance sheet, do not hide strength at all? We do not hide the amounts we allocate, we merely do not detail them. The strength of any company must be shown in the accounts or the auditors would not sign them, and the profit and loss account must be a true statement of that. Any movement from reserve has to be shown in the accounts; and in bad times, if we have to make transfers from reserves, that would have to be shown in the profit and loss account.

1626. *Mr. Brown*: It would seem to me the main argument is this: exemption

must be some loss to the shareholders, but in your view it is overridden by the national interest?—I do not think the shareholders lose at all. I think it would be right to say that in the case of any company which has a quotation on the Stock Exchange, the market value of its shares is measured firstly by profitability, which of course is disclosed, and secondly by the strength of the company's reserves, whatever they may be; and the fact that we do not detail those reserves or how our allocations are set aside and to which particular reserve, does not alter the value of the shares as quoted on the Stock Exchange, nor harm the shareholder in any way whatsoever. This, as I made clear earlier on, is done purely in the national interest and to protect us against foreign competition. So far as we are concerned we have no difficulty or doubts whatsoever about revealing anything to the British public.

1627. It seems to me to imply that the exemptions you have enable you to mystify the foreign competitor but that you do not mystify the British shareholder.—No, Sir, I do not think it is a question of that at all. "Mystify" is perhaps a wrong word, if you will forgive me. It is non-disclosure of vital information. So far as the shareholder is concerned, as I have said before, he is mainly looking to, firstly, how profitable the company has been able to show itself, and secondly how its free reserves show up in comparison with the issued ordinary capital; and that is shown in our accounts whether there is the Exemption Order or not. The British shareholder is in no doubt whatsoever what is the strength of the company he is proposing to invest his money in.

1628. I have some doubts in examining the accounts to form a view as to the profitability and I can only say, Sir, that I cannot agree with you. You may disclose your gross profits and make deductions from them in an omnibus item. Some of those deductions we would say are necessary deductions, some of them are free reserve deductions. If you do not separate them I cannot tell whether they are not all necessary deductions. I can only assume that what is left is the net

profit. Your own case I think is that in certain years you make large profits and in other years you make very little profit, or a loss, but you do not tell the shareholders the extent to which those variations occur?—That is true.

1629. Then the shareholder does not know in a good year how much you are earning, and in a bad year how little you are earning?—All I can say is that if he goes to the annual meeting and gets up and asks the Chairman, he will be given all the information he wants.

1630. If the Chairman is prepared to give that information in a meeting, which will be published, why is it refused in the accounts?—He does not wish it to be published but he cannot refuse a question of that sort put by a shareholder.

1631. I should have thought the answer of the Chairman would be, "this is a matter which is subject to exemption under the Companies Act and I am sorry I cannot answer it".—If the shareholder got up and asked what amounts had been transferred to reserve, I do not think the Chairman of the company would be able to shelter behind the Exemption Order; I may be quite wrong.

Mr. Charlton: I would not go quite as far as my friend Mr. Hull here because I would claim relief from supplying certain information because we have this Exemption Order and, I think, quite rightly too. There are a lot of questions asked at annual meetings which are merely asked, if I may say so, just out of pure curiosity and have no other purpose. I think the best way to explain it is that it is a matter for the Chairman at each individual meeting to deal with as he think best in the interests of the company and having regard to the type of shareholder asking the question. Personally I have never experienced any difficulty on this particular matter.

1632. That I can understand. It would seem clear, if you did answer questions of that kind, you would have defeated the purpose of the exemption.—I agree. If you analyse the accounts at the annual meeting this of course would all be reported, as you rightly say, and that of

course is what a lot of the financial papers hope will happen one of these days: I hope it will not because I strongly believe it would do infinite harm to the industry as a whole and to the country.

1633. And in times of prosperity therefore the shareholder will not know how much more profit has been earned?—In times of prosperity he is usually well looked after in the shape of a reasonable dividend, and he knows perfectly well that shipping is subject to these cycles of good years and bad years—unfortunately, more bad years than good years. I think they are all satisfied that the profitable years must take care of the lean years.

1634. Nevertheless, quite apart from take-over bids, individual shareholders will from time to time sell their shares and it may well be that the market price does not represent the true value.—That might apply to any industry.

1635. That is a subject this Committee is considering.—If I may say so, when you get down to Stock Exchange transactions I suppose we are all very much in the same boat. *Mr. Hull:* The directors of a ship-owning company are in duty bound to do the best they can in the interests of their shareholders; and I think anybody who invests money in the ship-owning industry is very brave and as he is brave he will obviously place trust and confidence in the board. It is not a question of trying to do a shareholder down or deprive him of anything to which he is entitled. A man who has given his life to shipping does learn that you cannot at all times distribute a dividend that will please the shareholders, for the simple reason that you have to set aside so much against the depression which will inevitably come. But at all times we do our very best to ensure that British shipping continues to exist. We cannot always ensure that it is profitable. If we were unable to make it continue to exist, then this country would be in a very sad state of affairs indeed.

1636. With regard to the questions you have already answered as to the harm this disclosure might do, I think I can see that in a particular line where large profits are being made, perhaps unduly large for the

time being, you would have difficulty with your customers on the other side. In a case where you are currently making large profits or losses, is the argument also that that disclosure would encourage the competitors of that nation to attack you particularly strongly?—Yes, Sir.

1637. The question of inefficiency of directors was mentioned. One of the suggestions put to this Committee about industry generally—not specially shipping—is that more disclosure should be given about assets and profits, particularly assets, so that some measure can be taken of the efficiency of the management of particular companies: if, in the case of one company, profits as a proportion of the assets (at their true net value) are not comparable with those of another company in the industry, the argument is that there must be some inefficiency and something should be done about it. That argument could apply to shipping companies, at least between one company and another, and between one country's shipping and another country's shipping. It would come from an economist's point of view, create a measure if there is criticism to be made.—You will not expect me to agree that ship-owning directors are inefficient.

1638. But of course some of them could be?—Of course it is quite obvious that it could happen: but if a ship-owning company does not make the profits the shareholder or anybody else thinks it should have made, it is probably for reasons of trade. Most trade these days is governed by politics. One country finds that it has not sufficient foreign exchange to buy British motor cars or other foreign goods and stops buying, and immediately the shipowner is affected. That is not a question of inefficiency but of fluctuation in world trade, and that is what causes a shipowner either to make money or not to make money. He can only give a service and wait for the trade to come to him. He cannot create trade. It is nothing to do with the efficiency or inefficiency of the directors that there are fluctuations in the shipping industry.

1639. The question was raised of prospectuses just now. I am not sure, but the implication was that in a prospectus full

disclosure would have to be given. Does that mean you do not mind giving disclosure in a prospectus, or that as a result of that there never will be a prospectus?—What you are saying is, if a ship-owning company issued a prospectus, would it be able to persuade the public to invest in such a hazardous enterprise?

1640. Not quite. I understood you agreed, if you issue a prospectus, you would have to make full disclosure. You say you object to making full disclosure; therefore either you would never issue a prospectus, or it would not be quite full disclosure?—*Mr. Charlton:* Well, it would not be quite full disclosure.

Chairman: The last paragraph of the Shipping Companies Exemption Order, 1948, provides that: "nothing in this Order shall be taken to exempt a company from complying with the requirements of the Act relating to prospectuses, statements in lieu of prospectuses, or offers of shares or debentures for sale". So shipping companies are no better off than anybody else in this respect.

Mr. Mackinnon: Under Section 39, if the shares are to be quoted on the Stock Exchange, they can get a certificate of exemption from compliance with the full prospectus requirements of the Act; so it is conceivable that a shipping company would not have to disclose in a prospectus the information which it is exempted from disclosing in its accounts.

Mr. Richardson: There probably would not be a prospectus at all in the case of an established company.

1641. *Mr. Brown:* In connection with the Exemption Order, is there any requirement for additional disclosure to the Board of Trade?—Yes, Sir. Indeed we have to make the fullest disclosure to the Board of Trade in whatever form they require, and to the taxation authorities as well of course.

1642. *Mr. Lumsden:* We heard that P. and O. do not take advantage of the Order, and the reasons were explained. Are there many other shipping companies that do not take advantage of the Order?—I believe there are quite a number, Sir. It is a question of course of where

they trade and whether they wish to take advantage or not. I could not tell you what percentage of shipping companies do not take advantage of the Order.

1643. But you would feel there is a special reason in all the cases in which the Order is not invoked?—I would have thought any company which really feels that it has any advantage at all in having the Order should be allowed to take advantage of it. If any company considers that the Order is of no real value, they need not use it. I know of one or two shipping companies which publish their accounts in the very greatest detail. They do not wish to take advantage of the Order. But so far as I am concerned I would like to say, if there is one shipping company to whom it is going to be of advantage nationally to have this Order, then the Order should be retained.

1644. *Professor Gower:* I want to be quite sure I have fully understood the case. Is your case against full disclosure based upon the fact that this would give valuable information to foreign competitors about the profitability of particular shipping lines, or is it based upon the fact that it would be valuable to them because they would know what reserves you have to replace tonnage; or is it based on both?—Both, Sir.

1645. As regards the first of those, you would concede I think that similar arguments would apply to any company which had a large overseas business, and not only to shipping companies?—I think so.

1646. The fact remains that no other type of company, apart from banking and insurance, has this exemption, nor have they asked for it?—If we may go back in history, I think an amendment was moved to the Companies Bill in the House of Lords that shipping should be included, and indeed it was the intention then that shipping should be specifically mentioned in the 1948 Companies Act; but the Act eventually provided for very much wider exemption than was originally intended. The fact that insurance and banking are specifically mentioned in the Companies Act has really very little to do with the matter.

1647. What I meant was that in addition to insurance and banking there must be large numbers of other concerns with international trade equally affected by this argument; Imperial Chemical Industries, Unilever and so on.—I would have thought so, but I am really not competent to speak about anything but shipping.

1648. As regards the second point, replacement of tonnage, could it not be argued that if it is in the national interest that shipping companies should be in a position to replace their tonnage, this is a matter for the Government to look to; and if it is in the national interest they will give a subsidy, as indeed they recently have to Cunard?—I think I would ask you to excuse me from discussing subsidies, on which the Policy Committee of the General Council are reporting to the Government at the present moment. If I may be excused from anticipating what the industry is going to say, I would be very grateful.

1649. My point is twofold. First, is it true that the only way of replacing tonnage today is out of your reserves? If the Government take the view that it is in the national interest, presumably they will see you are in a position to do it?—I am sorry, I am not sufficiently in the confidence of the Government to know if that is what they feel.

1650. Secondly, if it be a fact that the Government is making subsidies for this purpose, as they have in at least one case recently, will it really be valuable to foreign competitors to know what your reserves are? They will say—"these people may appear weak but in fact they will get their tonnage replaced because the British Government will give them a subsidy".—Tonnage replacement is not the whole problem. Reserves are set aside for a great number of purposes and tonnage replacement is provided out of the wear and tear provisions one sets aside; but if the replacement reserves are not sufficient to replace the existing ship the balance has to be found, say out of special reserves, if the company is to carry on.

1651. Your argument is that the national interest demands these things.

What I was suggesting is, if the interests of shareholders demand something different, is it not for the Government perhaps to tackle this problem in a different way?—*Sir John Brocklebank*: I think you have missed the most important point, if I may say so. The reserves are for hard times, and a company's policy in a conference can be vitally affected by the strength of the opposition and its own strength. If a hungry wolf turns up from the blue and attacks the trade, and you do not know his strength and he does not know yours, neither side quite knows how long the other can go on. If the other side do not quite know what you have in reserve it is of great value to you—it is really psychological—because they think twice before they will have a row.

1652. *Sir George Erskine*: Would it be true to say that the reserves could be in any form at all on the other side of the balance sheet, but what matters—so far as a company's strength is concerned—is its liquid assets; what it has in cash to fight a battle, or to replace tonnage. The reserves may be in a form that cannot help the company at all?—That is true, but the little bit of unknown does help.

Mr. Hull: I think Professor Gower brought in other large international organisations. I venture to suggest that that does indicate a slight misconception of what our business is. The ships that have the benefit of this Order are wholly in foreign-going trades. They have no home trade whatever and many of them are solely dependent upon one particular trade. If that goes, they have nothing else to fall back on because they cannot get in anywhere else. Other large international organisations have home markets, and if they cannot sell their goods in France they can sell them in Holland—they can advertise. Do not forget shipping companies cannot create trade but can only carry what trade is there.

1653. *Professor Gower*: But there are surely other concerns in exactly the same position? The British American Tobacco Company, for example.—That may be. I think another important point is that there are a number of shipping companies

whose trade is solely concerned with what we call "cross" trades between, say, Japan and Australia, who never come to this country at all but whose trade is wholly abroad and who are under attack at both ends of their routes.

1654. *Mr. Bingen*: It may not be relevant but I cannot quite accept the statement that shipping companies cannot create trade. With lower freight rates export trade can be increased; that is very relevant.—If I could be allowed exactly an hour, Sir, I could answer that question.

1655. *Professor Gower*: I understood you to say, Mr. Hull, that if a take-over bid was made you would regard it as your duty to make complete disclosure to your shareholders of all your secret reserves.—I think it is very difficult to make a generality on a take-over. I do not think it has ever happened in the shipping industry because nobody would have the temerity or the foolhardiness to buy a shipping company. It is not the sort of company the take-over man likes. We never have the cash reserves usually—that is why you said just now we asked the Government to help us. Take-over really does not come into this picture at all. But surely if somebody made an offer for the shares in their company, the directors would have to consider whether that offer was adequate or not. If they considered it was inadequate they would surely have to give their reasons.

1656. I cannot quite accept your statement that there are no takeover bids ever made in the shipping industry—take, for example, the P. and O. and the Orient Line: the Clan Line and the Union Castle; it depends on what you mean by a take-over bid, but there have certainly been mergers.—I did not realise you were talking about mergers. A take-over in the eyes of the ordinary public is something entirely different.

1657. *Mr. Brown*: Surely the Union Castle were taken over?—I do not know.

1658. *Professor Gower*: Obviously the directors would say whether they regarded a bid as fair, but surely they would not in fact make full revelation of the company's

net assets? It was one of the complaints in one of these recent mergers that the shareholders were entitled to a full prospectus and it was held they were not, and they did not get detailed information.—*Mr. Hull*: Would you not think that the directors would have to give their reasons why they thought that the offer was insufficient, or why it was the sort of offer the shareholders should accept? Obviously reasons would have to be given to persuade the shareholder or guide him as to what action to take.

1659. If that is right, your foreign competitors have only to put someone up to make a take-over bid if they really want to find out your strength?—It is a question of size. In the case of P. and O. I think a take-over would be a little difficult. In the case of Cunard again, and Mr. Charlton's company and my own company—I do not think we need discuss that.

1660. I am very alive to the force of Mr. Aston's arguments about the effect of the existing provisions about overseas companies' trade accounts, but there is this difficulty about the suggested solution: if an overseas company with an established place of business over here merely has to file such accounts as are required in the country of its incorporation, everybody might form companies where there were no accounting requirements.—*Mr. Aston*: That could well be, but I can only put the suggestion forward for consideration. I doubt if it would be a practicable proposition for United Kingdom companies, operating here, to incorporate abroad on a large scale. I do not know—I have never tried to do it.

1661. *Mrs. Naylor*: Can you envisage a situation arising in the future where the maintenance of the shipping industry at its existing level was not in the national interest?—*Mr. Hull*: Madam, surely shipping is so vitally necessary to the survival of this country that it must always be in the national interest that it continues?

1662. Shipping is absolutely vital, but what about the British shipping industry?—Are we not the biggest—in normal years do we not provide the biggest

invisible exports compared with any other industry?

1663. I was asking if you could envisage a position in the future where the maintenance of the British shipping industry at its present level was not in the national interest, perhaps because there were too many costs involved.—If the British shipping industry ceased to exist and the whole of the exports and imports of this country were carried by foreign shipping, the loss in invisible exports would inevi-

tably mean a lowering in the standard of living of everybody in this country.

Chairman: Gentlemen, I think that concludes all the questions anyone wants to bother you with, so we need not trouble you further. But I would like to express the Committee's gratitude to you for your help that you have given us this afternoon and for turning up in such strength, if I may say so, to put the case for shipping companies. Thank you very much indeed.—Thank you very much, Sir.

(The witnesses withdrew.)

APPENDIX XIV

Memorandum by Mr. Registrar Berkeley, Registrar of the Companies Court.

1. Incorporation of Companies—Memoranda of Association

- (a) *Requirements as to minimum number of members, and other conditions of incorporation*

No comment.

- (b) *Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

Although objects are not generally limited in modern Memoranda of Association, the power to limit them is invaluable as between a Company and its directors. Members should be able to limit a Company's and the directors' activities and if so empowered, it is the members' fault if they give the Company and its directors too wide a mandate. On the other hand as between a Company or its directors and third parties the *ultra vires* rule, if and when it applies, is likely to operate unfairly; for it is not really practicable when dealing with the Company to search, and, having searched, to construe, a modern objects clause so as to be sure that a transaction is *intra vires* the Company. There is much to be said for a Company incorporated under the Companies Act having all such powers vis-à-vis a third party as a natural person has, as is the case with a Company created by Charter. (See Buckley, 13th edition, p.25.)

- (c) *The company as a legal entity distinct from its members—"one-man" companies*

No comment.

- (d) *Shares of no par value. (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954.)*

If shares of no par value are introduced, it may be argued that there will be no "reduction of capital" when a capital payment is made to the holders thereof while the Company is still a going concern. The position of creditors should, in my view, be safeguarded by making it necessary to obtain the confirmation by the Court of any proposed payment of capital to the holders of such shares other than by way of distribution of a realised capital profit. An inquiry as to creditors could then be directed as on a reduction involving return of capital, if the Court were not satisfied that they would not be prejudiced by the payment to the members.

2. Prohibition of Partnerships with more than 20 Members

No comment.

3. Classification of Companies

- (a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

If the distinction between public and private companies is to be maintained, it is desirable to make clear in any new Companies Act whether a Company limited by guarantee without a share capital can be a private company. The doubt arises by reason of Section 28(1)(a) of the Companies Act, 1948, which could not apply to such a Company. It can be argued on the other hand that the words "if any" should be implied in sub-paragraph (a) and that such a Company if it fulfils sub-paragraphs (b) and (c) (so far as the latter relates to debentures) can bring itself within the Section.

(b) Nature and merits of distinction between exempt and non-exempt private companies (Sections 127, 129 of Companies Act, 1948)

The same applies with regard to the distinction between exempt and non-exempt private companies. Condition (a) in Section 129(2) cannot apply to a Company limited by guarantee without a share capital unless the words "if any" are to be implied after the words "shares and debentures" as they must be after "debentures" in condition (b).

(c) Unlimited companies and companies limited by guarantee

No comment other than the above.

4. Donations by Companies for Charitable and Political Purposes

No comment.

5. Exercise of Powers of Companies by Directors and Degree of Control—Control Retained by Shareholders

(a) Fundamental changes in company's activities

(b) Disposal of undertaking and assets

(c) Issue of shares

(d) Borrowing money and charging property, and

(e) Lending money otherwise than in the ordinary course of business

Under the existing law the shareholders have available the machinery to enable them to control their directors with regard to all these matters by imposing in the Articles appropriate conditions precedent to the exercise of these powers. In practice, however, such conditions are seldom imposed except in relation to the borrowing of money and charging of property. It is worth considering imposing a statutory condition requiring either an Ordinary, an Extraordinary or a Special Resolution sanctioning the exercise by the directors of the Company's powers under each of these heads as a prerequisite of their exercise.

It would seem right that fundamental powers such as these should be exercised only with the assent of the members and, if that should be agreed, it is for consideration whether a bare majority or a three-quarters majority of votes should be required. The latter would seem to be desirable as regards (a), (b) and (e) but the former may be sufficient as regards (c) and (d).

6. Directors' Duties

(a) Should their duties be stricter and more clearly defined, and if so, in what respects?

I doubt if stricter definition will achieve much. I had a case before me where the sole director of the Company could neither read nor write!

(b) Are Directors generally aware of the legal duties arising from their fiduciary position?

In the Companies Court and in practice at the Bar the impression is gained that directors (and particularly directors of small companies) are generally not only unaware of their fiduciary duties but also little aware of any of their duties at all. But this is probably because the majority of cases concerning directors which came before the Court or to Counsel for advice are those where such duties have been disregarded or overlooked.

It may well be that in the majority of cases directors are sensible of their fiduciary position and honestly endeavour to act in the best interests of the Company.

The views of solicitors on this heading are therefore likely to provide fairer guidance than those of Counsel or officers of the Court.

- (c) Directors' and officers' dealings in their own companies' shares
- (d) Disclosure of directors' interests, and
- (e) Should bodies corporate be allowed to be directors?

No comments.

7. Shares with restricted or no voting rights

I cannot see the objection to these. No one is under any compulsion to acquire shares of this character. It must be assumed that those who do so prefer to invest in a Company controlled by persons who have run it successfully and are likely to be able to retain control rather than be at the mercy of the unknown majority of a mass of shareholders, many, and probably most, of whom may be completely without experience in the kind of business carried on by Company.

8. The protection of minorities

Until the decision of the House of Lords in *Scottish Co-operative Wholesale Ltd. v. Meyer* 1959 AC 324 and the Court of Appeal decision in *H. R. Harmer Ltd.* 1959 1 WLR 62, Section 210 was virtually a dead letter. Since those cases, however, its provisions have been, or can be, successfully invoked and, in my view, it now affords an adequate remedy for the protection of minorities in cases where the facts would justify a winding-up order under the just and equitable rule. The relief which the section affords is, however, open to criticism both from the point of view of the minority shareholder and from that of the Company. It is in practice often difficult for a minority shareholder to establish a case for a winding-up order under the just and equitable rule, and this is a *sine qua non* of success under Section 210 (see Subsection (2)(b)). A common case where this difficulty may preclude recourse to the section is where the owner of 50 per cent or approximately 50 per cent of the shares of a Company dies having during his lifetime received 50 per cent or approximately 50 per cent of the profits of the Company by way of remuneration and little or nothing by way of dividend and leaving the owners of the remainder of the shares in the Company on the Board or in a position to control the Board. His widow and universal legatee finds herself the owner of her deceased husband's substantial interest in the Company but unable to derive any benefit from it, for the Board can continue the policy of declaring no, or minimal, dividends and at the same time refuse to buy her shares. Provided that the Board is careful not to do anything fraudulent or wholly unjustifiable, her interest can be rendered virtually valueless.

From the Company's point of view the connexion of the remedy under the Section with the just and equitable rule usually results in winding-up being claimed as alternative relief, with the result that the advertisement of the petition may seriously handicap a flourishing Company in the conduct of its business and this invites the use of the section as a weapon of blackmail.

In these circumstances it is worth considering the substitution of the words "even if" for the words "but otherwise" in subsection 2(b) of the section and the insertion after the words "complained of" a little further on of the words "and notwithstanding that the facts might not justify the making of a winding-up order had such an order been applied for".

This would give the Court much wider powers of preventing oppression and might at the same time save a solvent company from the embarrassment of trying to conduct its business with a winding-up petition on the file or the threat of one hanging over it.

If this suggestion were to be adopted it would seem desirable to insert somewhere between Rules 33 and 37 in the Winding-up Rules a new Rule on the lines of Order 53b rule 10 (but omitting the reference to Section 67(2)) providing for a Summons for directions where a Petition has been presented under Section 210. This would enable advertisement to be dispensed with where creditors would not appear to be affected and to be postponed until near the date of hearing in those cases where advertisement

is deemed necessary. It should also ensure that all necessary parties are before the Court, that the relief is properly stated in the prayer and that the matter is not referred to the Judge until the evidence is complete. Furthermore it would afford a useful breathing space in which wiser counsels might prevail and if, as often happens, the matter were to be settled on terms which required no Order from the Court, the Registrar would be able to authorise the withdrawal of the Petition and in that case neither advertisement nor public hearing would be necessary.

In such a case the Section would in effect relieve the oppressed minority without the Company suffering the embarrassment of having its members' domestic quarrel made public.

9. Protection of Special Classes of Shares

No comments.

10. Board of Trade Powers to appoint Inspectors

No comments.

11. Disclosure of Ownership and Control

No comments.

12. Share Transfer and registration

No comments.

13. Multiplicity of Directorships held by one individual

No comments.

14. Practice of carrying on business through associated and subsidiary companies

No comments.

15. Loan Capital

(a) *Debentures and debenture stock*

No comments.

(b) *Trust deeds—duties of trustees and receivers*

No comments.

(c) *Registration of Charges*

Under Section 96 of the Companies Act 1948 the duty of registering charges is imposed on the Company and liability to heavy penalties for non-registration is imposed on officers of the Company by subsection (3) of that section. But subsection (3) is in practice of no value because the Section nowhere makes it clear that the duty of the Company is to send the particulars for registration *within the time required by Section 95* namely 21 days after the date of the creation of the charge.

In practice there are on the average 2 to 3 applications to the Court a day under Section 101 to extend the time for registration of Charges and while it is desirable in the interest of the Chargee that the time should be extended wherever the case can be brought within the section, it does not seem right that where the directors of the Company have been guilty of gross neglect of their duty they should escape the consequences of such neglect under Section 96(3) merely because the Court has thought fit to grant an extension of time under Section 101. In fact the directors do escape, since the Board of Trade takes the view that on the present wording of Section 96 a prosecution would be bound to fail in a case where the Court has extended the time for registration and the particulars have been registered within the extended time.

The position should be clarified one way or the other by inserting in Section 96(1) words indicating clearly the time within which registration is to be effected by the Company and if, as I think was intended, an extension of time for registration under Section 101 should not operate to exonerate the officers of the Company under Section 96, Section 96 should contain a proviso making that clear. I have had one

case where the Company not only completely failed in its duty under Section 96 but also failed to co-operate with the Chargee, and indeed obstructed him, in his application for an extension of time under Section 101, failing for an unconscionable time to supply evidence which the Chargee asked for and which he required in support of his application. Ultimately, after the matter had come before me and I had expressed strong views on the director's conduct, the evidence was forthcoming and the Chargee obtained the extension of time. It would have been unjust to refuse it, for the fault was in no way his and he might have suffered if the charge had not been registered. I sent the papers in that case to the Prosecution Department of the Board of Trade but they felt unable to prosecute since I had extended the time.

16. Take-over Bids

(a) Procedure, and

(g) Application of provisions regarding compulsory acquisition of shares of dissenting minority (Section 209 of Companies Act, 1948)

Under Section 209 the transferee Company is required to obtain not less than nine-tenths in value of the shares whose transfer is involved before it can compulsorily acquire the shares of dissentient shareholders. In recent years the practice has grown up of procuring the same result as can be achieved under Section 209 by means of a Scheme of Arrangement under Section 206 and even in two cases by a reduction of capital under Section 66 without a Scheme of Arrangement. Under such a Scheme of Arrangement or reduction of capital the holders of the shares which the Transferee Company wishes to acquire become bound to submit to the cancellation of their shares in exchange for the issue of shares in the Transferee Company, an equivalent number of shares in the Transferor Company being then created to replace the cancelled shares and issued to the Transferee Company. Such a Scheme only requires a resolution passed by a majority in number holding a three-quarters majority in value of the holders of the shares which are to be cancelled who are present in person or by proxy at the meeting of such shareholders. Such a majority is very much easier to obtain than that required under Section 209 and furthermore there is the added attraction that *ad valorem* Stamp Duty at £2 per cent., which would be payable if that Section were invoked, is avoided.

It is true that such a Scheme requires the sanction of the Court whereas an acquisition under Section 209 does not; but such a disparity between the majorities required under the two sections to achieve the same result would seem unjustifiable. Accordingly, if the machinery of Section 209 is to be retained, consideration should be given to requiring the approval of a similar majority, whichever section is invoked, to enable the Transferee Company to replace the holders of the shares in question in the Transferor Company. Unless this be done, Section 209 is likely to become a dead letter. It is in any case unfair on the dissentient shareholder to place the onus of applying to the Court on him; for, apart from the financial risk this involves, he has seldom a sufficiently intimate knowledge of the Company's affairs to make out his case. For these reasons there is much to be said for repealing Section 209 and requiring the sanction of the Court for all compulsory acquisitions of shares or compulsory replacements of shares by shares of another Company. If these could be effected only by means of Section 206 or some similar machinery, the Court could ensure that proper meetings are held, that full disclosure is made and that the transaction is in all respects a proper one.

(b) Securing disclosure of information on which shareholders can form an opinion

Disclosure of information would be secured if my proposal in (a) were adopted.

(c) Functions of directors

The directors' functions would be to prepare a Scheme and Circular and initiate an application to the Court by the Transferee Company for leave to convene the appropriate meeting or meetings of its shareholders.

(d) *Disclosure of identity of bidder*

Disclosure of the identity of the bidder should be a *sine qua non* of the Scheme.

(e) *The financing of such transactions*

The Court would require to be satisfied of the ability of the Transferee Company to fulfil its obligations under the Scheme. The Transferee Company would have to submit to be bound by the Scheme.

(f) *Disclosure of directors' interests—compensation for loss of office (Sections 191–194 of Companies Act, 1948)*

Section 207(1)(a) would cover disclosure of directors' interests.

17. *Prospectuses—Statements in lieu of Prospectuses—Offers for sale—bonuses of shares to existing shareholders*

No comments.

18. *Control over business of dealing in securities*

No comments.

19. *Unit Trusts and "Open End Mutual Funds"*

No comments.

20. *Reduction of Capital and Purchase by a Company of its own shares*

The existing machinery for reduction of capital appears to work satisfactorily. The procedure on Petitions to the Court to confirm reductions is understood by practitioners and causes little delay in practice. In my view it is desirable in the interest of both creditors and shareholders that the Court should retain its existing control of reductions of capital with a nominal value and that if it be decided to allow shares of no par value, the same control should be extended to cover return of capital to holders of such shares as indicated in paragraph 1(d) above. If the existing control of reduction of capital is to be retained, the decision of the House of Lords in *Trevor v. Whitworth* 12 A.C. 409 that a Company cannot purchase its own shares except by way of reduction of capital must be allowed to stand. If it were not retained, reference to the Court on a return of capital could be avoided.

21. *Accounts*

No comments.

22. *Audit*

No comments.

23. *Provisions as to returns*

No comments.

24. *Company and Business Names*

No comments.

25. *Foreign Companies*

No comments.

26. *Internal Management and Administration*

No comments.

27. *Winding-up*

(1) *First Meetings of Creditors and Contributories under Section 239(b)*

This Subsection is in terms imperative but in practice cases have arisen where it has been impossible to comply with it and compliance has been dispensed with by Order made in Chambers in the Companies Court. Strictly speaking there would appear to be no jurisdiction to make such orders and it would seem desirable to insert a comma after the word "shall" followed by "unless the Court thinks fit to order otherwise and so orders". Compare Section 235(1) dealing with Statements of

Affairs. If this suggestion be adopted Rule 57 could be expanded to cover dispensing with first meetings of creditors or contributories by adding in the margin "or meetings of creditors and contributories" and inserting in sub-paragraph (1) after "235" "or 239(b)", and in sub-paragraph (2) substituting "any such requirement" for "the requirements of the said section".

(2) *Powers of Liquidator—Section 245*

On more than one occasion the Court has given leave to the Liquidator to enter into a transaction which was clearly beneficial for the purposes of the winding-up but which strictly speaking did not appear to come within any of the sub-paragraphs in subsections (1) and (2) of this Section. If my memory serves me as to two of such cases which came before me, they involved in one case the granting of a short Lease of property of the Company by the Liquidator where no sale of the property could be effected and in the other the granting of a long lease of property and the sale of the property subject to the Lease. It is suggested that a sub-paragraph (g) should be added to Section 245(1) in the following terms:—

"(g) to enter into any other transaction or do any other act or thing which may be deemed conducive to the beneficial winding-up of the affairs of the Company and distribution of its assets".

(3) *Private Examinations under Section 268*

No Form of Order or Notice is provided in the Appendix to the Winding-up Rules as under Section 270 is done in the case of a Public Examination (see Forms 27 and 28). The jurisdiction under Section 270 has in recent years rarely been exercised. That under Section 268 is regularly used. It is suggested that a similar form to the statutory form for Private Examinations in Bankruptcy (viz. Form 144 in the Appendix I to Bankruptcy Rules 1952) should be inserted in the Schedule to the Winding-up Rules.

(4) *Public Examinations under Section 270*

In view of the decision in *Re Campbell Coverings Limited* (No. 2) 1954 Ch 225 that the Court has jurisdiction under the joint effect of Sections 307 and 270 to order a public examination in a voluntary liquidation, it seems ludicrous that it should have no power to do so in a winding-up under supervision. See Section 315(2) and the Eleventh Schedule to the Act.

Although a supervision order is seldom made nowadays, it would seem to be desirable in the interest of consistency to delete the reference to Section 270 from the Eleventh Schedule to the Act.

(5) *Proof of Debts—Section 316*

The relevant date for the purpose of ascertaining the debts provable in a compulsory winding-up is nowhere stated either in the Act or the Winding-up Rules though a hint is given in the Note to Form 59 in the Appendix to the Rules. This seems a back-handed way of dealing with a vital point. The practice has been to treat the relevant date as being the same as that for the purposes of Preferential Payments under Section 319 (see subsection (8)(d) of that Section). It is suggested that Section 316 should become subsection (1) and that the following subsection (2) be added to that Section:

"(2) The relevant date for the purpose of ascertaining the debts provable under Subsection (1) of this section and estimating the value thereof shall be

- (i) in the case of a company ordered to be wound up compulsorily, the date of the appointment (or first appointment) of a provisional liquidator, or, if no such appointment was made, the date of the winding-up order, unless in either case the company had commenced to be wound up voluntarily before that date; and

(ii) in any case where the foregoing sub-paragraph does not apply, means the date of the passing of the resolution for the winding-up of the company. Provided Always that nothing herein contained shall justify the admission of a proof for interest in respect of any period after the commencement of the winding-up on a contractual debt carrying interest".

The proviso is suggested in order to avoid interference with the decisions in *Re Agricultural Wholesale Society* 1929 2 Ch 261 and *Parent Trust & Finance Co. Ltd.* 1936 A.E.R. 641. If the above suggestion is adopted, it may be thought advisable, in order to obviate the risk of an attempt to upset the established case law on set-off and mutual credits (see *The Ince Hall Rolling Mills Company Ltd. v. The Douglas Forge Company* 8 Q.B.D. 179 at p. 184 and *City Equitable Fire Insurance Co. (No. 2)* 1930 2 Ch 293 at p. 310), to add to Section 317 some such words as the following:—

"and notwithstanding the provisions of the preceding section, the commencement of the winding-up and not the date of the winding-up order shall be the relevant date for the purposes of applying the said rules in relation to set-off and mutual credits".

(6) *Verification of Petition—Rule 30*

The insistence on verification by a director secretary "or other principal officer thereof" has proved oppressive and perhaps ridiculous in some cases. For example the Local Branch Manager of a Bank is often much better qualified to verify a Petition than any of the persons referred to in the Rule. It is suggested that the words "person duly authorised by the Corporation" be substituted for "principal officer" in the Rule.

(7) *Notice by persons who intend to appear on the hearing of a Petition—Winding-up Rule 34*

Now that most Solicitors' offices are closed on Saturday "Friday" should be substituted for "Saturday" in this rule.

(8) *Winding-up Rule 57*

Consequential amendments to this Rule will be required if my above suggestion with regard to Section 239(b) be adopted.

(9) *Settlement of List of Contributories Winding-up Rules 82 and 85*

There is no provision in the Act or Rules for the filing of the List of Contributories (Form 41) or Supplemental List (Form 45). In practice the Court insists on their being filed before authorising any distribution to contributories: but inexperienced liquidators are not always aware of the necessity for filing the lists and it is desirable that it should be expressly provided for. This could be done by adding at the ending of Rule 82 "and shall be filed with the Registrar accordingly".

In order to ensure the strict observance of Rule 85 it is also suggested that Form 45 be amended so as to include paragraphs 2 to 5 inclusive of Form 41.

(10) *Winding-up Rule 109—Expunging a Proof at instance of a Liquidator*

The Court's power under this rule appears to be limited to expunging the proof or reducing its amount. In practice it is often necessary to vary it by increasing the amount for which it is admitted or altering it or part of it from non-preferential to preferential. This would be covered if the wording of this rule were similar to that of Rule 110, viz. "expunge or vary the proof" instead of "expunge the proof or reduce its amount". Rule 24 in the Second Schedule to the Bankruptcy Act 1914 is in similar form to Rule 109 of the Winding-up Rules, and if my suggestion were adopted it would appear desirable to make a similar alteration to that.

(11) *Summary of Statement of Affairs*

Rule 126(1) of the Winding-up Rules requires the Official Receiver to send to each creditor a summary of the Statement of Affairs. The Rule is peremptory. Compliance with it can be oppressively burdensome in certain cases, for example in a

Mail Order Business where there are thousands of creditors for small amounts—often only a few shillings—and only meagre assets. I understand that the Official Receiver estimates that the cost of sending such a Summary to each creditor works out at something like 1s. to 1s. 6d. a head. In practice in such cases the Court has authorised notification by advertisement and dispensed with strict compliance with the Rule: but it is doubtful whether it has jurisdiction to do this. It is suggested that the words "unless the Court otherwise orders" should be inserted as the opening words of Rule 126.

(12) *Summoning of Meetings of Creditors (Rule 129)*

Exactly the same point arises under this Rule and in practice in exceptional cases the Court directs advertisement in a Local Paper or other appropriate newspaper instead of written notice to every creditor as provided for the Rule. The difficulty could be overcome by the insertion of the words—"unless the Court otherwise orders" between "and" and "shall" in the second sentence of the rule beginning "and shall not less than seven days".

(13) *Determination of powers and rights of Directors*

There appears to be no provision in the Act or Rules determining the directors' powers and rights on a compulsory winding-up. Compare Sections 285(2) and 296(2) in the case of voluntary winding-up. It is suggested that similar provisions should be inserted somewhere in the Sections dealing with Winding-up by the Court namely Sections 218 to 277 in (ii) of Part V of the Act.

(14) *Unclaimed assets in England to be paid into Companies Liquidation Account*

Section 343 covers (*inter alia*) money held in trust but does not appear to cover Stocks and Shares and other property held in trust. Sometimes a Liquidator finds himself holding share certificates for shares in a Parent Company to which shareholders in the Company in liquidation have become entitled under a Scheme of Arrangement but have never taken up because it has proved impossible to trace the shareholders. In practice the Court has given the Liquidator leave to sell the shares and pay the proceeds of sale into the Companies Liquidation Account but *quære* whether it had any jurisdiction to do so. It is suggested that the terms of Section 343(1) should be extended to enable Stocks, Shares and any other property held by the Liquidator in trust for any person as a member of the Company to be sold with the leave of the Court and the proceeds of sale to be paid by the Liquidator into the Companies Liquidation Account.

28. Problems of Administration and Enforcement of the Law

No comments beyond those made under various other headings above.

29. Any other matters within the terms of reference

No comments.

Dated 29th March, 1960.

APPENDIX XV

Memorandum by the National Chamber of Trade

The National Chamber of Trade is the principal comprehensive organisation representative of the retail distributive trades in the United Kingdom. Its affiliated organisations and individual members were invited to comment on the questions asked by the Company Law Committee and the following is a summary of the opinions expressed.

1. Incorporation of Companies—Memoranda of Association

(a) *Requirements as to minimum number of members, and other conditions of incorporation*
No change recommended.

(b) *Limitation of objects to those stated in the Memorandum: obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

In the case of Exempt Private Companies a "universal" Objects Clause should be permissible in their Memoranda of Association. With all limited companies it should be possible to alter the Objects Clause by special resolution at an Extraordinary General Meeting called for that purpose.

(c) *The company as a legal entity distinct from its members—"one-man" companies*

A Limited Company should continue to be regarded as a legal entity distinct from its Members.

(d) *Shares of no par value. (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)*

It should be permissible for a Public Company to issue shares of no par value as part of its capital, but this should not be permissible in respect of a Private Company.

2. Prohibition of Partnerships with more than 20 Members

No change recommended.

3. Classification of Companies

(a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

No change recommended.

(b) *Nature and merits of distinction between exempt and non-exempt private companies (Sections 127, 129 of Companies Act, 1948)*

No change recommended.

(c) *Unlimited companies and companies limited by guarantee*

No change recommended.

4. Donations by Companies for Charitable and Political Purposes

No alteration necessary.

5. Exercise of Powers of Companies by Directors and Degree of Control retained by Shareholders

(a) *Fundamental changes in company's activities*

No alteration necessary.

(b) *Disposal of undertaking and assets*

No alteration necessary.

(c) *Issue of Shares*

No alteration necessary.

(d) *Borrowing money and charging property*

No alteration necessary.

(e) *Lending money otherwise than in the ordinary course of business*

No alteration necessary.

6. Directors' Duties

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

Directors' Duties should be more clearly defined in respect of their fiduciary responsibility to shareholders and creditors.

(b) *Are Directors generally aware of the legal duties arising from their fiduciary position?*

Directors of Private Companies are often unaware of their fiduciary position.

(c) *Directors' and officers' dealings in their own companies' shares*

Provision should be made for the disclosure to Members of the Company of Directors' and Officers' dealing in their own Companies' shares whether such dealings were in their own name or in the names of nominees.

(d) *Disclosure of Directors' interests*

The present provisions of the Companies Act are adequate.

(e) *Should bodies corporate be allowed to be Directors?*

No.

7. Shares with Restricted or No Voting Rights

Shares with no voting rights should only be allowed where there is a minimum fixed interest yield and a pre-determined date of redemption.

8. The Protection of Minorities

It is considered that the existing remedies are adequate.

9. Protection of Special Classes of Shares

No change required.

10. Board of Trade Powers to Appoint Inspectors

The present powers of the Board of Trade to appoint Inspectors in certain circumstances are adequate and should be retained.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies), and*

(b) *Control through nominee Directors*

In the case of Public Companies beneficial ownership of shares should be disclosed in the Annual Return submitted to the Registrar. In the Annual Report to the

Members, the Directors' shareholdings should be disclosed with a note of any changes made during the financial year.

12. Share Transfer and Registration Procedure

The present provisions are adequate.

13. Multiplicity of Directorships held by one individual

This is considered to be a matter for shareholders only.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

This should continue to be permitted.

15. Loan Capital

(a) *Debentures and Debenture Stock*

No change needed.

(b) *Trust Deeds—Duties of Trustees and Receivers*

Present provisions are adequate.

(c) *Registration of Charges*

This should be maintained.

16. Take-over Bids

(a) *Procedure*

(b) *Securing disclosure of information on which shareholders can form an opinion*

(c) *Functions of Directors*

(d) *Disclosure of identity of bidder*

(e) *The financing of such transactions*

(f) *Disclosure of Directors' interests—compensation for loss of office (Sections 191–194 of Companies Act, 1948), and*

(g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority (Section 209 of Companies Act, 1948)*

No changes recommended.

17. Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

(a) *Adequacy of protection afforded to investors by existing law*

(b) *Usefulness and necessity of the existing provisions, and*

(c) *Certificates of exemption (Section 39 of Companies Act, 1948)*

Existing provisions are adequate.

18. Control over Business of Dealing in Securities

Existing provisions are adequate.

19. Unit Trusts and "Open End Mutual Funds"

No comment.

20. Reduction of Capital and Purchase by a Company of its own Shares

No change required.

21. Accounts

Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies? Are all the existing provisions necessary and useful in present-day conditions?

(a) Revaluation of fixed assets and use of any resulting surplus

Any surplus resulting from a revaluation of Fixed Assets should be transferred to a capital reserve.

(b) Share premium account

In the case of a Share Premium Account the Board of Trade should have power to give permission for wider use of the Share Premium Account than at present allowed.

(c) Use of pre-acquisition profits of subsidiaries

No alteration in law necessary.

(d) Description of reserves

No alteration in law necessary.

(e) Definition of profits

No alteration in law necessary.

(f) Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948

No comment.

22. Audit

(a) Qualifications and appointment of auditors

Already sufficiently defined in the Companies Act of 1948.

(b) Duties and responsibilities of auditors

Already sufficiently defined in the Companies Act of 1948.

(c) Exemption of "exempt private companies" from the provisions of Section 161 of the Companies Act, 1948

All Limited Companies, whether Public or Private, should have a qualified Auditor, i.e. a member of a body of accountants established in the United Kingdom and for the time being recognised for this purpose by the Board of Trade.

23. Provisions as to Returns

An annual certificate of "no change" should be sufficient in the case of Exempt Private Companies where there has been no change in Capital, Shareholdings and other details now required by the present Annual Return.

24. Company and Business Names

Existing provisions are adequate.

25. Foreign Companies

No comment.

26. Internal Management and Administration

(a) Annual and other General Meetings

(b) Mode of passing extraordinary and special resolutions

- (c) *Securing proper disclosure of information in circulars seeking proxy votes, and*
(d) *Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g. by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company.*

The provisions of the Companies Act, 1948, are adequate.

27. Winding-up

Section 283(1) of the Companies Act, 1948, relating to the Statutory Declaration of Solvency in the case of a proposal to wind-up voluntarily, should be amended to allow a period of three years instead of 12 months for a Company to pay its debts in full, particularly where the assets of the Company include real estates.

28. Problems of Administration and Enforcement of the Law

The provisions of the Companies Act, 1948, are adequate.

29. Any other Matters within the Terms of Reference

The Chamber has no other points to make.

APPENDIX XVI

Memorandum by the General Council of British Shipping.

1. This memorandum is submitted to the Company Law Committee by the General Council of British Shipping, the constituent members of which are the Chamber of Shipping of the United Kingdom and The Liverpool Steam Ship Owners' Association and which thus speaks for the Shipping Industry as a whole. The Committee in asking, by way of the communication from its Secretary to the General Council of January 15th, 1960, for any views that the General Council might wish to submit to it, listed a number of items within the field of its consideration. This memorandum relates to the only two of such items about which the General Council desires to make a submission, the main one being in respect of the Shipping Companies Exemption Order made by the Board of Trade in July, 1948, in exercise of the powers given to it by the 1948 Act.

2. Annexed hereto are copies of two memoranda which the General Council submitted to the Board of Trade in 1947/48, in support of the case which it was then promoting for the Exemption Order that was ultimately made. This case was investigated by an advisory committee appointed by the Board of Trade under the chairmanship of Mr. E. H. Marker, the then principal official of the Companies Department of the Board of Trade, by which committee a deputation from the General Council was received. The outcome was acceptance of the merits of the case by H.M. Government, particularly the two departments specially concerned—the Board of Trade and the Ministry of Transport—and by Parliament.

3. The present relevance of these earlier memoranda lies in the fact that the case then submitted and accepted for the making of the Exemption Order applies today with equal, and indeed for the reason given below with even greater force to its retention. The case for exemption was made on sole ground of national interest that, both in good and depressed circumstances of shipping trading, the degree of public disclosure in accounts which would otherwise be entailed would provide foreign competitors with information that, in the competitive interest of British shipping and therefore in the national interest, it was undesirable that they should be given. It is summed up in paragraph 6 of the memorandum of the 23rd January, 1947, and is admirably stated in the speech made in the House of Lords by Viscount Swinton quoted in paragraph 3 of the memorandum of the 4th March, 1948.

4. The Exemption Order was thus made to give help and to avoid prejudice to British shipping in upholding itself in all its international trades against foreign competition, including, especially, State aided competition. On that ground of merit, the case for the retention of the Order in 1960 is as strong, if not stronger, than was the case for making it in 1948. Foreign competition has increased over the period and British shipping has lost ground to it in a number of the trades in which it is engaged. State aided competition in particular has increased with the maintenance of subsidies to which the earlier memoranda refer and with extension of practices of flag discrimination, i.e., action by Governments to bring about, by measures of law or in other ways, the transfer of cargo carrying from the ships of countries like the United Kingdom competing on an economic basis, to the ships of the National flag, some of which have themselves been brought into existence with Government aid. The whole picture is one of British shipping engaged in increasingly difficult and severe combat with other flags, including an increasing number whose Governments are using every conceivable device to foster their national shipping.

5. Competition has increased on the part of—

(a) the "conventional" maritime flags operated on a basis of fair and economic competition;

- (b) the State aided flags operating on a basis of unfair and Government assisted competition; and
- (c) the so-called "flags of convenience" of Panama and Liberia, operating on a basis of virtual freedom from taxation and without the supervisory control imposed by Government regulation on the conventional mercantile marines.

Tonnage under these flags has been the subject of extraordinary increase.

6. The following table is illustrative of the increase in tonnage over the period 1948-59 in the case of the principal competitive foreign flags. Among them, the United States, Japan, France and Italy in varying degree subsidise their shipping. India is one of the main practitioners of discrimination. In the case of the other practitioners like Chile, Argentine and Brazil, it is not so much a matter of increase in pre-existing tonnage but the use of discriminatory practices to increase cargo carrying by ships already owned.

Tonnage by Flag (1,000 gross tons and upwards)

(Based on Lloyd's Register Statistical Tables)

Flag	1948—G.R.T.	1959—G.R.T.	Percentage increase
Denmark	1,013,999	2,087,955	105.9
France	2,597,836	4,338,056	67.0
Greece	1,246,322	2,081,070	67.0
Germany	122,792	3,900,257	3076.3
Holland	2,492,083	4,245,196	70.3
Italy	1,961,834	4,911,664	150.3
India	250,000 (approx.)	707,695	183.0
Japan	729,409	5,602,999	668.1
Norway	3,954,615	10,051,666	154.2
Spain	977,681	1,445,608	47.8
Sweden	1,765,335	3,451,745	95.5
United States*	15,416,046	8,110,755	47.4 decrease
Liberia	none	11,916,750	non-existent in 1948
Panama	2,675,855	4,540,180	69.7
United Kingdom	16,875,459	19,727,846	16.9

* Sea tonnage excluding reserve fleet. About half the tonnage under the flag of Panama is in American ownership, directly or indirectly.

7. Another indication of the increased foreign competition which British shipping is encountering is to be found in the official statistics of shipping entering and clearing U.K. ports in the foreign trade with cargo as follows:—

Tons Net (000 omitted)

			Entrances		Clearances	
			1948	1959	1948	1959
British ships .. .. .	..	..	34,673	43,309	25,642	33,124
Foreign ships .. .. .	..	..	15,881	41,470	10,123	20,828
Total .. .. .	..	..	50,554	84,779	35,765	53,952
Percentage British .. .. .	..	..	68.6	51.1	71.7	61.4

8. The Exemption Order was made in 1948 after careful consideration by the Board of Trade of the case put forward in justification of it and as a protective measure for British shipping in its competition with foreign flags. The General Council submits

that the facts and figures given in the foregoing paragraphs in respect of such competition establish the case for the retention of the Order, which this memorandum is designed to establish.

9. The other point on which the General Council desires to make some observations concerns the position of foreign companies in relation to the accounting provisions of the Companies Act, 1948. U.K. shipping companies concerned with this point are in some foreign countries required to file accounts to comply with local Companies Acts. These Acts are sometimes modelled on the U.K. Act, but in certain countries abroad, India and Pakistan being particularly in mind, there is a tendency to be very exacting in the accounting requirements imposed upon U.K. companies liable to file their accounts. One result has been considerable difficulty in avoiding disclosure of information regarded as highly undesirable to have on a public file, with consequential need, in the case concerned, of divestment of a place of business in India to avoid those requirements.

It is understood that although the Companies Act 1948 requires every overseas company to file a balance sheet and profit and loss account, including Group accounts, nevertheless in practice the Registrar of Companies accept accounts of overseas companies in the form in which they are prepared in accordance with their own local laws. It has proved, however, most difficult to convince foreign Governments of this apparent contradiction between Act and practice. They point to the Act and tend to argue that what is good for U.K. Acts of Parliament must be good for themselves.

Hence it would be very helpful to the companies concerned if the requirements imposed on overseas companies to file accounts here could be modified.

MARTIN HILL.

H. E. GORICK.

Joint Secretaries.

April, 1960.

ANNEX A

Copy of Memorandum of 23/1/47

General Council of British Shipping Companies Bill—Disclosure of "Provisions"

1. This Memorandum is designed briefly to set out the grounds on which the General Council is asking that Shipping shall be put in the same position as Banks and Insurance Companies in regard to the requirements of the First Schedule to the Bill relative to disclosure of "provisions" as defined in Part IV of the Schedule.

2. Shipping is an Industry proved by the experience of a great many years to be abnormally subject in comparison with other industries to periods of depression. Detailed evidence of this fact can be given if desired. The customary cycle is a short period of prosperity followed by a lengthy period of depression, and to survive the latter it is essential that provision be put aside in the course of the former period. There is no objection to stating in the accounts that the Profit & Loss Account has been struck after making provision for liabilities and contingencies without stating the amount, or in stating in subsequent years that the balance of the Profit & Loss Account has been struck after taking in sums reserved for contingencies but no longer required for such purpose. Experience has provided that, unless provision is made for liabilities and contingencies known to lie ahead, the chances of overcoming the difficulties when they arise must be seriously jeopardised.

3. Shipping is wholly international to an extent that differs from other exporting industries in the sense that it has no home market; is open in all trades to foreign competition on terms of "freedom of the seas"; in the case of the Liner Companies, they cannot temporarily stop trading because the goodwill of the business involves the maintenance of the service, notwithstanding that it may be running at a loss; and, in the case of all shipping, the ships themselves can only be laid up as a last resort because of the heavy capital cost of the ship itself and the fact that it must be recouped by earnings over a relatively short expectation of life, and of the very heavy expenses and depreciation which go on, whilst the vessel is laid up; other industries can fall back on a home market or otherwise temporarily divert their activities. Shipping must maintain its services or lose them.

4. Shipping is far more subject to foreign competition than is any other industry and, in particular, competition of a subsidised character. It is assumed that, for the purposes of this memorandum, no detailed description of the nature and degree of such competition is required. It was on this main ground of unfair foreign competition that the Board of Trade in 1939, as the Department then concerned with Shipping, introduced the British Shipping Assistance Bill in Parliament. That Bill, it will be remembered, provided for a subsidy for British tramp shipping and a "Fighting Fund" of £10 million as support for liner shipping together with grants and loans for shipbuilding. The passage of the Bill was stopped by the war, but in connection with the present memorandum it is particularly worth recalling that the Liner Companies told the Board of Trade that they did not believe they would have to call on the Fighting Fund if Parliament provided it; they thought its mere availability, with the evidence that that availability would convey that the British Government was behind the Lines in their fight against subsidised competition, would so strengthen their hands in their Conference and other negotiations as to render actual resort to the Fund unnecessary. Evidence of the nature of foreign subsidised competition can be found in the reports of the Imperial Shipping Committee dealing with the incursion of the Japanese into the Eastern trades and with the American Matson Line competition into the Australia/New Zealand trade between 1920 and 1932. The main subsidising countries before the war were America and Japan, although the practice was also indulged in by France, Italy and Germany. Japanese competition has gone; that from America remains and, as at the end of the 1914-18 war, is in process of being increased in many trades of great importance to British shipping.

5. The nature of the depressions that British Shipping has to weather was demonstrated by the Industry to the Board of Inland Revenue when, on the introduction of the Excess Profits Tax early in the war, the Industry submitted a case to the Board in support of the proposition that, for the purpose of that tax, Shipping was a "Depressed Industry". That case was held by the Board of Inland Revenue to have been proved. A good example of a cycle of depression is to be found in the Report of the Deep Sea Tramp Fact Finding Committee submitted to the Board of Trade in January, 1939, showing that for the period of six years 1930 to 1935, out of a total depreciation of £18,665,000 for the six years, only £8,076,000 was provided from all sources leaving arrears of depreciation of £10,589,000 to be made up. Of the depreciation provided, nearly one-quarter was provided in the trading year ending in 1930 and thus included sums set aside during or, as a result, of the better trading conditions of 1929 and previous years.

6. The General Council feels convinced that the application to the Shipping Industry of the requirements of the First Schedule relative to "provisions" is against the competitive interest of the Shipping Industry and therefore against the National interest. It holds this view most strongly, and most sincerely. It believes that such disclosure, especially when compulsorily made at a time of depression when the resources of the Shipping Companies had been depleted and were attenuated, would be of real help to their Foreign competitors who are under no similar obligation to put their cards on the table. It is also undesirable to make such disclosure in a time of strength as

in certain circumstances it would indicate to the foreigner profitable trades into which to break, or tonnage of a particular type to develop. The Industry asks the Board of Trade to leave it the right to make in its accounts such provision for liabilities and contingencies as it deems necessary, in such manner that its foreign competitors may be left to guess at the degree of hidden strength and at all events may not have disclosed to them a condition of weakness, if such temporarily exists.

7. The above summarises shortly the grounds of the General Council's application. The application itself stated in terms of the Bill is for:—

- (a) exemption of shipping, as regards the Balance Sheet, from Sections 3, 4, and 5 of the First Schedule relative to "provisions" and as regards the Profit and Loss Account from Sections 9 (i) (a) and (f) relative to "provisions";
- (b) enlargement of the definition of "provisions" so as to cover contingencies in a rather wider sense than "liabilities", e.g. the setting aside of a reserve in the knowledge that a struggle with a particular foreign competitor is coming and will require to be financed when it comes.

MARTIN HILL,
Joint Secretary.

ANNEX B

Copy of Memorandum of 4/3/48

General Council of British Shipping Companies Act, 1947

1. The General Council of British Shipping, the constituents of which are the Chamber of Shipping of the United Kingdom and the Liverpool Steam Ship Owners' Association, is fully representative of all Sections of the Industry. By way of this memorandum, it makes formal application to the Board of Trade that the Board will, in exercise of the powers given to it by Paragraph 3(3) of Part III of the First Schedule to the Companies Act, 1947, exempt Shipping Companies from the requirements of disclosure in published accounts of those details which paragraph 3(1) of Part III of the First Schedule specifies. For this purpose, it is suggested that a "Shipping Company" should mean any Company in respect of which the Board of Trade are satisfied that the major part of its undertaking consists directly or indirectly of the ownership, management or operation of ships, but excluding a Company whose primary business consists of engagement in the U.K. coasting trade (including Eire, Isle of Man and Channel Isles).

2. The grounds of this application were set out in a memorandum which the General Council submitted to the Board at the time when the Bill was under consideration by the House of Lords. A copy of this memorandum is attached (see Annex A) and it is left to speak for itself. As will be seen, the primary ground is the undesirability, in the national interest, of compelling the disclosure of information which would be of great value to the foreign competition, and in particular subsidised competition, which British Shipping has to meet in the open international trade of sea carriage. The application does not extend to Shipping Companies wholly or principally engaged in the United Kingdom Coasting Trade because this primary ground cannot be claimed to apply to them. It does, however, apply to Shipping Companies as above defined—Liner, Tramp and Tanker—whose business lies, wholly or principally, in the overseas trades. For this purpose, overseas trades include the short sea trades with the Continent of Europe which are normally subject to a considerable degree of foreign competition which before the war was partly of a subsidised character.

3. On Committee stage of the Bill in the House of Lords, an amendment was moved by Viscount Swinton in terms which would have given to shipping companies the exemption for which application is now made. In the course of his speech (*Hansard*, 10th March, 1947, column 246-7) Lord Swinton said:—

“There are, I think, very strong national reasons for treating shipping companies in the same way as banks and insurance companies in regard to reserves. There may be other companies to which analogous reasons of national interest may apply, but in this Amendment I want to deal with shipping companies. I will briefly give your Lordships the reasons which I think apply—and apply to a unique degree—in the case of shipping companies. I base my case entirely on national grounds. First and foremost, I put defence. The Merchant Navy is just as necessary to us in war as the Royal Navy itself. Together they are our life-line, and two wars have shown us that our very life depends upon both. Another reason is that shipping is, and always has been, regarded in a very special sense as a national service, just as much as banking or insurance. It serves all our import and our export trade. Shipping is in itself the greatest invisible export we have. As the White Paper which we shall be discussing next week has shown, we are thousands of millions of pounds worse off than we were, and our other invisible exports have been largely exhausted to pay for the war. Shipping will be more important than ever as an invisible export. This peculiar position of shipping has always been accepted by all Governments. Before the war, by common consent, the Government of the day were considering special financial measures by which shipping could be aided.

“There is another reason. Shipping has more ups and downs than any other industry. It has had longer periods of depression than any other industry, and it has the unique feature, as distinct from all other industries, that you cannot protect shipping by a tariff. For all those reasons, it is absolutely vital that the shipping companies of this country should create and hold large reserves. Shipping has to face harder foreign competition than any other industry. It has to face competition from State-owned lines which are maintained and run regardless of profit and loss, or competition from national companies subsidised at almost unlimited expense and protected by the most extreme and exclusive forms of cabotage. In these circumstances, the disclosure of reserves shows the relative strength or weakness at any particular time of a shipping company's financial position, and that is just the very information a foreign competitor would wish to have. It is just the information which British shipping companies in almost every case do not and cannot get in respect of their foreign competitors.”

The Lord Chancellor in replying to the debate on this amendment (column 248) said:—

“Although I do not know that I go all the way with the noble Viscount opposite in regard to all his arguments, yet I must say that I think he has made out a case here. We must look at this matter from the point of view of the national interest, and I am not quite certain that it would be wise to confine this provision to shipping companies. I would, therefore, like to consider between now and the Report stage as to how to give effect to what he desires. Without pledging myself, I think the noble Viscount may rest satisfied that we shall be able to do something which will, in substance meet his point of view. I ask him to withdraw his Amendment and leave me to deal with this between now and the Report stage.”

4. The matter came before the House of Lords on Report stage on 25th March, 1947, when the Lord Chancellor moved the inclusion in the Bill of what subsequently became paragraph 3 of the First Schedule to the Act. In so doing, he said (*Hansard*, March 25th, 1947, columns 778-9) that his amendment resulted from his promise given on Committee stage that the desirability of exempting Shipping Companies from having to disclose their inner reserves would be further examined; that in the result it was proposed to give these wider discretionary powers to the Board of Trade

which would be exercised, not in the interests of any particular company or its shareholders, but only where considerations of national interest were involved, and then only on terms of certain conditions and safeguards. It was in these circumstances that this provision of the Act came into existence, and it is in these circumstances that this application is made. The General Council accepts, without qualification, the test thus laid down by the Lord Chancellor that exercise of the Board's powers of exemption is dependent on considerations of national interest and on such considerations alone. The General Council itself has from the outset stated the case for the Shipping Industry on that basis and is fully satisfied that on that basis its case is justified.

5. On the matter of safeguards, the General Council ventures to suggest to the Board that exemption should be conditional on two safeguards which in its view would be proper and sufficient, namely:—

- (i) The Board to have power in the case of any exempted Company to require the information, publication of which is withheld as a result of the exemption to be given to it confidentially;
- (ii) if a Company pays dividends otherwise than out of the profits of the year, the fact should be indicated clearly in the accounts or in a note thereto.

Reference was made to both these conditions by the Lord Chancellor on recommitment stage in the House of Lords (Hansard, 25th March, 1947, Cols. 8–9) as being safeguards on which exemption would be made conditional, which the General Council accepts. In the course of the same speech the Lord Chancellor pointed out that, under the Bill, Accounts were to be such as would give a fair picture of the Company's position in the sense that it may be an under-statement but never an over-statement. The General Council accepts this and calls attention to Sections 13 and 16 of the Act which require Accounts to show a true and fair view of the state of affairs and profit or loss of the Company. The General Council's application in no way seeks to lessen the duty placed upon a Company to comply with this requirement.

ERNEST H. MURRANT,

Chairman,

General Council of British Shipping.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
SIXTH DAY

Friday, 4th November, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. E. A. BINGEN (*Questions 1664 to 1849 only*)

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E. (*Questions 1664 to 1849 only*)

MR. K. W. MACKINNON, Q.C., M.B.E., T.D.

MRS. M. NAYLOR (*Questions 1664 to 1849 only*)

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

SIR EDWARD J. REID, BT., MR. K. C. BARRINGTON, MR. H. J. S. FRENCH and MR. J. W. HATCH *called and examined*

1664. *Chairman:* Good morning, Gentlemen, we are very much obliged to you for your valuable memorandum and for coming to help us here this morning. Sir Edward Reid, you are chairman of the Accepting Houses Committee; Mr. French is chairman of the Issuing Houses Association; Mr. Barrington is from Morgan Grenfell and Co. Limited and a member of the joint committee; and Mr. Hatch is from Lazard Brothers and Company Limited and also a member of the joint committee.—*Sir Edward Reid:* Yes.

Chairman: I will now ask Mr. Mackinnon to open the discussion.

1665. *Mr. Mackinnon:* I have read with interest your memorandum, and I will try to put my questions following the sequence of the memorandum. First, you suggest that the minimum number of members required should be two in the case of both public and private companies. We have had a suggestion that there is something to be said for allowing a wholly-owned subsidiary to have only one member, namely, its holding company.

I do not know whether you have considered that idea or whether you have any views about it.—Admittedly in the case of the wholly-owned subsidiary the second shareholder is a legal fiction, but surely it is the essence of the conception of a company that it should be owned by more than one person. One person cannot be a company, that is not what the word "company" means, and I would have said there is no practical advantage in reducing the number below two. So far as companies are concerned, whether wholly-owned subsidiaries or not, there is no particular hardship in having a minimum of two members, and in fact it preserves the conception of what a company is. I would like to ask Mr. Hatch what he thinks of this.

Mr. Hatch: I quite agree.

1666. If I may pass on to a question about the *ultra vires* rule; a great number of witnesses favour the abolition of the *ultra vires* rule, and the question of how it should be done—indeed whether it should be done at all—is one of considerable legal difficulty that we shall have to sort out in

due course. But we were wondering whether you had any further suggestions to offer on this subject, or whether you felt you had sufficiently dealt with it in paragraph (b) on page 2 of your paper.

—*Sir Edward Reid*: We do not attempt to suggest how the drafting should be done, but I suppose there would have to be a statutory provision abolishing the rule. I do not think we could go any further than that.

1667. Do you really see the position in this way, that when the *ultra vires* rule had been abolished you would still have a relationship between the shareholders and the company as to the limits to which the directors could go in exercising their powers?—*Mr. French*: I think so, yes.

1668. You would put it rather on the same level as the directors exceeding their borrowing powers and the position of the lender who in that case would not be protected? Would you give absolute protection to a third party who entered into a transaction with the directors which went beyond the powers given to them by the shareholders? Or only protection where the third party has not had actual notice? I think you have rather expressed the view that you would prefer the second?—Yes, I think so.

1669. Then at the foot of page 2 and at the top of page 3 of your memorandum you make the point that variation of special rights in the Memorandum of Association of a particular class of shares should be alterable under section 23. I suppose it is fair to say that when these special rights are embodied in the Memorandum they are usually put in there to make them rather more unalterable than when they are put in the Articles. Is not the fact that the company has to go to Court under section 206 a desirable procedure to preserve?—We feel it is a rather long-winded process.

1670. You would like to streamline the whole of that, and you feel there would be nothing wrong in that?—I think there would be nothing wrong.

1671. May we pass on to the question of no par value shares. The Gedge Committee took the view that you should not have side by side partly shares of no

par value and partly nominal value shares of the same class. Do you agree with that view?—*Mr. Hatch*: I should have thought it was undesirable to have in exactly the same class no par value shares and par value shares.

1672. Would you base that on the desirability of preventing confusion?—Yes, I would.

1673. This is an administrative point?—Yes. *Sir Edward Reid*: I would agree with that.

1674. The Gedge Committee was also against no par value preference shares. Do you think you could give some views on that?—*Mr. Hatch*: I do not think you could possibly have no par value preference shares. Preference shares must have a value—that is the amount the holder would get if the company were liquidated. I think no par value preference shares would be an impossibility.

Mr. French: The same as a debenture.

1675. You feel the shareholders should know what the share is worth?—*Sir Edward Reid*: They must know, because they must know to what they are entitled if the company is eventually wound up.

1676. I suppose one must admit that that, in effect, would give a no par value preference share a nominal value?—*Mr. Hatch*: Yes.

1677. But you do not have to adhere to the nominal value when you issue the shares?—*Mr. French*: I do not think no par value can apply to fixed interest securities at all.

1678. May we go on to heading 3, which is the classification of companies. You are in favour of abolishing the non-exempt companies and reclassifying companies into public and private, the private being represented by the exempt private company. This would involve the abolition of non-exempt private companies, and you say then that their use is falling into desuetude. How would you account for that? Is there any particular reason—the privileges the non-exempt private company has are not worth having? Is there no value, for instance, in being able to avoid filing a statement in lieu of

prospectus? I do not know whether you have any views on that?—*Mr. Hatch*: I do not think there are many advantages and there seem to be practical disadvantages, the limit on the number of members and so on. Quite a number of private companies convert themselves into non-quoted public companies to get round that difficulty. There does not seem to be any advantage in the non-exempt private company as distinct from a non-quoted public company.

1679. We have had a certain amount of evidence which favours the abolition of the exempt private company. You have not expressed any view on this point in your paper, but it is rather implicit that they should just go on as they are at the moment. However, it is said that if somebody wants to have the advantage of limited liability then he should have the disadvantage of making public his figures. That is the brief argument. If he wishes to avoid publishing his figures he can remain where he was before, with unlimited liability. That is the argument. What are your views about that?—*Mr. French*: Our views are that, where the company is really a private concern of two or three people, the paraphernalia required of a public company, which means a company of interest to the public, is unnecessary. If the exempt private company had to produce elaborate accounts and publish them it would involve about 300,000 companies in this additional work; administratively this would be a big job.

1680. But these companies have to get their accounts out anyhow?—They all get their accounts out.

1681. Then administratively there is no reason why they should not file them with the Registrar?—They probably do not have them printed. They have detailed accounts for their own information, but they are not of interest to anybody else.

1682. This privilege does mean that a great number of companies can conceal their true position, and one gets the feeling that this exemption of private companies may have been used in some cases for not very scrupulous purposes.—I would not know about that.

1683. Then one other suggestion. Do you think it might be desirable, if it were practicable, to divide the exempt private companies into two parcels and make the smaller ones disclose their figures, while continuing to exempt the larger ones?—Or the other way round, give exemption to the small ones?

1684. Whichever way you care to look at it, whether it is the large ones which should have exemption because they are important companies, or the small ones?—*Sir Edward Reid*: Among other things we had in mind the practical difficulties a number of small companies would experience if they had to publish accounts. Perhaps the reasons which would justify the exemption of bigger companies are different from those which would justify the exemption of smaller companies.

1685. Then on heading No. 5, the main point you are dealing with here is the difficult question of fundamental changes in a company's activities. You rather indicate in the first paragraph on page 4 under heading 5 that there would be difficulties in controlling the gradual or evolutionary changes of activities. I think that is apparent. But you then go on to discuss changes of a more drastic nature, and you contemplate that the control over these changes could be effected in two ways; first, by the shareholders' sanction being required for the sale of the undertaking or the major part of the undertaking; and secondly, by the control over the cash issue of equity shares. I think that sums up your paper on this problem. The point I would like to ask you is this: if a suitable definition could be found for what we mean broadly by fundamental changes in the company's activities, would you say that such changes should always be submitted to the shareholders for their approval, or would you stand by the limit (in your paper) to fundamental changes achieved through sales or share issues?—We were thinking of the position where there is a drastic change; I would say if the whole business is sold and the cash resulting invested in some other business of a different kind, that sort of situation.

1686. I would like you to consider the matter as getting a direct sanction for the

change rather than an indirect sanction to change by getting approval for the sale. I put the point in this way, because there are certain aspects of this problem that are not really covered by the two cases you have chosen. Supposing a company wishes to acquire a very different business by the issue of fully paid shares. It might, in effect, be creating a fundamental change in its activities which would not be caught by the suggestions you have made at all. Therefore one is going back to the earlier stage to see whether it would be practicable to have a definition of a fundamental change to cover all cases?—*Mr. Hatch*: That could only happen if the shares had been authorised; the shares have got to be created for the purpose by resolution of the shareholders.

1687. As I understand it you are suggesting that it is only cash issues which should be controlled by the shareholders?—*Mr. French*: No. An increase in the authorised share capital must in all cases be approved by the shareholders.

1688. Are you saying that in order to complete an exchange of shares transaction, the directors must have available sufficient authorised capital, and that in order to get the authorised capital increased to the necessary extent the directors would have to go to the shareholders; so that in that indirect way the shareholders would get control over fundamental changes effected through share exchanges?—I think it is a pretty definite way of control. More and more now shareholders will not authorise directors to have unissued capital in large amounts. I think it is a proper sanction.

Mr. Hatch: We say in paragraph (c) on page 5, under "issue of shares", that the shareholders have a measure of control over the issue of equity shares through the fact that the authorised capital of every company is laid down and can only be increased by the vote of the shareholders. We are thinking about issues for cash and issues for the taking over of other businesses.

1689. It is really the second paragraph where you go on to say that directors should have reasonable freedom to issue

equity shares for a consideration other than cash.—Yes.

1690. That is another question. If we may now turn to this cash problem. In the last paragraph in (c) you appear to accept the view that directors should, in the first instance, offer to the shareholders *pro rata* any equity shares they may decide to issue for cash, if a substantial amount of equity shares is being issued. What would you consider a substantial proportion?—*Mr. Barrington*: It is difficult to quantify the word "substantial". I think we meant any significant number of shares. There are occasions when a small number of shares are issued for some purpose such as rounding off the capital or some quite minor transaction. But any significant number of shares should be offered in the first place to the shareholders. Presumably the control would have to be imposed when the shares were authorised. They would have to be authorised on terms that they could only be offered to the shareholders unless a resolution had been passed approving otherwise.

1691. What you are saying is that the Courts should decide what "a substantial proportion" means?—Yes, I think we see in many of these instances the difficulties of drafting a definition.

1692. Do you see this provision as a statutory provision, or is it one that is to be left to the constitutional arrangements within the company?—It could be a statutory provision.

1693. Is that what you had in mind?—Yes, in the negative way that the statute would say shares could only be issued to shareholders unless they had authorised an alternative issue.

1694. Normally to-day when a new company is formed the Articles say that the shares shall be at the disposition of the directors. Then you are suggesting that the statute should say in effect, notwithstanding what the Articles say, that the shares are not to be at the disposal of the directors, but are to be offered *pro rata* unless the shareholders otherwise resolve.—Your difficulty is how do you start, how do you get your body of shareholders in the first place?

1695. Perhaps we could ignore that for the moment; but when the directors have to get the sanction of the shareholders, would you see a blanket sanction being given to override the statute? It is no good saying it can only be done with the sanction of the shareholders if the next day the shareholders say that all the shares may be issued for any purpose. Should the sanction be related to the operation?—*Mr. French*: I think it should.

Mr. Hatch: I think on the whole this had much better be left to practice. It is pretty well universal that a substantial number of shares is always in fact offered to the shareholders. I think in all large companies you find that any substantial issue of shares is automatically offered to the shareholders. Whether you can strengthen that by putting it in the statute I rather question.

Mr. French: I think our word "substantial" might have been "considerable". That is really what we mean. If it is a fractional thing it does not matter, but if you have x per cent. of the equity of a company you are entitled to maintain that percentage if you have got the money. That is what we mean.

1696. What you are putting forward would not in fact control the case where the finance was found by loan capital, which might easily be the case.—That would be pretty rare. If you are really going to acquire a large company that company would want equity or cash.

1697. Heading No. 11 is the next one. This raises this difficult question of the disclosure of nominee holdings of a public company. The limit you place is quite a high limit, 15 per cent., which is a great deal higher than the Cohen Committee. I think they put the figure at 1 per cent. The difficulty with this seems to be one of enforcement. If a man is deliberately going to conceal his holdings he will probably do it any way, and therefore if such a provision is to be made effective one would have to have a very heavy sanction, make it a serious crime.—We do not want £100 or anything like that, we want a penalty of x per cent., perhaps thousands of pounds.

Sir Edward Reid: We realised that it was impossible to enforce completely, but

we thought the main sanction was the fact that he would be breaking the law if he did not disclose; it would be a certain deterrent both to the man himself and to the lawyer who advises him.

1698. Yes, that would cut quite a lot of ice with a great number of people. That would be well worth the imposition of the provision, in your opinion?—*Mr. French*: That is a possibility.

Sir Edward Reid: Of course in a case like this when our two associations discussed it, our views were rather varied by the different experience of different individual members. Our suggestion was regarded as a reasonable step to take to fight against this possible abuse, as opposed to taking no step at all.

1699. Have you any views about the Board of Trade's powers to investigate; did you think they did not go far enough when you made this recommendation, or were too slow in operation?—*Mr. French*: A positive obligation on the individual would be better.

Mr. Barrington: Very large holdings would normally come to light sooner or later. If one is talking of a 15 per cent. or a 20 per cent. holding in a large public company, sooner or later it is bound to come to light, and therefore this statutory provision has quite a considerable sanction.

Mr. Hatch: The sort of situation we had in mind was where a company was trying to get control, buying on the market through agents, and so on, and the Board of Trade power would obviously be too slow.

1700. What would you do in a case where they were bearer shares? How would you try to deal with that type of case?—*Sir Edward Reid*: It does not make any difference. The obligation still affects the person who has beneficial ownership. Another point we make here, and it is one on which we feel strongly, is that you cannot and should not try to put the obligation on the nominee to disclose; first there is the fact of secrecy, and secondly he does not know the real owner because his client himself may also be a nominee. Here whether they are

bearer shares or registered shares it does not matter, because if any person has acquired beneficial ownership of 15 per cent. he must disclose the fact.

1701. Beneficial ownership could be moved very rapidly?—Of course it could; we realise that.

1702. What you are saying is that something has to be done about this, and that this is the most reasonable sanction that can be made for doing it?—Yes.

1703. Then on heading 14—this is concerned with associated and subsidiary companies. It has been suggested that in the case of wholly-owned subsidiaries the holding company should be made responsible for their liabilities—a statutory guarantee. Would you have any views on that?—*Mr. Hatch*: Only wholly-owned subsidiaries?

1704. Some people would extend it to a proportionate part of a partially-owned subsidiary.—*Sir Edward Reid*: It is not a matter we have considered or discussed. In most cases of course in practice they do feel a responsibility. I do not think any reputable company would allow a wholly-owned subsidiary to fail.

1705. It would seem to follow from that that the good companies would not be prejudiced by such a provision, and it might have some salutary effect in the case of the bad ones. Is that it?—*Mr. French*: I think in practice the fundamental thing about wholly-owned subsidiaries, or about any companies, is that they should stand on their own feet and be proper companies, otherwise they become mere departments. We want to avoid that at all costs. It is important that, to some extent, they are at arm's length from their parent, if they are proper companies. I do not think one should legislate for this but that you should try to raise the standard of practice; otherwise you will find you are in all sorts of difficulties.

Mr. Hatch: You mean in a case where all the capital is held, not simply where all the equity capital is held? Are you proposing that a holding company should guarantee the preference shares of its subsidiaries?

1706. That is another suggestion which has been made, that the preference shares should be guaranteed by the parent company where all the equity is held by it.—Any reputable company, I should say, would effectively do that.

1707. *Professor Gower*: Even with a foreign overseas subsidiary?—They might not be able to; exchange regulations might prevent it.

Chairman: A smart operator could take a particular company out of the category of wholly-owned subsidiary in no time, and the holding company would then have no obligation. One would have to have very elaborate legislation fixing the date on which it was determined.

1708. *Mr. Lawson*: It would be very inconvenient in another way. Sometimes a company buys up another business which might have a big debenture issue, with a view to saving it; if it failed it would surely have no moral obligation to pay?—*Mr. French*: I think legislation on this would be very restricting. I think in practice it works all right.

1709. *Mr. Mackinnon*: Your view would be that this sort of position is taken care of by the good companies, and in order to catch the bad ones the legislation would have to be very complicated. Is that it?—I think so, yes.

Sir Edward Reid: And you would often find you would not catch the bad ones anyway.

1710. In your memorandum you have made the suggestion, along with one or two other people, that there should be attached to the annual accounts a list of all the subsidiaries showing separately any whose results had not been consolidated. But we have had advanced to us the contrary point of view that it might be very undesirable to disclose the names of all the subsidiaries. I think one of the cases mentioned to us was the case of a subsidiary owned in a foreign territory where it would be undesirable for the government there to be aware that the beneficial ownership was vested in a company which was foreign to their territory. I do not know whether you have any

further comments to make in the light of that?—*Mr. Hatch*: I should not have thought that happened very often. If it did, would it not be possible to make some arrangement whereby the company could get permission to leave it out on application to the Board of Trade?

1711. Would it then meet this sort of point if one gave the Board of Trade power to make exceptions?—We think it would give a better picture of the company and of the group if details of the trading subsidiaries were provided. There may be cases where there are non-trading subsidiaries. Probably in those cases you could indicate that they were non-trading.

1712. It is good practice now to do this, I suppose?—Yes.

Mr. French: There might be commercial reasons for not stating the subsidiaries.

1713. There is another case in which it has been suggested that disclosure would be damaging. The type of case where a company is making a high-class product, and they also want to market a low-class product; to put the low-class product through the same company would impair the goodwill of that high-class product.—*Mr. Barrington*: As the law stands at the moment you can have the accounts of a company which do not tell you what it does or the names under which it trades. That frequently happens.

1714. That is the sort of point in principle that you wish to be met?—Yes.

1715. Now we come to heading 16, take-over bids. Since your memorandum was prepared the Board of Trade draft regulations have been made into an Order. Do you want to say any more on this heading than you have already expressed?—*Sir Edward Reid*: I do not think so.

1716. You have made a number of detailed suggestions for improving Section 209 for which we are most grateful. They will need careful attention in the revision of the section. That brings us to heading 17, which is concerned with prospectuses. It is possible today for a prospectus to be published and circulated which has not been through the filter of scrutiny by the

Stock Exchange. We were wondering whether you had considered this particular problem and whether you had any suggestions to offer?—You mean where no quotation is sought?

1717. Yes.—We think that the law provides the protection, by means of the prospectus provisions in the Act, but the requirements of the Stock Exchange provide additional protection in cases where the shares are going to change hands.

1718. I think in the case we have in mind the shares might well change hands although they are not quoted. You are satisfied as regards the Stock Exchange cases, that the Stock Exchange provides adequate protection for the public by their additional and stringent requirements. There is no such protection for the public against the second category of prospectus, and since it has been found desirable by the Stock Exchange to impose more rigid requirements in the case of publicly quoted shares, should we not consider closely the problem of what I call the intermediate prospectus? Would it meet the point to provide for the prospectus to go to some authority like the Board of Trade or something like that to have a control of it there?—What is the intermediate stage?

1719. *Chairman*: There is a position of this nature. A man can, without breaking the law, put out a prospectus which complies formally with the requirements of the Companies Act but which will not have been subjected to Stock Exchange scrutiny. I think, ever since 1929 at all events, great importance has been attached to the Stock Exchange regulations as tightening up the ordinary statutory regulations.—*Mr. French*: I think this is something which does not concern us in any way. I do not think it comes within the province of Issuing Houses at all.

Chairman: We did have an actual instance, I think it was brought to our attention by Professor Gower.

1720. *Professor Gower*: It was the case of a hire purchase finance company which keep their shares constantly on tap by publishing a succession of prospectuses. There is no quotation, and by this means they have succeeded in selling, mostly to

small investors as far as I can gather, something like £200,000 worth of shares. This is not backed by any issuing house and has never been subjected to the scrutiny of the Stock Exchange and does not comply with a good many of the requirements of the Stock Exchange regulations.—*Mr. Hatch*: I doubt whether, if you did put that through the Stock Exchange sieve, it would make very much difference.

1721. I expect it would. For example, the preference shares in question never have any votes in any circumstances. The Stock Exchange clearly would not have passed that. It was never emphasised that they were shares of a nominal value of 5s. issued at 6s. 3d., and that on winding-up the holders were entitled only to 5s. This was not brought out, and I should have thought the Stock Exchange would have looked at that rather carefully. Apparently at least two companies are doing this.—What you are considering is whether the law is to be added to by incorporating the Stock Exchange requirements into the Act?

Mr. Mackinnon: The difficulty about doing that is that the Stock Exchange requirements themselves are to some extent flexible and variations are made to meet the needs of particular cases. It would seem possibly that the way to meet this point would be to have some authority like the Board of Trade, which would scrutinise the prospectus in the same sort of way as the Stock Exchange does in the case of quoted shares.

1722. *Professor Gower*: Or of course you could say that no general issue should be made to the public unless a Stock Exchange quotation was going to be applied for. Do you think that would be too extreme a measure?—By the public, you mean asking the public generally to apply?

1723. Not shareholders, debenture holders or employees, but a general public invitation.—*Mr. French*: I would say that Issuing Houses do not make these sort of issues.

1724. *Mr. Mackinnon*: At the top of page 17 of your memorandum you are dealing with rights issues and you say that

in recent years only a relatively small proportion of money raised by companies has been obtained as a result of issues to the general public, the greater proportion having been obtained by offers to existing holders of the company's securities. Those are made, are they not, in a circular to the shareholders, and is it not a fact that quite a substantial proportion of what is offered to the shareholders themselves is never taken up by the shareholders but is passed on by renounceable letters of allotment to the public?—*Mr. Hatch*: This is true not only of rights issues but of open offers to shareholders.

1725. I am seeking to draw a distinction between the two cases, perhaps a distinction should not exist. The man who buys the shares by renounceable letter of allotment does not get full prospectus information because such offers do not have to comply with the prospectus provisions of the Act. Would you agree with that?—Yes.

1726. Then it might be said, and this criticism has been offered, that this procedure for a rights issue is really a method of avoiding the prospectus provisions of the Act. I am not using that in a bad sense, but it is a fact that they are doing it. We should like to have your views on whether some further provision should not be incorporated by reference from the prospectus provisions to cover this case. It may be that the Stock Exchange inspect these rights offers and make sure they are all right. Perhaps you would let us have your views on it.—As far as a rights issue to the shareholders is concerned, you are offering the shares to the shareholders in the company who presumably know the business of the company, what it does and so on, and the purpose of raising money is explained in the letter sent to the shareholders. The shareholders have also had the accounts of the company. It seems reasonable, therefore, that you should not have to comply with the full rigour of the prospectus requirements in such cases; it does not seem to me to involve difficulty at all. It is really a domestic concern between the board and the shareholders.

1727. The criticism offered is that although they would say it is a domestic

concern, it is not in fact a domestic concern.—That is surely up to the man who buys a letter of allotment.

1728. The argument for a prospectus is to protect the man who buys shares on a letter of allotment; the suggestion is that some sort of protection should be given to the man who indirectly buys them.—*Mr. Barrington*: Is he in a different position than if he buys the old shares of the company, which he can do any day of the week on the Stock Exchange?

1729. No, I quite agree with that.—*Mr. French*: When the company makes a rights issue, it is already publicly known, on the Stock Exchange and elsewhere.

1730. What you would say is that even if a prospectus were required in this type of case, the procedure of obtaining a certificate of exemption would still be available and the Stock Exchange would only require the same sort of information as they require now to be given with issues by letters of allotment.—*Mr. Barrington*: Historically these prospectus requirements go back to the days when new companies were floated for cash. Today that very rarely happens, and a great number of the detailed prospectus requirements are not really applicable to existing companies. In fact you find a large number of prospectuses are issued today with the benefit of Stock Exchange exemption under Section 39, because rigid compliance with the Act is deemed inappropriate. You would have to have an entirely new set of tests if you wanted to judge the type of offer by circular. You would have to have a new section in the Act which, once fixed, would be difficult to alter, whereas the Stock Exchange machinery is much more flexible.

1731. You have also dealt with another point, which arises out of the Union Castle case, at the foot of page 17 of your memorandum. In that case, where there is an exchange of shares, there is no need to comply with the requirements of the prospectus provisions by reason of the fact that the Union Castle case decided that such an offer was not a prospectus. You can appeal to a section of the community, who are not shareholders in the company, to exchange their shares without giving them the sort of information that

you would have had to give them if you had offered the shares for cash. Have you anything to say on that?—In such cases the share exchange offer must either be made by an exempted dealer or the circular must comply with the Board of Trade rules, and a comparison of the Board of Trade rules with the prospectus rules shows how completely different the approach is, where one is putting forward the figures relating to two existing companies which perhaps are going to merge by forming a third holding company. The prospectus rules are based on cash issues. The requirements are quite different.

1732. You would say we should not alter the law to take account of the Union Castle decision.—Following the making of the new Board of Trade regulations this year the situation seems to be covered.

1733. Quite adequately?—Yes.

1734. *Mr. Lumsden*: If a company invites capital from the public, it would require a prospectus, but if it is offering its own shares to the shareholders of the company which is being taken over no prospectus is required and you are satisfied with the Board of Trade rules. If the Board of Trade rules are better, might it not follow that we should do away with the present prospectus requirements and bring the Board of Trade rules into the prospectus provisions? It seems to me the information which the investor requires is exactly the same in both cases.—You mean the two sets of rules could be brought into line, or merely that the Board of Trade would have discretion to vary what are now the contents of the Fourth Schedule by statutory rule?

1735. Yes. The two sets of rules should really be brought into line, because it seems to me the investor in the company being acquired is a member of the public in every sense in relation to the company taking him over. He may know absolutely nothing about the company and he is a complete outsider, just as if the other company has invited him to put up new money, except that he is putting up new money in the form of tendering his shares in the old company. I should have thought, whichever way is the better, there is a very strong argument for bringing the two sets of rules into line and not

having an entirely different set of requirements and of procedures for the two.—You are saying in effect that the prospectus position should be made less rigid and more flexible, are you? Some of us feel that the difficulty with these provisions is that once a thing is in the Act it stands there for ten or twenty years. Times change and circumstances change and it is very difficult to bring flexibility into these matters.

1736. I think that probably is so. It may be the prospectus requirements do not give adequate protection in certain cases and that these Board of Trade rules might give better protection in certain cases. The point I am really making is that if the Board of Trade rules are the better approach to a problem for the take-over side, that that should be a better approach for all cash issues as well.—With the heavy penalties and sanctions involved in the prospectus sections of the Act, would public opinion generally accept the fact that they could commit a crime, for which there were heavy penalties, merely by infringing a statutory rule of the nature you are talking about?

1737. In the two cases the operation in relation to the public is substantially the same?—*Mr. Hatch*: I am not sure it is substantially the same. In the one case it is a company issuing its own securities for cash; in the other case it is a shareholder accepting an exchange of shares, which he has already got in a company, for shares in another company.

1738. Of which he may know nothing?—Admittedly. Therefore what is required is to make sure that he knows what it is essential for him to know and to make up his mind; in that he has the advice of his own board as to whether or not he should accept this offer, and presumably they would go into that very carefully as a whole.

1739. His own board of course may be opposed to the whole thing?—His own board would have looked into it, and they are the people whose advice he should take.

1740. *Mr. Mackinnon*: I think what one is looking at in both these cases is whether considerable further information

should not be put forward, which may not necessarily be available in the market at that moment, and whether there should not be some sanction introduced to ensure that information is forthcoming. Perhaps we could now pass from that topic to heading 16 and a point which relates to section 193 and arises on take-over bids. That is the case where it is necessary to get the consent of the vendor shareholders, on a take-over, to payment of compensation to the outgoing directors of their company. There are two suggestions on that. One is that the purpose of the section is defeated if the directors control a majority of the votes, and should they therefore be precluded from voting on that resolution? The second one is whether it should not require a 75 per cent. majority instead of, as at present, a simple majority? I do not know whether you have any views to offer on that question.—*Mr. French*: I do not think you can take votes away from ordinary voting shares. They are ordinary shares for all purposes and you cannot say that those ordinary shares will not vote on this particular point.

1741. Although the directors are judges in their own cases?—Everyone knows that. The fact remains, if you have got 75 per cent. of the shares in the company, you have got them.

1742. The other question is whether a 75 per cent. majority would be preferable to a 50 per cent. majority. Do you see any difficulty in that?—I think that might be a good thing, I had not thought of it. But I certainly would be against the shares having limited voting rights on some particular point.

1743. Heading No. 20 is the next one. In the first paragraph you propound, as a fundamental proposition, that a company cannot purchase its own shares. I think we have all been brought up on that. But we understand that investment trusts in the United States do have facilities under which they can re-purchase shares in their own company. Whilst accepting the principle that a company should not be allowed to purchase its own shares, would you see some value in introducing that facility in this country, or would you regard that as a retrograde step?—*Sir Edward Reid*: You mean

only in the case of investment trust companies, not industrial companies?

1744. Only investment trusts?—I do not think there is any need for it. Investment trust companies are one thing and unit trusts are another.

1745. You would say there is no demand for it, so why start it?—Yes, exactly.

1746. The second point is this. You would not consider putting a clause in this general rule about a company not buying its own shares to enable purchases to be made out of reserves or profits available for dividends?—*Mr. Hatch*: For the purchase of their own shares?

1747. But only out of reserves. Would that be a facility that would be desirable?—I should not think so.

Sir Edward Reid: After all from the point of view of the creditors of the company, from the point of view of the persons with whom the company is doing business, they must know what the capital is. If it purchases shares, whether out of reserves or other assets, it is reducing its capital without it being known.

1748. I do not want you to get the impression that these are necessarily my own ideas I am putting forward, they are exploratory.—I quite understand that.

1749. Then we come to heading 21, accounts. The first question is about the share premium account; in the last two sentences about this on page 20, you say: "In particular we do not feel that attention should be paid exclusively to market prices at the time of issue which may be temporarily and artificially inflated. We favour the addition of words to the section to make it clear that the calculation of the premium in such cases is to be at the directors' discretion". It was the precise thought behind the last sentence that we should like to have explained to us, and perhaps it would be fair to suggest that possibly what you are getting at is this. At the present moment there is nothing laid down in the section as to who should make the valuation for the purposes of assessing the share premium or the way in which they should proceed in doing it.—*Mr. Barrington*: Basically we felt the

practice a few years ago, which I believe was based on the Ropner case, of compelling companies to bring very large share premiums into their accounts, particularly in the cases of merger, was undesirable. Since our memorandum was written I think there has probably been a shift of opinion. One or two large mergers have been carried out this summer, and in at least one case of which I am aware no share premium at all has been entered into the books, although the shares of the new company clearly had a value substantially above par at the time of issue. This was a negative recommendation in the sense that we would not wish to see large share premiums automatically put into the accounts merely because of market prices which might be of a temporary nature.

1750. Taking your first point first. Are you saying that it should be at the absolute discretion of the directors whether they should establish a share premium account or not? In other words, to destroy one possible interpretation of the Ropner decision?—I think that is obvious. We welcome the present tendency, which is to start the new merger company off without a large share premium account.

1751. That would dispose of the question. You do not even get to the stage as to who would calculate the share premium. You would say, let us have the law so that we do not have to have one at all?—But if the directors felt it was appropriate to have a share premium because at a later date they might wish to capitalise part of the accumulated reserves of the underlying companies, it should be within their power to have one.

1752. Would you want them to have any statutory guidance, or just leave it like that?—I think you must at that stage leave it to their discretion.

1753. *Mr. Lumsden*: Might I put a question in here? Might there be some difficulty in a case where alternative offers were made, where the shareholders were offered either shares in the acquiring company, which might be really at a very

substantial premium, a £1 share worth £10, or alternatively the equivalent in cash; a small number of shareholders might accept the cash and the vast majority accept the shares. Might you then be in a position where you could bring in the part of the assets acquired by the issue of shares at a purely nominal value and the part acquired for cash at the price actually paid?—I think there is a difficulty there.

1754. You have not any suggestion as to getting out of that?—Unless the suggestion that the premium on the non-cash element should be at the directors' discretion helps in some way. It would lead to flexibility.

1755. *Mr. Lawson*: In suggesting that, at the discretion of the directors, there might be no share premium, have you in mind a complete merger? Or would you apply that also when shares are issued for something less than 100 per cent. of the capital of the acquired company?—I was thinking primarily of the merger of two existing businesses through a new holding company.

Mr. Hatch: I should have thought in the partial case as well, the directors should be free to put on the shares they issue the kind of premium they want to.

1756. *Mr. Mackinnon*: That would mean you would maintain the existing section for cash issues?—*Mr. Barrington*: Surely there is a fundamental distinction? If shares are issued for cash, one wishes to prevent that cash being dissipated in the form of distributions, since it is part of the company's capital; but if shares have been issued in exchange for consideration other than cash the point hardly arises.

1757. It does not matter whether the assets are represented in cash or in kind, it would still be possible to distribute the premium where there was an excess of value in assets taken over by the company as against the nominal amount of shares issued in exchange. If I buy £1 million worth of assets for £500,000 worth of capital, it could be said that in principle the transaction has been offering £500,000 shares at a premium of £1 each. I have still got £500,000 worth excess value from

the transaction. In one case it is entirely in kind, in one case it is in cash. You agree that one should not distribute the cash, but you appear to accept distribution of what is received in kind.—The sum received on realisation in the latter case would surely be put to capital reserve.

1758. It would be capital reserve I should have thought, whether or not it could have been distributed. That is the origin I think of the old section. That does not alter your views at all on that?—No; I take your point.

Mr. Hatch: If you wished you could value the assets you had acquired at the equivalent of the nominal value of the shares issued.

1759. That would still leave you in a position in which you had £1 million of actual assets and could distribute the surplus?—Yes.

1760. I do not know whether the discussion we have had really affects the views you were advancing or whether you are prepared to pass by dealing with the merger case as a special case?—*Mr. Barrington*: No, I would prefer to see more flexibility, even with the disadvantages that you outline.

1761. *Mr. Mackinnon*: The next one is the use of pre-acquisition profits. Here again perhaps it is necessary to clarify the position. Your memorandum starts from this point of departure, that pre-acquisition profits are not available, as matters stand, at all by way of dividend. I think that you are saying in your paper that you would like to be able to antedate the time from which pre-acquisition profits may be distributed by the acquiring company. Is that the point?—That was the point.

1762. Could we take the merger case which you were just explaining. Where there are very substantial reserves held by the two merger companies, say the case of two companies merging together into one holding company, would you want to open up in any way the possibility of using pre-acquisition profits in that case beyond the point that you have made in your paper?—Judging by one or two large mergers recently, opinion is moving in that direction.

1763. That is why I asked. Would you like to have the pre-acquisition profit question opened up further and put back beyond the sort of date which you have suggested in your memorandum?—Yes, I would welcome a move towards greater flexibility, but one sees the difficulties; that it can lead to abuses.

1764. Your approach here ties in with your approach on the share premium account because the fact, on one view of the share premium account, that you have to value the assets to the full value to get the share premium means that you are in effect capitalising the pre-acquisition profits to some extent.—I think this is all based on the approach that if you are merging two existing companies it is a continuing business; it may be continuing in a different form; but to apply a rigid set of rules as if it were an entirely new business brought into force on a particular date can be unduly rigid.

1765. Have you any suggestions to offer as to some way in which we could deal with the rule because, as you say, if you open the thing completely wide this opens the door to all sorts of malpractices?—I am afraid I have not any specific suggestions to make.

1766. This is one that you offer up for us to apply our minds to?—I am afraid so.

1767. But you would certainly like something done, or your association would like something done, beyond the limited remedy you have suggested in the paper?—Some of our members have been concerned in these cases that have occurred recently, and I feel sure the body of opinion would support a further move.

Mr. Hatch: It would be of great practical advantage to have more freedom. You do so often get the situation that on a merger or amalgamation by means of a holding company all the reserves are frozen for all time if you do it this way, which the companies regard as very unreasonable; it does make practical difficulties. I agree that the possibility of distributing pre-acquisition reserves is fairly remote anyway.

1768. Could we look at one further matter on trade investments, a point

which arises on page 23. You say at the end of the second line there should be a requirement to disclose details of the investment, that is a trade investment, to include (if necessary by way of note) the proportion of assets at book value. Then you go on to say there should also be a requirement to disclose the profits attributable to the holding of the reporting company. Then at the end, just before paragraph 23, in the last sentence, "It is suggested that where the value of trade investments is material, the accounts should show by way of note the approximate value, based where the shares are unquoted on the underlying balance sheet values." The only practical point that one ought to explore here is this. Your argument starts from a fundamental position that trade investments at cost can be a misleading item to the shareholder who is looking at his balance sheet; he does not get a true figure. It could be said that if you take the balance sheet values of the company in which the trade investment has been made the shareholder is certainly getting a little more information but he might well not be very much wiser; and the point that perhaps is to be considered here is whether, if you are going into this field at all, you should not make the directors attempt, or somebody attempt, some true valuation of the trade investment. It is in parallel with the requirement as to quoted investments where you must give the Stock Exchange valuation. Why should not the shareholder—and on your own admission he should be given more information—be given full information?—*Mr. Barrington:* Are trade investments any different in this respect than the remainder of the company's assets? Its freehold land and properties may be equally undervalued. We have said in another part of the evidence that we are not in favour of statutory periodic revaluation of assets. We did not feel we wished to go beyond a requirement that the balance sheet assets attributable to investments should be disclosed where there was no quotation.

1769. And that is really your argument. You say—"We are being quite consistent in this with our approach to revaluation of fixed assets"?—We find the revaluation problem very difficult, and the

variation between one company and another and between assets of different types within each company leads us to the view that it is not a suitable subject for legislation, that it must be left to the force of opinion.

1770. In fact the criticism one could make of the trade investment point would always be the same one, that a company, whether it is the company itself or the trade investment company, might be sitting on a valuable site and nobody would know its value. You would say that there would be no reference to that in either case?—Quite.

1771. *Mr. Lawson*: Could I ask a supplementary on that? Would you make a distinction between disclosure of the profits and the accumulated reserves of these underlying companies and the disclosure of the assets? You see, it could be said that there is some danger in disclosing the assets because the shareholder of the holding company might assume from that that the assets were in some way or other available to him, whereas in fact of course they are not available. All he can get is income on the investment. The profits, of course, are highly important because he can assess what are his chances of getting a higher income from that investment, but is it equally important in your opinion to show particulars of the assets?—I think we suggested this as being the best available test. There are cases on record of a trade investment which has stood at a figure for years and years and now has no relation whatever to the underlying assets of the company in which the investment has been made. That is the only available practicable test that we felt able to suggest; it has its limitations, as you say.

1772. You would like to have both the assets and the profits really?—Yes.

Mr. French: I think myself on this that there might be power to go to the Board of Trade and get an exemption. This is only my personal view, but I think there are cases where this disclosure would be undesirable commercially. Personally—we have not discussed this—I think there might be a loophole allowed for those cases. I know one particular case of a company which has a 50 per cent. interest

in another company, and it would be highly undesirable if that were known in the trade.

1773. *Mr. Mackinnon*: That is the sort of point we were discussing, the high grade and the low grade products.—I think if something is done about this it might be borne in mind that it should not be an absolute requirement.

1774. May I finally come to what is a weighty matter in your memorandum and that is the exemption of banks, insurance and shipping companies from the accounting provisions? What has been suggested by those who would have this exemption withdrawn or abated is this. They say, in brief, that the broad situation that banks are in, in times of stress or shock, is sufficiently well known. So that the publication of full figures some time after the strain or shock had taken place would not affect the position. One of the arguments which you have advanced is the contrary one, that this enables the impact of shocks and stresses to be concealed and so preserves the stability of the bank.—*Sir Edward Reid*: Your suggestion is that the status of the banking community in general is so established that the disclosure would not affect it?

1775. Yes, the difficulties in any particular international situation, to take an example, must be apparent to people who would know, and therefore does it really matter if a few months afterwards the true position of the bank at that period is disclosed? The shock may take place and the accounts will come afterwards.—I think it is very difficult to disclose the complete position without also disclosing some sidelights on your customers' business. It may be a question of a fall in gilt-edged securities; there is no difficulty about that; or it may be a particular patch of bad debts in some part of the country or in some part of the world. It is very difficult to start giving full particulars of that to the public.

1776. Of course it is said that that is just what the public would like to know about; if a lot of bad debts piled up they would then question the skill of the management. I do not say that in an unpleasant way; I am merely offering that as an observation that has come from

certain quarters.—Yes, but of course the skill of the management would have provided for the building up of reserves in the past, so that when some particular development of that kind occurred it could be easily absorbed by the reserves. It is felt by us and I think by the whole City, that the fact that there are large reserves and the fact that unavoidably from time to time there are certain stresses and shocks—it may be in the value of money or it may be in trade developments somewhere—would make it difficult at times to present the full facts in proper proportion in such a way that they could not be distorted in the minds of the public and create alarm and dependency which, even though it was not justified, might nevertheless be created.

Mr. Hatch: It seemed implicit in your first suggestion that by the time the accounts of the bank are published the shock has passed, but in fact this may not be the case because banks produce their accounts very quickly—within a few days after the end of the year. You could get the position where the bank is publishing its figures in the middle or at the end of the time when this difficult situation is still going on, and therefore it is not unreasonable to suppose that the bank might publish figures which would necessarily have to disclose the situation in its immediate past and not a situation which has been cleared up some time previously.

1777. We can forget that gloss on the question and confine the question to the main point, which is that everybody will know, broadly speaking, the impact of international monetary developments or of the government policy on the finances of a bank. Is that a fair view? Would it make much difference if the real situation were disclosed?—I should have thought it was not a true assumption because the figures of reserves have never in fact been published, so how should people know? The experts would know the sort of effect.

1778. But would the foreign depositor—one of the people I think you refer to—using British banking services get much more information that might influence his decision on moving his funds, when he would not have acted already on the broad situation?—No, probably not, but he would be an expert.

1779. There is one other aspect of this too. You see it is quite possible for a small concern to be in the line of banking or for a highly reputable firm—this is theoretical you may say—to fall into the hands of undesirable people. At that end of the scale one has perhaps some duty to see the small depositor is protected, and for that reason one is inclined to ask is there no half-way house that can be introduced to reduce the scope of the exemption and perhaps meet that point. Have you given any consideration to that as a possibility?—*Sir Edward Reid:* I cannot say that we have.

Mr. Hatch: The only thought that occurs to me is, as I have no doubt is the case, the Bank of England knows this position extremely well and knows the position of the banks generally; and I should have thought the protection for this general position is provided in this confidential information which the Bank of England has on the whole banking position rather than that we should have to rely on figures to do this and attract large headlines in the papers.

1780. You mean there is in effect responsible surveillance of this problem behind the scenes?—Yes, a much better surveillance than would be provided by people producing misleading figures in the papers.

1781. *Mr. Lawson:* On that last point, has the Bank of England any power to act? Supposing information in the hands of the Bank of England showed that there was a situation developing where the secret reserves were being used not just in one year but perhaps in a succession of years to cover losses. Have they any power, or do you think they ought to have any power, to do anything about that situation?—*Sir Edward Reid:* I suppose in practice they have. Membership of the Accepting Houses Committee, for instance, depends upon the Bank of England being willing to take our bills at prime rates. I do not think that the situation is ever likely to arise where any of our members would drop from that high standard, but it is always a possibility. The status of the houses who are members of the Accepting Houses Committee does depend in practice on the Bank of England

being satisfied of their position, and their accounts are taken and shown in detail to the Bank of England every year.

1782. That rather leads me to another question, as to whether there is or may be any appropriate definition of a bank, because there are people who have this exemption who are not members of the Accepting Houses Committee.—Yes.

1783. I wonder, have you any views on that, as to whether there could be some kind of definition which would limit the people to whom this concession was allowed?—The liberty to have hidden reserves is really at the discretion of the Board of Trade. Are you suggesting that their discretion should be limited by a formula?

1784. Do you think it would be practicable to have a formula? I believe there is no formula now, or not one that is generally known.—I have always regarded a bank as being a concern part of whose business consists of holding money on current account for customers and paying their cheques when drawn. I suppose the Board of Trade is guided by considerations such as that.

1785. *Chairman*: There is a very helpful definition in the Eighth Schedule: "In this paragraph the expression 'banking or discount company' means any company which satisfies the Board of Trade that it ought to be treated for the purposes of this Schedule as a banking company or as a discount company."—Mind you, the word "bank" has in the past found itself in the names of companies where it should not be. We make that point in our memorandum.

1786. *Mr. Lawson*: Perhaps I ought to know the answer to this, but do all banking companies which have the benefit of this exemption have to submit their accounts to the Bank of England or to the Board of Trade in detail? Do you happen to know that?—That I do not know.

Mr. Hatch: Certainly all the Accepting Houses do.

Sir Edward Reid: Accepting Houses do, but you are referring to those which are not members of the Accepting Houses Committee but who nevertheless have this

privilege from the Board of Trade of having hidden reserves?

1787. Yes.—I am afraid I do not know.

1788. We can find out. I have one other question. I have no doubt you have considered this, but is there not a problem as regards possible take-over bids for banks? I suppose people could take over a bank and then distribute its secret reserves if they felt so disposed, or even wind it up and perhaps make a large sum of money at the expense of the existing shareholders, whose shares would be quoted on the basis of the published accounts?—As you say, in theory at least it can happen.

1789. *Mr. Brown*: It has happened recently.—It has happened. There have also been cases where I think some recent banking amalgamations took place because they had that possibility in mind, and wanted protection by making the entity bigger.

Mr. Hatch: There should be some protection to the shareholders in the advice given to them by the board of the bank being taken over. The board would be able to assess whether the offer price is fair, taking into consideration the actual position of the bank concerned. They should be able to say to the shareholders that this is or is not the right price to be offered for the shares. Were you thinking of an offer of that sort?

1790. *Mr. Lawson*: Yes, but I suppose it could come about by a gradual purchase in the market. The control could be acquired presumably and with the change of control a new policy could be developed which might be extremely profitable to the man who had control. I wondered whether you had given thought to that, as to whether there was any way to deal with it?—*Sir Edward Reid*: There has recently been a certain regrouping of banks. There have been cases of banks coming together, particularly the exchange banks, into bigger units, and that makes it in practice much more difficult to take them over against their will, although, in theory at least, it is still not impossible. As my colleague says, there is a safeguard in what the board of the bank in question would say to its shareholders.

1791. May I ask just one question on another subject. It is this very difficult question of the revaluation of assets, and I think you say that it is not really practicable or desirable to attempt revaluation of the balance sheet generally speaking because the value of the assets depends on the earnings in most cases. You go on to say it is only in a number of limited cases that assets can be re-deployed to better advantage. Of course it is in that limited number of cases that there is a certain amount of criticism. We have had it in evidence. The public house is the sort of example which comes up time and again in evidence; the public house situated on a key site which could be developed for other purposes. Have you any suggestion at all as to any way in which that type of special case could be met by some form of note on a balance sheet, or do you think it is too difficult to deal with at all?—*Mr. Barrington*: I have no suggestion I am afraid.

Mr. French: The owner of the public house has a duty to use it to the best advantage. If someone wants to buy it at a suitable price for an office block he sells it, does he not?

1792. He might or might not. The point is made that it is a question of policy for the board. The board may decide to change their policy, in which case there is a great increase in value because the property is now going to be used for a new purpose, and that comes as a surprise to the shareholders, some of whom might just have sold their shares in the market. We come back again also to the take-over bid: a take-over bid as such is met by your previous answer, that the board can express their views on it.—*Mr. Hatch*: This is frequently done by the board getting a valuation of the property and saying in their annual accounts or in the Chairman's speech that they have had a valuation and the assets which were worth £1 million are now worth £3 million. That has actually happened. Does not that meet the point?

1793. It does but I was wondering whether there was any way of making people do it who did not do it in the exceptional type of case.—I do not see how you can make it universal; it would be very difficult I think.

1794. *Mr. Lumsden*: In the annex to your memorandum one of the points you suggest is that companies should be empowered to convert issued irredeemable preference shares into redeemable preference shares. Is there not a danger that that would be an easy way round of avoiding going to the court for a reduction of capital, because you could really convert any issued share capital. For example you might convert ordinary shares into preference shares, and convert them into redeemable preference shares—redeemable in, say, three months?—*Mr. Barrington*: But they are only redeemable out of reserves which are available for dividend or from the proceeds of a new issue, are they not?

1795. Yes, within that restriction.—So the fundamental capital of the company is preserved intact, I think. Is not the company free in any case to distribute these reserves by way of dividend without going through this procedure of creating redeemable shares?

1796. It might wish to make the repayment as capital?—It might have tax implications.

1797. You suggest on page 25 that the trustees of a pension fund should be restricted in the number of votes they should exercise at general meeting in case the directors are given indirect control. Is that not disenfranchising beneficiaries of that fund, and is it perhaps a little inconsistent with the suggestion that directors should not be debarred from voting on paying gratuities to themselves? This seems a less difficult case than the other one. Indeed the trustees might not be directors at all.—*Sir Edward Reid*: This point really was to avoid a self-perpetuating management.

1798. I quite see the objection. But you might have a public corporation as trustee; it might not be the directors at all.—*Mr. Barrington*: They might have to consider the interests of their members, as it were, as distinct from the interests of the shareholders, might they not?

1799. Yes.—They might say—"We will not vote for this because it will have an effect on the employment position" or something of that sort.

1800. But they are shareholders; should they be debarred?—*Mr. French*: You might say they should not have more than 10 per cent. of the voting shares of the company.

1801. *Mr. Richardson*: May I ask a question on the subject of the issue of shares, on page 5 of your memorandum? In the second paragraph of sub-heading (c) you start off by saying:—

“Directors should have reasonable freedom to issue equity shares for a consideration other than cash, but where a substantial amount of equity shares is issued for cash, they should first be offered to the existing shareholders . . .”.

I take it that means the existing equity shareholders:

“... or alternatively, if this is not possible, a resolution should be passed by the shareholders permitting an issue outside the company.”.

Would I be right in thinking the word “possible” should be glossed to mean “desirable”?—*Sir Edward Reid*: Yes, or perhaps “necessary to achieve some particular object”.

1802. Yes, the example that immediately comes to mind is in the case of a bank going into the hire-purchase business where it desires to take an interest of a certain proportion.—What is meant is “if this is not possible consistently with achieving the object that is desired.”.

1803. The question that worries me about this is the question of the authorisation for issue outside the company, because it seems to me that this in some way—and I wonder if you agree—must depend on the timing of the resolution and the information of the purposes for which the issue is being made being given to the shareholders. If I could take a moment to go back on this, it seems to me that the situation which used to obtain, if I understand it correctly, was that you normally found that the original authorised share capital of the company was at the disposal of the directors. Then I think, in practice, you found you would require some sort of resolution of the company to increase the authorised capital and you usually found in the Articles that the additional shares should, in the

absence of a direction by the company to the contrary, be issued *pro rata* to the existing shareholders, or the existing ordinary shareholders; and in the absence of such a direction or if it was not possible they should be at the disposal of the directors. I do not think in the cases that have brought this into public prominence there has been any suggestion in any case that what the directors have done has not been in accordance with their powers under the Articles. But a practice has grown up by which, when you increased the authorised capital, by the same resolution you put it at the disposal of the directors. It seems to me that if you merely require a resolution before an issue is made outside the company, you would very quickly get back to the existing position of creating the appropriate number of shares and putting them at the disposal of the directors for issue to such persons at such times and in such manner as they think appropriate. We know that a practice has grown up, through the activities of the protection committees, of requiring boards to give an undertaking they will not issue more than, let us say, 10 per cent. of the capital to an outside person without going back to the shareholders. The question I want to ask is really this. Is it the situation that everything is now all right because shareholders at large are alerted to this problem and will not in the future be so ready to give their blanket approval to issues of new ordinary shares, or ought we to protect the shareholders against too much trust in their boards by saying that boards should not issue equity shares otherwise than to ordinary shareholders of the company except in relation to a certain small proportion—not more than 10 per cent. we will say; or should we provide that any issue, whether for cash or for consideration other than cash, should only be to shareholders unless a resolution had been passed by the shareholders within a defined period and on certain information?—*Mr. Hatch*: I think our view probably is this: that directors should be given a certain limited freedom to issue shares which are available and have been authorised for purposes of possibly taking over another small company, or something of that kind, without having to go back to their shareholders,

but anything which involves a substantial change in that business should require the shareholders' approval. The sort of thing I have in mind which frequently happens is that a small company becomes available and wants to be taken over by a large one. It is to everybody's interest to do it, and they can fix it up straight away with a very small issue of shares by the big company without having to go back to the shareholders for their approval. If you had to go back to the shareholders the whole thing would become public and other people might come in and start hidding for the small company, and so on. So it is not in the interests of any company for the board not to have some slight or moderate flexibility in this sort of situation. But anything which involves big changes in the company's position must be referred to the shareholders.

1804. Whether it is a big change in the nature of the business or a big change in the capital?—Yes.

1805. So that a significant issue of shares for other than cash should not be made without the shareholders' approval?—Yes. I would hesitate to suggest that you should try to legislate about that, but I feel that the situation is that now shareholders are alerted to the situation, and no company is going to be allowed to create a lot of authorised capital solely at the disposal of the directors without the shareholders making sure it will not be used without their prior consent.

1806. You do not think that further provision will be necessary as to what authorisation should be required or as to the information to be given when authorisation is sought?—No, I do not think so. If the company authorises a reasonable increase in capital and the directors say there is no present intention of using this capital for any purpose, then when it is to be used the company could go back to the shareholders, if it is a substantial item, and say what it is going to do.

1807. *Mr. Brown*: I rather thought from your previous comments on this that you were planning control here to the time of authorisation—that is, that when an increase in authorised capital was agreed the shareholders would have power to control its issue. However, you have just

said authority could be given but the directors should go back to the shareholders at some later date, which does not seem consistent with my understanding of your position. You did suggest that the current practice has changed, and I rather doubt whether that is true. It still is current practice for companies to authorise large amounts of unissued capital with no formal restriction on the directors at all; and the only change that has occurred is an undertaking by some chairmen that they will not issue this in a way that alters the fundamental business or the control of the company—in quite a number of cases that undertaking is refused anyway. So the position is that, subject to a verbal undertaking from a chairman who obviously cannot control any successive chairmen, there is not much improvement in the position; there is some improvement but not much. What I would like to know is this. Is it your attitude that shareholders should in fact refuse to give authority for extra capital without limitations on its use; or would you prefer that if there were to be a restriction it should be at the time the shares are issued and not at the time of the authorisation?—No, I feel the shareholders should be prepared to agree to their board's increasing the authorised capital by a substantial amount. It is not always for taking over other companies; they may want authorised capital for a capitalisation issue and it is convenient to do it at a particular moment. The capitalisation issue normally requires the specific consent of the shareholders. I should have thought it was adequate, if the authorised capital was increased by a reasonable amount at some moment of time, if the board said they were not going to use this in any substantial way without consulting the shareholders again; that would be adequate.

1808. Should there be a provision that the board must consult the shareholders, that is the position?—*Mr. French*: I think this subject is very tricky. I should have thought that you do not have an enormous increase in authorised share capital for fun. When you have an enormous one you have some particular capitalisation of reserves or some particular acquisition in mind. I should have

thought it would be wrong to legislate on this subject at all; I would leave it to practice. I do not think any board would ask for a colossal increase of capital irresponsibly; but if it did it should be refused.

1809. I was not suggesting it was irresponsible. But take, as an example, an increase of capital equivalent to doubling the existing capital of the undertaking without any apparent immediate intention of using it.—I think that would be undesirable.

1810. You would therefore think the shareholders should refuse it?—Yes. I think if the directors have 10 per cent. above their issued share capital up their sleeve that is a reasonable thing to let them have, but not 100 per cent. for no good reason. I think probably it is best left to practice rather than legislation.

1811. *Chairman*: Would it be feasible do you think to provide that where an unfettered power had been given to the directors as regards the issue of shares, then that power would lapse, so to speak, if the shares in question were not issued within say a year, so that then the shareholders would have another say in the matter—probably quite a different lot of shareholders?—I think really if there is something big in mind, a capitalisation of reserves or an acquisition, the directors should go to their shareholders about it. They do it on the increase of the authorised share capital and they should say why they want to authorise it. I do not think they should have authorisation of great amounts just for fun. Why should they spend their shareholders' money on the stamp duty on big increases if they have not got something in mind?

1812. This point has probably been mentioned before, but can any of you throw any light on the fact that the provision about allotting shares *pro rata* to members appeared in Table A in the Act of 1862 and went on down to 1929, and then it was abolished in 1948 with nothing in the Cohen Report to say why they did so? When that article was put in it must have been considered, I suppose, as a fair and reasonable provision to make, but why it was taken out I have not been able to discover. It seems

to be something of a mystery, but I believe the suggestion was made that the tax position might be affected.

Mr. Scott: Was it not that it enabled a board to issue shares on the acquisition of another business without having to go to its shareholders, thus enabling it to conclude negotiations without having to make them conditional upon the shareholders' approval? It gave the board more flexibility.

Chairman: Yes, that is true.

Mr. Scott: Would you recommend that there should be no legislative change so that there is nothing laid down in the Act as to the amount of authorised capital which may be available at the disposal of the board, and just leave it to the good sense of (a) the board and (b) the shareholders, rather than try to legislate about it?—I would.

1813. I have one other question on take-over bids, concerning section 54. On page 15 of your memorandum you say you do not think it is right or practicable to introduce a measure of control over take-over bids by controlling the provision of finance for such operations. But do you see any objection to the present wording of section 54 which prevents a company financing the purchase of its own shares? If company A makes a bid to acquire the shares of company B, having got them, can it use the funds of company B to reimburse it for the expense it incurred in buying the shares either by loans or otherwise?—I think if the transferee gets hold of something or other in cash he gets the cash; you cannot help it.

1814. You see no objection to the company's cash being applied to what is then its parent company in reimbursing the parent company for the expenditure it incurred in buying the shares?—I do not think I do.

Mr. Hatch: Is it not the case that in a situation like that the transferee is in effect paying for the cash in the price?

1815. You have bought out the shareholders for cash.—You have bought out the shareholders for cash, and in that cash price you are buying the cash which is in the other company. So you are paying an enhanced price because of the

cash that is there. Therefore surely it is not unreasonable to take that cash out and reimburse yourself for that enhanced price which you have paid. I do not see any objection to that.

1816. *Professor Gower*: Even though you do not take the whole of the shares? Supposing there is a minority left.—I was thinking in terms of a total take-over.

1817. *Sir George Erskine*: Supposing there were certain shares which were not taken over, the reimbursement of the holding company would to that extent reduce the level of the assets available to the preference shares.—I must say I was thinking in terms of a complete take-over. I do not see there is any objection in a complete take-over but I can see there is difficulty in a partial take-over.

Mr. French: It is a question of control, is it not?

1818. *Mr. Scott*: You might get 51 per cent. of the capital of that company and change the board and utilise the funds of that company towards reimbursing you for your expenditure in buying that 51 per cent.—I think if you are going to make a take-over bid one of the things you look at is the cash.

Sir Edward Reid: It would not be entirely reimbursing; the taken-over company would remain a separate entity. It could not give you the money; it might lend it to you.

1819. Yes, lend it to you. No particular comments on that?—It is difficult to lay down a hard and fast rule when circumstances can vary so much in different cases.

1820. I have one small point of comparative detail. You suggest as regards alternate directors that their particulars should be filed and they should disclose their interests and so on. One can see that perfectly well if it is more or less a permanent appointment, but you would not I suppose apply that just to one or two isolated appearances by an alternative because his principal was away? Would you limit it to someone who was going to act in that capacity for three months or more?—I should think so, yes. No, of course we do not mean isolated cases.

Mr. Barrington: It is true, is it not, that the Act is quite silent on the subject of alternate directors?

1821. Yes. If he acted for, say, three months, you think he should be treated as if he were a director from the point of view of registering him and disclosing his interests?—Yes.

1822. *Mr. Brown*: I have one particular question on the non-voting share section on page 9, the last paragraph particularly: "The general feeling of our members is against legislation prohibiting non-voting shares. We prefer to rely on the force of City opinion and expert financial advice to ensure that they are only created or retained in suitable cases where the admitted privileges which the system gives to a small controlling body will not be abused." As a principle I would agree with that, but could you give any thoughts as to what are the principles on which the City will judge what are the cases where the admitted privileges will not be abused?—*Mr. Hatch*: I think we were thinking there in terms of a company which has grown up under the excellent direction of a body of possibly family shareholders. We can all think of cases where it is reasonable they should go on under that control.

1823. But how do you judge that those privileges will not be abused—not merely this year but in twenty years' time?—*Sir Edward Reid*: I think the point is you cannot do it by legislation, but the force of City opinion and financial advice can judge individual cases.

1824. I appreciate that, but how is the City going to judge cases where it will not be abused? I am really interested to get the implications.—It is difficult to answer hypothetical questions, is it not?

1825. It is not put down as a hypothetical suggestion.—*Mr. French*: It was only the general feeling. There is no unanimity on this point.

1826. You do use the words "they are only created or retained". How does City opinion in any way have any opportunity of securing they will not be retained in cases where they will be abused?—*Sir Edward Reid*: If a family controlled company has already non-voting shares and it then comes to issue them to the public...

1827. You are thinking of the point at which they are marketed?—Yes.

1828. You are not thinking of retention ten years later?—As you say, beyond scowling at the chairman of the company or something of that kind you cannot do much, but perhaps sometimes a scowl does have an effect.

Mr. Brown: In a limited number of cases.

1829. *Chairman:* But would not the merit of the management of the particular concern be reflected in the price of the shares? I go to my broker and say—“Here are some shares; I see they have no votes but they seem to be a lucrative proposition; what do you advise?” The broker, if he is up to his job, says—“These are non-voting shares, you will get no vote, the board are getting inefficient, I suggest you keep off them.” Would not that sort of process operate?—*Mr. French:* I think it does.

Sir Edward Reid: On the whole we do not like non-voting shares but we think that legislation prohibiting them would unnecessarily prohibit cases where they are justifiable.

Mr. Hatch: There is a very powerful body of opinion in the City that likes non-voting shares, because they can buy those shares cheaper than otherwise. They say—“I do not want a vote; I would rather have my share cheaper; I am quite content to leave it as it is.”

1830. There would be quite an appreciable difference in price?—*Mr. French:* Very often. That is how City opinion reflects itself I think really, in the price.

1831. *Mr. Brown:* One small practical point on take-over bids. We have had a suggestion that there should be a rule in some form that when a take-over bid is declared unconditional, at that point the bidder should disclose his position as to the number of shares he holds, controls or has acquired. Do you see merit in that at all?—*Mr. Hatch:* He almost always does.

1832. The proposal would cover the case where he does not.—*Mr. French:* I do not think you want legislation on that.

1833. The point being clearly to help those who are still outstanding to know

what sort of minority they are likely to be left with.—It is rather tricky in some battles.

1834. If the offer had been made unconditional I should have thought it was quite straightforward.—There may be a good deal of bluffing going on, and you can declare it unconditional when you have less than 50 per cent.

1835. Is not that the point; bluffing should not go on, and the shareholders should be entitled to know whether it is bluff?—*Mr. Hatch:* Declaring an offer unconditional means simply “I will take all the shares I have got at the moment”; it does not mean necessarily I have got control. I think if the bidder does not say that he has got control or that he has got so many shares, the implication is that he has not.

1836. You are not in favour of requiring the bidder to declare his position?—I would not be in favour.

Mr. French: I like freedom.

1837. *Professor Gower:* Could I ask you a question about the prospectus provisions? You have pointed out in your memorandum that the situation in England differs from that in America in that there is no scrutiny of the prospectus by any public official to see everything is clearly and fully stated, but you also point out that, in effect, scrutiny does take place by the Stock Exchange and by the reputable Issuing Houses who handle the issues. We shall no doubt be told by the Stock Exchange what sort of scrutiny they carry out. I was wondering whether you would be prepared to tell us a little about the type of investigations you carry out before you back a public issue. Do you in fact put your accountants in to investigate the books for you, and send someone round to have a look at the properties of the company? Do you attempt to assess the efficiency of the management and if so, how? Is that a proper question to ask you?—The Issuing Houses Association does not attempt to fetter or prescribe the methods of business of any of its members.

1838. I was really asking you in your individual capacities.—It is a very difficult question to answer.

Mr. Barrington: The issuing house is sponsoring the company with all that that word means, and the degree of investigation depends very much on the circumstances, the length of the relationship of the Issuing House with the company. It would be unusual, certainly in my House, for a new proposition to be sponsored without a full accountant's investigation made by an independent accountant.

1839. I am thinking of a particular case before the war where there was an issue of debentures in a company which had just bought large housing estates. The prospectus said that the houses were completed and fully let. Two days after the issue had been made it was discovered that a large number of houses were not in fact completed and they had only been let because the vendor had let them all to his son at a rent which obviously his son would never be able to pay. Would it be possible for that sort of thing to happen today with an issue sponsored by a responsible Issuing House, or would you have sent someone round to look at the houses and to look at all the leases?—We would have a valuation in that case.

Professor Gower: We had a valuation here.

1840. *Chairman:* I remember that case. There was a certificate from the surveyor or architect that the houses were complete, and there was a certificate from some other professional man that the houses had been let. I think that puts rather a different complexion on the case because it was a case where two gentlemen gave false certificates; that is right, is it not?

Professor Gower: That is quite right.—The Issuing House certainly would not set itself up as an expert in property valuation and all the other fields that come into commercial life; it must rely on the experts in those fields.

1841. This was discovered because the solicitor's articled clerk went round because of some difficulty on the deeds, and he found out that the houses were not completed. I am just wondering whether in circumstances like that you would have sent someone round to look at all the houses before you sponsored such an issue?

—*Mr. French:* It depends who the valuers are I think.

Mr. Hatch: I would put it like this, that every statement of fact in a prospectus which was in any way substantial and important we should make sure was correct either ourselves or by the assurance of some other experts in whom we had complete confidence, whether they were accountants, valuers or anything else. We would make quite sure; we are as responsible for every statement of fact in the prospectus as the company making the issue.

1842. One other question about your remarks on section 50. As I understand it you want to make it provide that an application, even though made before the opening of the subscription lists, shall be irrevocable until the expiration of a further three days. Surely that would defeat the whole object of section 50(1). As I understand section 50(1), the object is to ensure that there is an adequate waiting period before any applicant is bound. That is provided, as I understand it, by saying he cannot become bound until three days after the publication of the prospectus. If you are going to say that if he in fact chooses to put in an application earlier he cannot revoke it, are you not going to defeat the object of the waiting period?—*Mr. Barrington:* This is a practical matter. In a successful issue the lists are said to be open for one minute but this is a legal fiction. In fact the great bulk of the applications have probably been received the night before or by post. So that if your interpretation of the law is correct the provision against revocation is of little protection to the Issuing Houses.

1843. Section 50(1) does in fact say you have got to give at least three days between the publication of the prospectus and the opening of the subscription lists. As I understand it, the intention of subsection (1) was that an application made after the opening of the subscription lists should be irrevocable, but that nothing should be made irrevocable during those previous three days, thus affording the applicant some period in which to get advice and hear what the financial press had to say. If we alter it as you suggest we destroy this protection, do we not?—*Sir Edward Reid:* I do not think that

that is the point of the section. The point is that no allotment can be made for three days. Before the 1948 Companies Act provided that this interval must elapse, a prospectus would be published in the papers one morning and copies distributed the previous afternoon after business hours and the list would be closed on the morning on which the prospectus was published, in a successful issue two minutes after it was opened; consequently unless you were very quick off the mark you could not get your application in time to get an allotment at all. That was regarded as being unfair, and so it is now provided that the prospectus must be published in advance. The point of section 50(1) is to provide a delay in order to give everybody time to get his application in.

1844. You take the view it is not intended to give people what the Americans call a waiting period at all?—No, previously it was almost a matter of luck if you succeeded in getting your application in time, and this provision was meant to put that right.

1845. Could I follow that up, because the Americans are always very critical of our arrangements over here because we do not provide for an adequate waiting period. They have always considered subsection (1) as at least providing a three day waiting period, which you tell me is in your view not the case. Is there not something to be said for providing a more adequate period? There is none at the moment apparently if your construction is right. There is a minimum of three days if my construction is right. The Americans provide in effect for at least twenty days by provisional prospectus arrangements. Ought this Act not to provide something of the sort?—He does not have to apply immediately when the prospectus is published but as the Act stands, he has three days to consider whether or not to put in his application.

1846. If he chooses he can have three days, but is that adequate? The Americans

say it is grossly inadequate and he must have more than that. Would you see any real business objection to making it ten days?—Yes, one must remember that it takes less time to read a British prospectus than an American one.

1847. You would agree that more than three days should be allowed? Very often the lists will not be open until more than three days after the publication.—*Mr. Hatch*: Not very often; I should have thought very rarely; for the practical reason that when you are doing an issue you obviously want to get it finished and get the underwriters off the risk as soon as possible.

1848. I quite see the underwriters do not want to be on risk. The Americans have got round this by allowing a provisional prospectus to be published which does not state the issue price, or any figures which depend on the issue price, but does give all the rest of the information so that the public and its advisers can digest everything except that. If we could evolve something like that would you think it useful?—*Mr. French*: No.

1849. Why not?—We alter our prospectus up till the last minute and so on. Our system works absolutely admirably; I do not think it could work much better. We make our own arrangements about when we say we are going to make an issue so that people who are interested will know when we think they should know all about it and we probably tell the public when we have underwritten it. But we do not want our underwriters to be at risk for a second longer than they need be, because they charge us for it. For goodness sake do not let us have anything American in our prospectus arrangements!

Chairman: Gentlemen, I think that concludes all the questions we have in mind to put to you. May I say again we are very much obliged to you indeed for your memorandum and for coming here to help us; your help has been most valuable. Thank you very much.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

SIR HENRY WARNER, BT., and MR. P. W. FREEMAN *called and examined.*

1850. *Chairman:* Sir Henry Warner and Mr. Freeman, for the purposes of the record I understand you are members of the Council of the Society of Investment Analysts Limited.—*Sir Henry Warner:* Yes.

1851. I need hardly say that the Committee is most grateful to you for your memorandum and for coming to give us further assistance today. I gather that the members of your Society are mainly employed as experts by financial institutions and stockbrokers, with a few independent consultants and financial journalists. Is that right?—That is correct.

1852. And you are concerned chiefly with professional investors, as distinct from the laymen seeking suitable investments for their savings?—In so far as nearly half our members are with stock-broking firms, we of course advise laymen as well.

1853. I was going to put that to you. You probably agree that, in a direct sense, the improvements in company accounts advocated by you would for the most part be above the head of the ordinary uninstructed layman?—In some cases, yes—not in all, I think.

1854. But, at all events, I take your claim to be that you perform a useful function in that the additional information for which you ask would be for the benefit of the lay investor, by enabling stockbrokers and financial journalists, who may be members of your Society, to advise him correctly?—Yes.

1855. He gets better advice because his expert adviser is better informed?—We think so.

1856. In effect, you act as experts to the experts, you might say?—Yes. I suppose we are reluctant to admit that there are people more expert than ourselves, but no doubt there are.

1857. Amongst a number of points you raise on the company accounts, you suggest that the published accounts of every company should disclose (a) turnover, (b) wages and salaries, (c) materials consumed, and (d) under appropriate

headings, any other material expenses. Do you think that all companies should be compelled to give this information in all circumstances, whatever their business and whatever the scale of operations may be at home or abroad? Do you think it should be made a universal rule for everybody?—Broadly speaking, yes.

1858. We have had a number of witnesses before us who have touched on this topic, and some of them have said that it would be impracticable in their particular business; others have said it would involve doing work out of proportion to any useful purpose served, and others that it would be positively harmful, especially in trading abroad, from the point of view of the advantage such disclosure might give to competitors. What is your view about that?—With regard to a disadvantage, companies in the United States do it, and many British companies already do it. One example is the Ford Motor Company, which I think is in a very competitive business.

1859. And you say it is desirable that it should be done and some companies already do it. They do it in America and, therefore, there is no good reason for not insisting on the same practice here. Do you put it as high as that?—Yes, that is the answer to the objection that it would do the companies harm to publish it. So far as our positive reasons for it are concerned, information of this kind enables us to make much better comparisons between one company and another. It enables us to compare their relative performance. It enables us to tell very much better how vulnerable they might be to economic circumstances. That, we think, would be of help to the investor.

1860. That would be of help to yourselves and your clients?—Yes.

1861. Would it be of much help to existing shareholders in the concern, so to speak?—Yes, because the existing shareholder may not wish to be a shareholder for ever. He wants to know how his own company is doing. In certain respects he has a better right to know how his own company is doing than other people.

1862. That is one of the prime objects of accounts, I suppose, so that the members may know how their venture is getting along.—Yes.

Mr. Freeman: In so far as companies which have given evidence before you claim that it would be a nuisance to produce figures of turnover, wages, salaries and so on, one might reply that such figures could even be of help to themselves.

1863. You mean they could find out where they were falling short of ideal efficiency, and where they were wasting money?—Just so. The figures that we ask for are, after all, not very complex. They are simply broad figures which one would expect any efficient company to have. I should think that in most cases it is merely a question of publishing existing figures, not of producing them.

Sir Henry Warner: May I make a point here, Sir, that this particular information was, I think, suggested in Table A of the Companies Act of 1862.

1864. And it took them nearly 100 years to resuscitate it.—Table A is only recommendatory and not mandatory.

1865. That does really lead to the next question. It could be possible, could it not, that this disclosure is practicable and unobjectionable, and even advantageous in some cases, but can one say this will be right in all cases and legislate accordingly?—I think in certain parts of the Companies Act there are provisions for companies to be able to go to the Board of Trade and get permission not to disclose certain things if they would harm their competitive position.

1866. Would some such form of legislation meet the present question, in your view?—Yes, but we would like the emphasis to be very much in favour of disclosing the information, and the cases in which the companies were permitted not to publish to be very exceptional.

1867. You think the great majority of cases can do it, and it is mere obscurantism to withhold it?—Yes.

1868. You put it as high as that?—*Mr. Freeman:* In practically every industrial and commercial group in Britain,

there are at present companies, large and not so large, producing all the information that we require. For example, the P. and O. Shipping Company takes, as far as I know, little or no advantage of the exemptions which are granted to shipping companies. One or two insurance companies operating in Britain give much of the information, if not all, that we ask for. If that is any indication, it may be obscurantism on the part of the other companies.

1869. Supposing the shareholders in a given company convened a meeting and voted heavily in favour of a resolution that this information ought not to be given, because it was not in the best interests of the company, would you still make them give it?—Shareholders put up with so much at present, that it might not be too objectionable if what could only be a small minority had to put up with a little more for the general good.

1870. That introduces a new factor, does it not? Should companies be run to provide a school for accountants?—*Sir Henry Warner:* No, Sir, but we have to have regard to potential shareholders as well as existing shareholders.

1871. That is the man who is thinking of investing?—Yes.

1872. And he goes for the company with the fattest accounts, and the most shiny paper, or something of that sort?—Not necessarily, but if he has got the information it is his own fault if he makes a mistake.

Mr. Freeman: Giving this information works to the end of making all the companies in which we advise investment or may advise investment, more efficient and more profitable. We believe this is one of the general effects of publishing more information of this kind, and that is what I meant by the general good.

1873. It does, in fact, make their businesses more profitable?—Not in every individual case, but as a general rule.

1874. I see how you put it; and the sort of modification, which you would allow in cases where the Board of Trade authorised departure from the system you advocate, you say should be rare; that is

to say, the discretion should be very sparingly exercised.—*Sir Henry Warner*: Yes. I would even think that, if this information had to be published by everybody, the number of applications for exemption would be very few indeed.

1875. You made a proposal in your memorandum that a company's accounts should disclose the undistributed profits of companies in which it holds a substantial trade investment, so far as those profits are attributable to the trade investment. I think you make it clear in that proposal that you mean companies in which the holding company has interests not exceeding 50 per cent. and not less than 25 per cent.—That is right or, in the alternative case, where the profits of the associated company would be 25 per cent. or more of the holding company's profits.

1876. And the object of that recommendation, as I understand it, is to enable a better assessment to be made of the real profits and the cover for the holding company's dividend?—That is right.

1877. I take it you would agree that there is little advantage in knowing the value of the assets attributable to the trade investment as distinct from the profits, because *ex hypothesi* the holding company is not in control of the assets?—*Mr. Freeman*: I think it is desirable to know both. In an analysis you need to know what the assets are, and what they are earning. This is the ideal.

1878. But these people are only minority shareholders in the companies that we are speaking of now.—*Sir Henry Warner*: But they put a substantial proportion of their own funds into another business, and I think it is important for their own shareholders to know how well that other business is doing.

1879. Yes. They know how well it is doing as regards profits if your recommendation is accepted, but I was wondering about whether the information you ask for, so far as assets are concerned, is of any use?—We do not reckon that you really know how well a company is doing unless you can relate the profits to the assets.

1880. That would bring in the assets of the associated company?—Yes.

1881. I am only putting it to you that the holding company not being in control would not really be in a position to state the assets position with any accuracy.—Somebody must be in a position to state it. The associated company, itself, must have accounts. They must be available.

1882. I suppose accounts would be available to the holding company as a member of the associated company, but they would not necessarily have any more information than any other shareholder.—No, but at the moment the shareholders of the holding company do not even know what are the accounts of the associated company, in some cases.

1883. The next point is this. It has been suggested to us by other witnesses that every company should give the names both of its subsidiaries and its associated companies. Do you think that is right? Do you think the annual returns should be accompanied by a statement of the names of the company's subsidiaries and associated companies?—In principle yes, but I think it would be unreasonable to have all the names of every minor subsidiary put in the accounts. The important ones, down to quite a low level of importance, should certainly be put in.

Mr. Freeman: In our opinion, the naming of subsidiaries is less important than describing their activities. There are certain accounts at present published where a shareholder receiving these accounts, and having no other source of information, would be quite at a loss to know what the company did at all, and this is a state of affairs which should not be allowed to continue.

1884. One often reads a tantalising statement from the Chairman in the Press, and seeks in vain for any information as to what the company has been doing.—The Chairman's speech may give no evidence, or may refer mainly to certain activities which are far from important.

1885. He says "The demand for our product is well maintained", and never says what the product is. But that, no doubt, is because they are assumed to be

talking to people who know what the company does, although it is a curious feature of some of these publications. Then your view would be that, saving certain exceptions of small insignificant cases, it would be a good thing for the names of the subsidiaries and their leading activities to be stated with the annual report?—Yes.

1886. There again, would you allow the Board of Trade discretion to excuse complete compliance?—I think we must, because we cannot be aware, in general, of particular cases where some overriding interest might be involved. We would hope it would be very sparingly used.

1887. Would you leave it to the auditors, perhaps, to make a note that certain subsidiaries had not been included because they were satisfied that these subsidiaries really had no material bearing on the company's position?—*Sir Henry Warner*: That would be all right, but there is the other case where a company might claim that it was actually harmful for anybody to know that it owned another company. I suppose cases of secret research might be cited, I do not know. It is very difficult to exclude altogether the possibility of exemptions of that type, much as we would like to do so.

1888. We have had evidence that in some cases disclosure would be harmful. There is the case of the company which is minded to go into a different market than the one it is operating in now; perhaps it is now producing very high class articles and forms another company to produce articles not quite so good.—I think that, where the amounts were material, it is likely that the people who really wanted to know would know in any case.

1889. The other case is the manufacturer who was minded to go into retailing through a subsidiary, which might be an unpopular step so far as the existing retailers were concerned.—*Mr. Freeman*: I think the same comment applies, Sir, as indeed it does in many examples of information not available to shareholders, that within the trade these facts may be perfectly well known or perfectly well ascertainable.

1890. Do you adduce from that that it would do no harm to make a formal disclosure, because the trade would know in any case?—In general, yes.

Sir Henry Warner: There is a possible half-way house, if I might suggest it. The accounts only appear once a year. It is just possible that, if the company entered a business in November and its accounts were published in December, that might be the first information anybody had, but if it was postponed until the following year then it is very unlikely that its competitors would not have found out by then.

1891. So it would be a sort of ostrich procedure. The withholding of the name would not really gain a company anything. That is your view?—Yes.

1892. There is a suggestion in paragraph 12 on page 3 of your document that companies should be required to indicate the main activities carried on, and any material variations by way of additions or otherwise during the year under review. Is not that suggestion met to some extent—I do not say the full extent—by the directors' report required under Section 157 of the Act?—I have four company accounts in my bag here, from which I do not think you could tell what the companies do.

1893. You mean that you think the directors' report is completely uninformative in these cases?—If you would like to see them, Sir, here they are, and if you can tell me what the company does I would be satisfied with the Act.

1894. You know the language of the Act. Section 157(1) requires to be attached to every balance sheet laid before a company in general meeting a report by the directors with respect to the state of the company's affairs, the amount if any which they recommend should be paid by way of dividend, the amount if any which they propose to carry to reserves, and so on. Section 157(2) says "The said report shall deal, so far as is material for the appreciation of the state of the company's affairs by its members and will not in the directors' opinion be harmful to the business of the company or of any of its subsidiaries, with any change during the financial year in the nature of the company's business, or in the company's

subsidiaries, or in the classes of business in which the company has an interest, whether as member of another company or otherwise." If that statutory language was loyally followed this report would, I suggest, go some way to meeting your proposal.—We can only judge by the results. From some company accounts you cannot tell what they do.

Mr. Freeman: And more serious things can happen. There is a particular case of a company, of which I have details before me, which was always described as doing one thing, but after a very sharp setback in profits in 1958, which caused a decline in the value of the stock, the Chairman explained that the fall was due to the importance to the company of a certain activity which until then had never been heard of. That is the kind of situation we wish to avoid.

1895. It is difficult to prevent people leaving out what ought to go in. You can tell them what ought to go in, and you can threaten them with pains and penalties if they do not put it in, but you cannot do much to the man who does not put it in, short of a prosecution for breach of the terms of the Act, can you?—You can perhaps frame the Act in such a way that less of a loophole is left for omission, and the directors are given less encouragement to withhold information on some vague ground.

1896. The directors are absolved from making any disclosure which in their opinion would be prejudicial to the company. That is only reasonable, is it not? You would not expect them to disclose anything which was, in their opinion, really detrimental to the interests of the company, would you?—It might be possible to withhold that power from them, subject to submission to, for example, the Board of Trade.

1897. There might be things which it would not be in the interests of the company to disclose.—Of course.

1898. The dispensation is rightly given, you would agree?—I do not think we can agree, having seen the results, that it is rightly given to those particular people acting entirely on their own initiative.

1899. But in principle it is a dispensation which ought to be given, although

in practice it may or may not have been abused. That is the situation.—It may be so, but it would always tend to be abused so far as it was given in the present form.

1900. It looks as if your view is really met by perhaps restating in more imperative language that this information should be contained in the directors' report, and postulating greater activity as regards the enforcement of this obligation.—This might meet our minimum needs, yes.

1901. You are very cautious.—We are cautious because we have seen the use which is made of any exemption which is given.

Sir Henry Warner: Here again there is the example of what is done in the United States, where they go very much further than this, I think. There a report has to be submitted to the Securities and Exchange Commission if anything material happens to the business, including a substantial purchase of another business or sale of the assets.

1902. Would you suggest some similar procedure here, substituting the Board of Trade for the Securities and Exchange Commission?—No, I do not think we would. We think they overdo it over there, but that is an example of what can be required.

Mr. Freeman: I think we would hope that the centre of gravity of information demanded would settle down far nearer the American position than our own.

1903. In the United States is an annual report required or a report *ad hoc* on each transaction?—Both, Sir.

1904. Then you may get to the position where you have to put a Section in the Act obliging the directors to accompany that document with a summary so that people can understand it.—Perhaps the summary would suffice.

Sir Henry Warner: I think this is something where it is perhaps a matter of alerting auditors. Clearly, where a company can publish accounts and not say at all what it does, the provision in the present Act is not taken much account of. If that was tightened up, and the accounting profession was, so to speak, alerted to

it, I think there would be arguments between boards of directors and their auditors, but on the whole we would expect the general standard to be improved.

1905. I think that really covers that point so far as we can take it today, and of course it will be for the Committee to consider what more can be done in the way of disclosure of that kind in section 157, or a comparable section of a new Act. Then you make the suggestion that there should be included in the accounts comparative figures for the past five years. That, I think, is your paragraph 14. You say that every company should be bound to submit in its annual accounts a statement, certified by the auditors, summarising the salient features of the profit and loss accounts and balance sheets of the five years immediately before the year shown by comparative figures in the accounts under consideration. As to that the Act, as I understand it, already requires a balance sheet to include corresponding figures for the previous year. —Yes.

1906. Now I was wondering whether your proposal, if adopted, might not impose a fairly heavy burden on companies, if they had to produce figures for the past five years. I take it you ask for something more than a mere reproduction of the figures as they appeared in the earlier accounts, or does it satisfy you if they go back for the five years?—Provided it was done on a basis consistent with those which have appeared in previous accounts, that would satisfy us.

1907. But you can get such information from, for example, Exchange Telegraph cards, can you not?—That is so, but the layman may not have access to those.

Mr. Freeman: Nor, so far as the balance sheet is concerned, can you get the figures from the Exchange Telegraph or Moodies service for more than two or, at most, three years, although the profit and loss analysis goes back further.

1908. You say those cards, if they were available, would not give adequate information?—No, not as at present constituted.

1909. But, of course, the intending shareholder can go to his stockbroker and

ask about a particular company, and the stockbroker would surely be able to produce copies of the accounts going back a long way?—To put it at its lowest, it is very much more convenient if the required information is summarised, as many companies already do, in each set of accounts. It is particularly important, and this is something which cannot always be done by those outside a company, to make this record consistent; that is to say, things do happen which make a comparison between successive years misleading, and it is an important part of our submission that the company should then either adjust previous figures or, where this cannot be done, at any rate draw a line and say that one cannot compare above and below this line.

1910. You warn the reader where a plain comparison would be misleading?—Just so.

1911. As an existing shareholder, he gets his balance sheet and profit and loss account every year, and if he kept them and every now and then looked back for five years or so, would he not get a reasonable conspectus of the company's performance over that period?—There is the point of consistency and there is the human point that many shareholders do not keep past accounts. Thirdly, as Sir Henry Warner has said, we do act for potential as well as for actual investors.

1912. I am not saying that there is anything wrong with this suggestion. I am only putting it to you that the questions of the practicability, and the amount of work involved, do have to be considered, and I was only suggesting that the intending shareholder and the existing shareholder would really get all the information they wanted from the documents which companies already issue. That is a point of view, no more.—Our main objection to that is the point of consistency, which arises quite often when companies change their activities, but I think we would submit that it is very little extra work for a company to extract and sometimes adjust salient figures which have already been prepared. It is very much less work for them than might be supposed, and a greater advantage to the people who might read those accounts than might be imagined.

1913. But making figures for different years consistent might be quite a task in some cases, might it not?—Surely not, if a company was always at liberty, if it met real difficulty, to draw a line and issue a warning.

1914. I think that exhausts that point. Then there is this disputed question about the exemptions from the disclosure of information, which are enjoyed by banks, discount companies and insurance companies, and you say you would like to see these exemptions abolished except where, by the nature of their business, the production of such figures would be meaningless. Can you give an example of the figures being meaningless on account of the nature of the business?—*Sir Henry Warner*: With a bank, I think a statement about repayment of loans might not mean very much. Banks borrow money on current account, in fact, and that provision, of course, is really designed for debentures and loans of that type.

1915. As to these exemptions, from a practical point of view do you say that shareholders, depositors and policy holders are prejudiced by non-disclosure?—They are prejudiced in so far as they are not really able to judge the performance of the company.

1916. The concern is really shown to be a little worse off than it actually is, is it not? Is not that an effect of it?—*Mr. Freeman*: Or better off. In the case of a shipping company, for example, unless you know the true value of the assets, and the true value of the company including its reserves, and are able to relate those to the profit they earn, you have no idea if a company is using its assets in a way which should attract your money.

1917. I see how you put it, and I understand as a matter of accountancy principle that that might be important, but is it from a practical point of view? You buy your shares in a well-known shipping line on the market, I suppose, at their market value.—But investors are concerned with the continuing situation. They may buy, hold or even bequeath shipping shares, and they may be unaware of the gradual deterioration in the profitability of the particular company. Had they known it they might have wished to sell their shares long ago.

1918. That point has been made before by other witnesses, and other witnesses have also suggested the possibility of take-over bids. It is put in favour of your view that the non-disclosure might have the effect of undervaluing the shares, so that shareholders might part with them to the take-over bidder at less than their proper value.—Yes, moreover we have a general feeling in favour of a smooth and free market, not subject to sudden shocks. It may be that a situation is hidden for many years and then, because a company fails or alternatively is taken over at much more than the apparent value of its shares, a sharp price rise occurs. In many cases where a company is taken over or its shares are acquired, it later emerges that the true value of the shares was far greater than any lay shareholder had any means of telling. This seems to us to create a situation which we consider wrong, of a privileged class of people who have access to information which the generality of shareholders or potential shareholders are denied. There may be a group of property experts, for example, who know perfectly well what is the value of a company's properties, whereas most of the shareholders of that company do not, and those shareholders are then persuaded to sell their shares in the open market, quite willingly, but under a gross misapprehension as to the value of their shares.

1919. There are arguments the other way, and I gather that these institutions attach very considerable importance to them. Would you agree that, if this privilege does no harm, there is no particular reason for ending it?—*Sir Henry Warner*: We would not agree that it did no harm. Our argument in favour of disclosure is exactly the same as for any other company, that the investor ought to be able to judge the performance of the company.

1920. There is not sufficient ground for distinguishing?—No.

1921. I do not want to take up too much time on this, but of course, so far as banks and insurance companies are concerned, they have to consider their shareholders, no doubt, but before the shareholders there come the claims of the

depositors and policy holders—the customers, so to speak—and it is said that the exemption makes things more stable from their point of view.—*Mr. Freeman*: We doubt strongly whether this is true, Sir.

Sir Henry Warner: In the case of a life insurance company with “with profits” policies—I am a director of an insurance society, and of course anything I say has nothing to do with them; I am giving evidence on behalf of the Society of Investment Analysts—if it is a proprietary company, the interest of the policy holders is the same as that of the shareholders, because they gain from the bonus and the bonus and the dividend tend to go hand in hand. They should have the ability to judge the performance of the company just as should the shareholders.

1922. Surely, their claims are paramount to those of the shareholders, in the event of the company being wound up or something of that kind?—Yes, in that unfortunate event, but if somebody wants to decide which insurance companies he wishes to invest in, or which insurance companies he wants to take out policies with, he should be able to judge the record, and we say that neither an intending policy holder nor an intending shareholder can judge that properly from the present accounts.

1923. Of course, insurance companies keep their accounts in accordance with certain statutory rules, do they not?—Yes.

1924. And that, I suppose, in some respects puts them in a different category?—Only to the extent that they can dodge from one Act to the other.

1925. They can dodge from one Act to the other?—They can say that they are exempted from the Companies Act because they disclose certain information to the Board of Trade under the Insurance Companies Act, and unless there is an inquiry into the working of the Insurance Companies Act nothing will be done about that. We would say that, whichever Act it is disclosed under, the full information ought to be disclosed.

Mr. Freeman: Since a number of our members are actuaries, and therefore might hold a view different from that

which we put forward, we did think that we ought to seek the views of some of them. While among those asked there was a strong majority for our point of view, there were one or two who raised this very point, and it seemed clear that they were raising it in the hope that insurance companies would escape the searchlight of this present Committee's investigations, and that no similar committee would investigate the Act under which they do submit their accounts.

1926. Then you say there is no difference in principle between an insurance company, a bank or indeed any other company which wants to claim such an exemption?—There are, of course, strong differences in detail, in that the assets and liabilities of insurance companies are of quite a different kind from those of a banking company. While we believe in both cases that there is no sufficient reason for the exemptions, our detailed reasons would be different in the two cases.

1927. Then there is the case of the shipping companies which, of course, are in a different category from banks or insurance companies. As to those, I think you did mention the Peninsular and Oriental Company, and in paragraph 21 of your memorandum you said that one of the largest shipping groups did not avail itself of the exemption order. Now in actual fact, you were not to know this but representatives of the P. and O. Company did give evidence before this Committee the other day, and they said that they attached great value to the exemption and that they used it in the accounts of their subsidiary companies. That, perhaps, is a matter of fact, but it is right that we should state the position accurately.—*Sir Henry Warner*: I am not surprised, and I think it is perfectly fair. As I understand it, shipping companies are not actually referred to in the Act. The wording of the Act is that the Board of Trade has power to grant exemptions to certain classes of companies, and if the Act were to be amended and that swept away the Board of Trade would have no power at all. We think it might be reasonable for the Board of Trade to be allowed to give exemption to certain companies, so that if there was a

case where a shipping company felt it was really oppressed by the threat of subsidised competition, that particular company—possibly a subsidiary of a big group—could claim exemption. But we do not think there is any ground for exemption for the large world-wide groups. In fact, there is at least one group where it is by no means certain that it is a shipping company at all on balance.

Chairman: I gathered that the P. and O. position is that they operate through subsidiary companies all over the world, that they have got this exemption, and that it is not their policy to apply it unnecessarily. In those cases, where they think it ought to be done because of foreign competition, or whatever the difficulty is, then they avail themselves of it.

1928. *Professor Gower:* You would not mind that, as I understand it, as long as the holding company, which will be the one whose shares are issued to the public, makes full disclosure on a consolidated basis? You would not object if the accounts of some subsidiaries did conceal exactly what their exact profits were, is that right?—We should not object nearly so much. We recognise that there could be cases where there is subsidised competition, where it would be fair to grant exemption.

Mr. Freeman: But I think again that we would like the onus placed elsewhere than purely in the hands of the company; at present exemption is given to entire industries and no application has to be made. If it could be done through the Board of Trade as before—that a company sought exemption in a particular case for particular reasons—we should be satisfied.

1929. *Chairman:* Turning to another topic, in paragraph 26 of your memorandum you recommend that the issue of non-voting shares should be prohibited by law. The critics of that view say, amongst many other things, that this would be open to criticism as an unwarrantable interference with the freedom of companies. Your view, as I understand it, is that the inconvenience of this type of share carrying no votes, outweighs consideration of the sanctity of contract.

—*Sir Henry Warner:* In principle, shareholders control the company and company law is based on that democratic process. They vote the directors in, and we think that, so far as possible, the law should recognise that.

1930. You say that shares carrying the same equity risks should all be in precisely the same position as regards voting power?—Yes.

1931. Of course, the difficulty does arise in measuring the relative equitable interests, does it not? In the case of preference shares, it seems to be recognised, I suppose, as a matter of long custom, that there is no objection to them carrying no vote except in a certain well-known set of circumstances, including altering their rights, or a resolution to wind up the company, and perhaps one or two other instances. But perhaps we could put them on one side and say they are not part of the equity. But then you get participating preference shares, they get their fixed dividend and, after the ordinary shares have had 10 or 20 per cent., or whatever it may be, they participate *pari passu* or otherwise in the residue of divisible profit. How would you compare them with an ordinary share, or with a deferred share, in estimating how many votes each should have?—It is very often quite clear-cut, because the profits are well over the limit where the participating preference share starts to participate, and in that case there is no practical difference between the ordinary share and the preference share.

Mr. Freeman: I think it is fair to add, since we are speaking of a practical matter, that there are not a great many participating preference shares which have unlimited participation. The rule generally is that they participate up to a certain maximum amount. I do not mean there are not cases of complete participation, but they are the minority, so you are speaking of a relatively small number of cases. I think that our case is based on observation of the evils which flow from the present situation, not from an assumption that there are no difficulties in another direction. But there have been many cases which have demonstrated to us, at any rate, the unwisdom of having non-voting shares.

1932. One view is that, if non-voting shares are as bad as all that, they will die out because they will become unmarketable, and I suppose measures would then be taken ultimately to enfranchise them.—There is indeed evidence of a movement outside of legislation in that direction. I suppose our wish is to see that movement hastened as much as possible.

1933. The ordinary law of supply and demand might do something about it in the end.—Such is the conservatism of investors, and such are the complexities of this case, that it might take a very long time.

1934. But we have had witnesses here whose taste is so depraved that they say they positively like them.—*Sir Henry Warner*: They are usually cheaper.

1935. You get them cheaper, you get the same dividend, and you do not get the doubtful benefit of travelling to Birmingham or somewhere and attending a general meeting where your vote cannot sway the issue at all.—*Mr. Freeman*: But you do get the real benefit of not being subjected to certain highly inequitable situations. There is a well-known tobacco company which was taken over by the exchange of a very small proportion of shares which carried a vote, and the vast majority of the shareholders had no say in this.

Sir Henry Warner: Nor had they had any say in the management which led up to the situation in which that company was taken over. I think we rather stand on a matter of principle here. The theory behind company law is that equity shareholders run a company but, as the law stands, "A" shares are allowed and that conflicts with that principle.

1936. Finally, as regards non-voting shares, one of our witnesses strongly objected to enfranchisement of non-voting shares, on the ground that this would be done at the expense of the non-voting shareholders who would have to find compensation payable to the voting shareholders, and thus in effect to pay for a right to vote which they might not want. Might it work like that, that the voting shareholders would have to be compensated for letting in the non-voting ones

on equal terms as regards votes?—*Mr. Freeman*: Under our suggestion the compensation, if any, to be given would be a result of mutual agreement between the two classes of existing shares. It would not be for the ordinary shareholders to say "We vote ourselves such-and-such a bonus in recognition of our giving votes."

1937. Somebody would have to find the compensation. I suppose it would have to come out of the pocket of the non-voting shareholder who was getting a vote conferred on him.—In our opinion he would gain over a period much more than he would lose, granted such a system of enfranchisement as we suggest.

1938. If he said anything against it, he would be told "This is good for you. The directors know best."—He is told that on so many occasions that once more would hardly matter.

1939. *Professor Gower*: As regards disclosure of the activities of companies and their subsidiaries, as I understand it your real objection to the present section 157 is, first, that it only requires the directors to give notice of a change of activities, whereas you want the report each year to state what the existing activities are, irrespective of whether there has been a change.—*Sir Henry Warner*: Yes.

1940. Secondly, that you do not want the directors to be judges in their own cause, as to whether it would be detrimental to disclose this information, your view being that directors invariably consider that any disclosure is detrimental. Perhaps that is putting it a little high, but you think that it should be the Board of Trade, rather than the directors, is that right?—Yes.

1941. And, thirdly, you do not think this should be in the directors' report, because over that the auditors have no jurisdiction, but should be disclosed somewhere where the auditors have a say?—Yes.

1942. Those, really, are your three objections to the present position?—Yes.

1943. Secondly could I make sure that I have understood what you were saying

about profits of associated companies? Let us assume that we have a case where a company holds 30 per cent. of the equity shares in another company. As I understand it, you would say that in those circumstances the company holding the 30 per cent. should, somewhere in its accounts, state what the 30 per cent. of the distributed profits in the other company were, and also what 30 per cent. of the non-distributed profits in that other company amounted to?—Yes.

1944. You would not want complete disclosure of assets in the other company, merely of the distributed and undistributed profits in that year, is that right? —No. We should want the profits relating to the holding company. In regard to that there is one company, a Scottish company called William Baird, which does this, and the form in which they do it, certainly with regard to profits, is how we think it should be done.

Mr. Freeman: There are two points, which I can illustrate with an example. Thomas Firth and John Brown owns, jointly with the English Steel Corporation, Firth Vickers Stainless Steel, and in Firth and John Brown's accounts the trade investment in Firth Vickers is shown at a value of a little under £3 million. For 1957-58 no dividend was paid by Firth Vickers, and the shareholders of Thomas Firth and John Brown were given no precise evidence whether or not this was a remunerative investment. The following year a substantial dividend was paid. You will see that as things stand, the accounts of a holding company can be very misleading, and can be subject to large changes without sufficient underlying reasons being given. There may be no possibility for the ordinary shareholder to discover whether his company in a particular year has done as well as might have been expected or not, for they may or may not have chosen to take in a dividend from associated companies. That is the point relating to the disclosure of distributed and undistributed profits.

1945. Do you want disclosure of all free reserves, or merely of the profits for the year, distributed and undistributed? —*Sir Henry Warner:* No.

1946. Each year you want complete disclosure of all free reserves in the

subsidiary company?—As applicable to the holding company; what we call the appropriate proportion of the net worth of the associated company.

1947. How would that be done? Presumably, in the actual balance sheet they would still show this at cost or market price, according to whether it was quoted or not, but somewhere else attached to the accounts you would show this information, would you?—By way of note.

Mr. Freeman: Or indeed, in the case of a true 50-50 division, of which there are several examples at present, the whole balance sheet and accounts of the company owned by two companies might be shown.

1948. That is another point. Would you approve an alteration of the definition of subsidiary, so that it included a 50 per cent. interest? In other words, do you see any objection—as some people do, apparently, although I have never understood this myself—to the idea that a company can be a subsidiary of two companies? I should have thought that was precisely what the position was when you had a 50-50 holding. —*Sir Henry Warner:* That would, I think, lead to a number of other complications in regard to voting and perhaps tax matters and so on, and also it is not only the 50 per cent. one that we are interested in.

1949. I appreciate that, but you raised this 50-50 case and I thought I would ask. —*Mr. Freeman:* I do not see any objection to it, but it is not a point which I have considered.

1950. The definitions of subsidiary companies in some other Commonwealth Acts do cover the 50-50 case, so far as I know, without any great difficulty. Coming back to my original point, your argument would be that disclosing this information would, in fact, impose no difficulty on the holding company because it would get the accounts as a member of the subsidiary, and therefore would have the requisite information?—That is right.

1951. *Mr. Lawson:* You do not want any statement of the individual assets and

liabilities of these subsidiary and associated trading companies? You only want the figure of net worth and the figure of the current year's profit?—*Sir Henry Warner*: Those are the most important. We would, of course, like the others.

1952. I want to get it clear whether you want the detailed assets and, if so, why? Supposing a holding company has 25 per cent. of another concern, it cannot get its hands on those assets. I wonder, therefore, if that information is of any use to anybody?—*Mr. Freeman*: It may be. For example, a shareholder might wish to ask a question at the meeting about the remunerativeness of this investment, and it would help him if he knew more details of it. At present shareholders are often completely at a loss to know whether this section of their company's assets is well invested or not, and it is something if you have its net worth and the income it earns. But as analysts we would naturally wish to go further and we would like to know the business the company is interested in, and to have complete sets of accounts.

1953. *Mr. Scott*: In your suggestion on page 2, you ask for details of turnover, wages and salaries, materials consumed and so on, and you also suggest that information should be required as to the company's activities. Is that with a view to informing shareholders or potential investors? If it is, as I understand it, to help potential investors, would you confine your recommendations to public companies, because, presumably, nobody who is not already a shareholder can assume that he has much chance, necessarily, of becoming an investor in a private company. I am not, of course, referring to exempt private companies.—*Sir Henry Warner*: By public company, you mean a quoted company?

1954. No. Of course, as we know, an exempt private company does not have to file its accounts. Your memorandum says the published accounts of every company, i.e. whether they are quoted or not, and that would include private companies, although they happened not to be exempt. Did you intend it to apply as widely as that, or only to quoted companies?—*Generally speaking, no. But I have come across a case where a quoted company*

was controlled by an exempt private company, so it is a little difficult to be quite sure how far one wants to limit this sort of requirement.

Mr. Freeman: The main scope of our activities is, of course, confined to public companies. There are, however, cases of private companies which one comes up against, where one has to advise upon investment or realisation, and of course there are quite a number of private companies where it is possible to obtain shares if one wishes to. So that while I would like to listen to the argument against extending this requirement to private companies, I should have thought that, in principle, we would extend it to all except exempt private companies.

1955. I think the real argument against extending it to private companies is that many of them consist of only a handful of shareholders. They may not enjoy the status of exempt private companies, but they are still a private company, and they all know one another. It might be imposing quite a burden.—Not quite a burden of preparation, because I would have thought that the information we ask for is the sort of thing which every company would have. You mean, perhaps, the burden of publication?

1956. That might be so.—I think we have to confess that in the case of an extremely small company that might be so.

1957. In paragraph 12 you suggest the main activities should be disclosed, but you do not suggest, do you, that the amount of profit or loss on each activity should be shown?—This was an omission which we regret. Our suggestions as submitted were minima: we do think it very important to know the breakdown by the kind of activity of turnover, assets, and profitability.

1958. Lastly, about non-voting shares. On whose behalf do you think measures should be taken to make them unlawful? Whose interest would be protected?—I would say the general interests of investors and potential investors. I would rather not risk saying the immediate advantage of the shareholders concerned, because there might clearly be exceptions to this. But we believe it is generally advantageous to investors and potential investors that

these shares should be banned. It would result in far fewer situations which we view as inequitable.

1959. So you would recommend preventing equity shareholders from creating non-voting shares in their company?—This is clearly a subject which is complex and on which there are two points of view. I think it therefore right that we should take our stand on the general advantage, the avoidance of a great many inequitable situations, without discussing in detail, unless you wish to, the pros and cons of particular cases.

1960. Some companies have preference shares with full voting rights, even although they have only a very small or no participation in the equity. Now would you suggest that that should also be made unlawful. Should there be any restriction on a preponderating preference vote, which would have the effect of investing control in the preference shareholders?—I doubt if we would be wise to set ourselves up as perfectionists. This is a very complex subject. The drafting even of the proposals we make would admittedly require much skill and even then no doubt anomalies would remain.

1961. *Mr. Mackinnon*: I think you have said here today that what you wanted to find in the balance sheet of the company was the net worth of the trade investment. I think you put it in that way. But in your paper, you appear to say only that you want the profits disclosed. But if you only get the net profits and do not get the real value of the underlying assets of the trade investment, you do not really get to the position which I thought you were advocating of being able to test the earning capacity of the assets, and the employment in which they have been kept.—I am afraid that is a second omission.

Sir Henry Warner: Yes. We can only plead that in practice it often comes to the same thing, because we have asked for the profits retained, and very often these associated companies start from scratch, so that the only reserves will in fact be the profits that have been retained.

1962. Yes, but that is making a positive assumption that the profits are still repre-

sented by the assets in the trade investment, and if you merely disclose the profits without the trade investment you might give a very misleading picture of the value of the trade investment, would you not?—Yes.

1963. It would be worse than not putting it in at all?—We should have asked at least for the net worth of the associated company as well.

1964. Which in turn presupposes that your proposal would have to accept some principle of valuation of, as it were, the fixed assets in the trade investment?—If our proposal about producing an up-to-date valuation of fixed assets is accepted, that would happen in any case.

1965. Yes.—But in any case, to give the net worth as shown by the books of the associated company would be an advance which we should welcome.

1966. Notwithstanding that it might in turn be rather misleading?—*Mr. Freeman*: It would surely not be more misleading than is the case with the majority of balance sheets at present.

1967. *Mr. Lawson*: You have referred to the accounts of the holding company. You say in paragraph 4 that where a holding company is trading you would like to have a separate profit and loss account. Could you amplify that?—*Mr. Freeman*: If one had a breakdown of activities showing turnover, profit and assets applicable to each main activity, this point would be of less importance. But as things stand there are companies where, if one knew the parent company's profit and loss account as well as its balance sheet, one would have an inkling—which one does not have at present—of the profitability of some major part of the company's activities. There is, for example, a company in the electrical industry whose activities are divided mainly between production of gramophone records and certain other electrical apparatus, and the parent company is the company which is chiefly concerned with gramophone records. Now it is of the greatest importance to us, in approaching the future profitability of this company, to know how its activities are divided

between these two activities, and how the two completely different activities contribute to profitability.

1968. You are on the question of different activities, and I thought perhaps you were on a different point. I do not know whether you would care to express a view upon it. Where, for example, the holding company has many subsidiaries overseas there is, I suppose, something to be said for the view that the holding company itself should publish a profit and loss account, so as to show how much of its profits from overseas have found their way into the parent company?—Yes. We are concerned in several places with the question of overseas profits. I think, for instance, that, if one had fuller figures of the basis of taxation, one might be led to a somewhat similar kind of information.

1969. The only further point is in relation to this suggestion of yours about showing figures for the previous five years. You ask for five-year figures both of profits and of assets in the balance sheet, and that is going a good deal further

than even prospectuses go these days. Do you intend to go further than prospectuses?—Much of our power, which is severely limited, to compare the profitability of one company with another is based on the ability to examine profitability, trends of profitability, and so forth. For this we need to form certain ratios between profit and the assets producing the profit, between one kind of asset and another, and so on, and since the absolute value in many of these cases can be misleading it is particularly the trends that we watch. For this we must have past balance sheet figures, and know, for example, what the market value of investments was in previous years.

Chairman: That, gentlemen, concludes the questions we have in mind to put to you. We would like to thank you again for your memorandum and for coming to help us today. The discussion has been most interesting, and we are greatly indebted to you.—*Sir Henry Warner:* Thank you very much, my Lord, and may I on behalf of my colleague and myself thank you and members of the Committee for hearing us so patiently.

(The witnesses withdrew.)

MR. E. P. HUBBARD, MR. K. MINES, MR. J. W. BARTER, M.P. and MR. C. E. TAYLOR
called and examined.

1970. *Chairman:* We are much obliged to you, gentlemen, for coming here to help us, and for having supplied us with this very useful memorandum, of which due note will be taken. Mr. Hubbard and Mr. Mines, you are respectively Chairman of the Council and Chairman of the Law and Parliamentary Committee of the Association of International Accountants? Mr. Barter is a member of the Council and Mr. Taylor is a member of the Council and Secretary?—*Mr. Hubbard:* Yes, that is so.

1971. Subject to any questions other members of the Committee may desire to put to you, I propose to confine my questions to the matter of particular concern to your Association, namely the possibility of the exemption of exempt private companies from the requirements

as to audit contained in section 161 of the Act being withdrawn. That is the burning question so far as you are concerned.—Yes.

1972. Now I understand from your memorandum that you think it would cause hardship to many of the small private companies which now enjoy the privileges of an exempt private company if all the existing provisions of section 161(1) of the Companies Act regarding auditors were extended to them, without some modification of the qualifications required by that section. Do you base this view on the ground of expense; do you think it would be unduly expensive for these exempt private companies to employ auditors if they were compelled to employ exclusively auditors as now recognised by the Board of Trade?

—*Mr. Hubbard*: No, it is not based entirely on expense. It is the numerical question as well.

1973. Do you to any extent base it on questions of expense, the greater cost? —*I think not.*

1974. Or is it that they would have difficulty in finding a sufficiency of qualified auditors to audit their books? —*It may well be; and it may be some people may prefer to have an International Accountant—they should have freedom of choice.*

1975. It is a hardship because it impinges on their right of free choice? —*Agreed. We do such a number of such audits that we think hardship would be caused if we were eliminated, and furthermore we submit that the freedom of choice would also be exercised if our name was struck out.*

1976. They would be deprived of your services, have to go to somebody else, and that would interfere with their freedom of choice, and you do not base your case on expense? —*No, because we are in practice similarly, and our fees are just the same as the auditors recognised by the Board of Trade. We use the Institute scale.*

1977. One of the privileges of an exempt private company in regard to audit is that the auditor may be a partner or employee of an officer or servant of the company. Would you see any objection to that privilege being withdrawn? —*No, my Lord; I think that privilege is open to objection.*

Mr. Mines: I agree it is highly undesirable.

1978. Then our next point is this. We have been told in the course of the evidence that we have been hearing that the small family business which is so often conducted by an exempt private company frequently faces complicated tax problems, and furthermore we understand that the minorities in such companies may be particularly vulnerable to oppression. Does not that suggest that these exempt private companies in the interests of their own members should have the benefit of thoroughly competent and

completely independent accountants and auditors? —*Mr. Hubbard*: I would not deny that, but on the other hand I do not think they rank equally with public companies where vast sums of public money are involved, particularly in this age of the greater diffusion of wealth and the greater holding of shares by larger numbers of people. But I would certainly not dissent from the view that the auditor should be a competent person and a person of integrity, which qualifications naturally we think members of our Association have.

1979. And he should be able to deal with the intricacies of taxation? —*Agreed.*

1980. And hold the scales fairly if he can between the warring members of a small private company? —*Agreed.*

1981. Then you say that the extension of the provisions of section 161(1) to exempt private companies without any modification in the qualifications which it requires would impose "even greater hardship on most of the smaller practitioners of accountancy by depriving them of a major source of their livelihood". —*Yes.*

1982. To develop that, do you mean most of the smaller practitioners of accountancy derive their main livelihood from auditing, and that such auditing is mainly the auditing of exempt private companies? —*I should say quite a large proportion of the practice of an International Accountant would be concerned with small private companies; I would not say the preponderance, but I would say a very substantial proportion.*

1983. Would most of them be the small private company of the exempt kind? —*Yes.*

1984. And would you say that with most of them the work your members do for exempt private companies is auditing the accounts, acting as auditor? —*Yes.*

1985. And you would apply that general statement, would you, to your own membership? —*Agreed.*

1986. Yes. Can you tell the Committee how many members you have practising in Great Britain? —*387 in the United Kingdom in public practice.*

1987. In England and Wales, Scotland and Northern Ireland?—Yes, 387, and 58 overseas—in all 445.

1988. Then I think I am right in saying it appears in your memorandum that you have 3,000 students who are at present preparing themselves for the qualifying examinations?—Yes, many of those take Governmental appointments, Civil Service appointments, and the like. They do not all go into practice.

1989. You provide the training, and they sometimes go off to other jobs?—Agreed. That tendency applies today in all associations. The young qualified man tends to go into industry and commerce because there is a greater lucrative attraction.

1990. How many of these students will be resident in Great Britain?—*Mr. Taylor*: 948 in the United Kingdom, 2,024 overseas, total 2,972; we have the break-down of the overseas element if you want them, Sir.

1991. What part of the world chiefly?—Nigeria, Ghana, Singapore, Hong Kong, East Africa, West Indies, India, Ceylon, Malaya, West Africa, Pakistan, Cyprus, Malta, South America, Borneo and miscellaneous—and that is a very small number, miscellaneous.

1992. People from all over the world. How many of these students are serving articles with members of your Association, do you have that?—A negligible percentage.

1993. What proportion of your members are practising full time as independent accountants, and what proportion are in salaried employment, could you give me that?—*Mr. Hubbard*: The figure of 387 reflects practitioners in the United Kingdom. They may be practising solely or in partnership with others. When I say "with others" I mean with members of other bodies. I myself am in practice and I have a chartered accountant and a certified accountant as partners.

1994. Then the final statistic. How many exempt private companies do your members audit, can you possibly say that?—We sent out a circular to our members. We have not had a one

hundred per cent. reply thereto, but the number of such companies audited is far in excess of 6,000.

1995. Your 387 members audit 6,000 companies?—6,000 plus because we have not had replies from all of them. Public companies 52—these are known from the replies we have received—non-exempt companies 198 and exempt 6,256. They are the replies to the questionnaire from 270 out of 387 practising members, so the figures are in fact in excess of those which I have given.

1996. Could you give me how many of your members are in salaried employment?—1,291 is the total membership, comprising Fellows 491 and Associates 800, and of those 387 are in public practice and the rest are in salaried appointments.

1997. The 387 is public practice?—I think I misled you there. 387 in the United Kingdom, 58 overseas, so we have 445 in public practice, and the balance of 1,291 would be in salaried occupation, or in the profession as audit clerks and jobs of similar nature.

1998. You made a suggestion for the modification of section 161(1). As I understand it you would like the formula in section 52(4) of the Income Tax Act, 1952 to be substituted for the present qualifications, limiting the formula to hodies incorporated before some date, such as 1st July, 1948.—We think that section 52(4) has operated very well in the view of the Board of Inland Revenue and other parties, and we do feel that an incorporated society of accountants should be of some standing. Our submission is that having been in existence for something like 28 years we would qualify within that category. We think a body should be a body of some reasonable standing, that is our submission. A body of one year's standing would hardly qualify, but we think a body like ours of 28 years' standing should qualify in that respect. As the Board of Inland Revenue has found this arrangement has worked very suitably over the years we think that it could form the basis for the Companies Act; more especially as the Companies Act becomes the foundation from which springs the term "recognition" and its unfortunate opposite "unrecognised".

1999. Now as to this section 52(4) it deals, does it not, with a very different subject matter from what we are concerned with today? What it is concerned with, as far as I understand it, is rights of audience before the General Commissioners.—Yes, but I should think a person who is competent to deal successfully with the Commissioners of Inland Revenue is, other things being equal, sufficiently competent to deal with the audit of an exempt private company, a non-exempt or a public company, and that is our submission. May I allow one of my colleagues to add a rider here, Sir?

Mr. Mines: We had in mind an alternative to this proposition which, although possibly not wholly satisfactory, would go a long way to meet the proposal that has been put forward from another quarter. We recognise that a very high standard of auditing and accountancy is required in the public interest in the case of public companies. That can only be put, I think, properly on the footing of public interest where you have a large number of small shareholders who have no control, no access to information, and might at the worst lose their life savings if there were fraud or mismanagement. Be that as it may one does not challenge that, but when one comes to extend that proposal to every company including private companies, it is my submission that we have a different situation. The factor of public interest—protection of the small shareholder—hardly arises, certainly not to the same degree, in the private company, which is very often a small family company with no outside interests, and where very often the shareholders are themselves directors. To apply a very stringent provision of the highest standard of auditing to that type of company seems to be asking for more than is necessary in the public interest. I would submit that if encroachment on the liberty of choice of auditors or encroachment on the livelihood of accountants is at stake, but nevertheless there is an overriding factor of public interest, so be it, those things must go to the wall. But if there is no overriding factor of public interest, the very stringent provision has no justification. We would therefore suggest that there should be considered setting up a two-tier basis of recognition

under this Act, and we suggest that it should be administered, as now, by the Board of Trade, after investigation and inquiry as may be necessary, and has been done in the past. The only rider we would put to that would be that there should be right of appeal from the decision of the Board of Trade. We think that this proposition would serve a very useful purpose, because admission of a second tier of bodies who would be competent to audit private companies' accounts would serve to extinguish two categories that everybody wishes to see eliminated. The first is the category of members of a so-called accountancy body who only require for membership the completion of an entry form and the payment of an entrance fee. Such bodies do exist, and they should be eliminated. Also the free lance, who is not a member of any body, and is not subject to any disciplinary or professional control—may merely do Sunday afternoon audits—would and should be eliminated under this provision. It would preserve the existing machinery. We do not ourselves admit that we should not qualify for recognition for audit of public companies, but I do not propose to inflict that argument on you. Let that stand, but let us get forward with some degree of registration and closure of the accountancy profession by having this two-tier system if it is considered necessary to preserve the existing standard as regards public companies.

2000. How would you fix the tiers exactly? Would it be on a basis of paid-up share capital?—No, Sir, it would be on the existing discretion of the Board of Trade. Application would be made for entry into the second tier as it was originally done for the first tier, and it would be at the Board of Trade's discretion.

2001. I was thinking of the analogy of the two kinds of master's certificates. One entitles you to navigate in home waters, and the other entitles you to go further overseas. The latter type of work would require a higher degree of qualification in seamanship.—Yes. Saying nothing further as to the affairs of my own Association, let it be admitted that there could be two standards of certification, one for public companies as it is, and one for

private companies—the second tier—also under the administration and discretion of the Board of Trade.

2002. What sort of qualification would you require for the second tier?—On that, my Lord, I would say that the qualifications for an accountant are ability, experience, integrity, and subjection to disciplinary control. All those four matters can be looked into by the Board of Trade just as they have done with the first tier. It would eliminate a great deal of the undesirable element, but it would not inflict hardship or encroachment on personal liberties to the extent which is not justified where the public interest is not so deeply concerned.

2003. The matter that was troubling me I confess was the importation of the income tax definition which would amount to this, as I understood it, that any accountant who could show that he was a member of an incorporated body of accountants could claim *ipso facto* recognition as a qualified accountant under section 161?—As far as I am concerned I do not support that suggestion.

2004. You would require membership of a body of that kind I suppose as a prerequisite, but the Board of Trade would still have to look at the constitution of the society and its records and see what sort of education its young men were provided with, and what measure of disciplinary control its members submitted themselves to?—Yes.

2005. As regards professional ethics and so forth?—Quite so.

2006. And the judge of suitability, given the pre-requisite of membership of a society, would rest with the Board of Trade?—Precisely. I would like to make this rider, my Lord, that it does seem to us invidious that a decision of that nature, which is of such vital importance, should rest entirely on the final word of a public department, and that there should be no right of appeal from it.

2007. Yes. Rights of appeal in cases of this sort are I think fairly fashionable in modern legislation, so it may be that the legislators might think fit to provide that. Then of course the composition of

the tribunal would require consideration unless it was an appeal to that outmoded institution the ordinary court of law.—May I submit one further point? If the proposal put forward to you from another quarter were to be implemented as it stands, it would have the effect of at least a partial automatic registration and closing of the accountancy profession, because it would rule out automatically so many possibilities of audit to certain people. I would observe that in 1930 the Board of Trade had a Departmental Committee to enquire into the registration and closing of the accountancy profession, and they reported adversely. Again in 1945/46 there was a considered and sustained attempt to achieve registration and closing of the accountancy profession, and it took the form of the Public Accountancy Bill which was discussed at great length, and finally dropped and withdrawn as impracticable and unworkable. I do suggest an attempt to achieve a partial closure and registration of the profession, as it were by the back door in clauses of a bill which is primarily dealing with company law would be undesirable, unless the whole of that quite separate and difficult and complicated subject were fully ventilated, but if the proposals which have been made to you from this other quarter were implemented it would have that effect.

Mr. Hubbard: It states in paragraph 204 of the memorandum submitted to this Committee by the Institute of Chartered Accountants in England and Wales that a person holding the audit now can continue to hold it, but although that seems reasonable at first blush none the less that would result in the stultifying of all advancement by the members of any unrecognised association, because we could not get in the business. At best we could retain what we hold now, and it would be stultifying in effect, and therefore an unnecessary encroachment upon the liberty of the subject.

Mr. Mines: On the question of competency may I add this? It is not our intention at all to approach this Committee from the point of view of the particular interests of our Association, but if one is talking at all about bodies other than those at present recognised by the Board of Trade for public company

audits, I would like to put it on record that our Association has been established for 28 years; it is a viable body; it is an examining body, it holds examinations in centres all over the world, some 70 to 80 centres. The standard of examination questions is admittedly high, and, what is more important, the examiners are independent and competent examiners, and the standard of pass is a high percentage. We are not interested in the percentage of people that pass. We have a corporate life, literature, a journal, and all the rest of it, and above all we have a disciplinary committee which can and does act with as much ruthlessness as that of, say, the Institute of Chartered Accountants or the Law Society itself. We have many members who have been in public practice, and in particular doing the audits of private companies for many years, with no trouble. We submit that at any rate as regards private companies—this is returning to my suggestion of the two-tier recognition—this is a body which would expect to qualify for the second tier. In saying that, my Lord, I must not be taken as admitting that our Association is inferior. I merely put this forward as a compromise suggestion on the specific proposal that has been made to you from another quarter.

2008. What sort of general education do you require a young man entering your society to have?—*Mr. Hubbard*: A preliminary examination similar to the G.C.E.

2009. Approximating to matriculation standard at the university, that kind of thing?—Yes, and then there is the intermediate and final examination, the same as in other bodies. We have got copies of our examination papers and we could leave them with you, my Lord.

2010. I just wanted a general idea. We need not go into the examination papers because, as Mr. Mines says, you are not really concerned specifically and particularly with your own body. You are putting out the general principle.—Quite.

Chairman: Those are all the questions I have in mind to ask you. I do not know if other members of the Committee would like to ask any questions?

2011. *Mr. Lawson*: Could I ask one or two questions? You referred to the fact that a number of your members are in partnership with chartered and certified accountants. How have you dealt with that situation in calculating the number of 6,000 plus of companies which are audited by your members?—Perhaps I might answer that, because I am the senior partner of a firm where I have chartered and certified partners. As far as all those companies go they are mine originally because I got the business. My partners fortunately help me to execute it.

2012. I see that. Have you got anywhere separately the numbers of audits done by your members who are in partnership on their own?—*Mr. Taylor*: We have had to take it on the basis of the returns that have been submitted, but I do not think it makes a tremendous amount of difference. There is not a very large number of members who are in partnership with chartered and certified accountants—not so large a number as would make these figures vastly different. We have not made any independent inquiry or breakdown of the numbers in the case of the partnership other than what the member himself has done. When asked by members about this practical difficulty, I have told them they must use their own discretion.

2013. I am not sure you understood my question. Even after these returns came in, you would know whether they were coming from one of your members who was in sole practice or in practice with another one of your members, so that you would be able to say, would you not, as to how many of these audits were covered by your members who were working on their own as apart from those working with chartered and certified accountants.—There is a practical difficulty there. In a few cases I have told members, who asked me, that as far as possible we were concerned with actual numbers of audits affecting our own members personally, and not as part of a larger partnership. But apart from those who have asked me we have to take the figures on the return forms they have made. There is no question where there is a large number involved in any one particular partnership.

2014. I see your difficulty. One question on examinations. What proportion approximately of your present members have entered by examination?—55 per cent. 55 per cent. by examination and 45 per cent. without.

2015. At the present time you do not admit anybody except by examination?—Excepting such cases for example as where they have Board of Trade authorisation, which, if we may say so, at the present time, gives them a rather higher status than we can offer them. Those people are in fact entitled by the Board of Trade to audit accounts of public companies, and we feel that they are the kind of people that ought to be in an organisation such as our own, and they are in fact already professionally recognised.

2016. One final question. If your body were recognised under your proposal, whether it be in a second tier or first tier, would that mean that all these 2,000-odd members in Ghana and Nigeria and Singapore and all over the world would be authorised if they came to this country to audit accounts in this country automatically?—*Mr. Mines*: Those are only students at the moment.

2017. I thought they were members?—*Mr. Hubbard*: We have a right to treat them as not fully qualified to practice here if they come to this country.

2018. You have 2,000 students overseas?—Yes.

2019. But those 2,000 students will in due course become members, will they not?—Not necessarily.

Mr. Taylor: They have to have qualifying experience. In addition to the examination they have to have five years' qualifying experience of an approved standard and on that basis we could prevent anybody coming here to practice accountancy. It is most unlikely they would come anyway. We find only a small percentage of students actually become members, but even if they did come over here to practise—and incidentally they take exactly the same papers as the English candidates take, English law, English mercantile law, and company law, English income tax law and practice—

from the point of view of academic examinations they are precisely qualified in the same manner as the students who take the examinations here. But the difficulty in many cases, such as Ghana, is the actual practical experience, particularly professional experience, and for that reason one of our Articles provide for the Council to require them to undertake a separate examination in subjects appertaining to English law if that were considered necessary. But, as I say, they actually take the same papers, and it would not come into operation unless the Council had a reason for this. I would not myself envisage very many would be coming from West Africa to practise here. The position is the reverse. They come here for experience and training and go back because they can get a far better living in their own country than they could here in competition with English people.

2020. In fact not all these 2,000 would become full members?—By no means all, Sir.

2021. And when they had become members they would mostly be resident abroad anyway?—They would go back abroad even if they had qualified here. Invariably they go back.

Mr. Barter: They would have obtained the same standard as the English membership.

2022. *Mr. Brown*: I would like to learn a little more about your organisation. With your present membership the majority of members are in the U.K. What is the real significance of the word "International" in your title?—*Mr. Hubbard*: We are not restricted to the U.K. and we have association with many members of the Commonwealth.

Mr. Mines: I think the number of students perhaps speaks to that question.

Mr. Hubbard: In fact we really supply a need and with the "wind of change" that is blowing I think that need is more imperative.

Mr. Taylor: We have 2,500 enquiries annually from people overseas regarding our examinations, and we have enrolled 9,000 students since the end of the war.

There is really a vast interest in accountancy from these up and coming countries, West Africa particularly.

Mr. Hubbard: As a matter of interest one of the recognised bodies has now resumed its activities in those fields where we operate.

2023. With the obvious advantage of the recognised institutes, why do these 3,000 students come to your body and not to the recognised institutes for training?

—*Mr. Mines:* I think, if I might stress that point, the Act refers to bodies recognised for the time being by the Board of Trade for the purposes of this provision. The wording "recognised" in that context is in general parlance taken out of that context, and you find the layman, that is to say anybody who is not in the profession, talking about recognised accountants. From that you come to the position of the opposite—"unrecognised" accountants. Literally it is correct. By implication it is a most unjust stigma. It is not a question of unrecognised in the sense of having no qualification, having no status. It is merely not recognised for the purpose of that section, and I know how far in countries abroad the meaning of the words "recognised", "unrecognised", "unqualified" carry weight. But if I may take this opportunity of referring again to the question of two-tier recognition, it would also serve to remove that totally misunderstood stigma of the word "unrecognised".

2024. But you have over 900 students in this country?—Yes.

2025. They at least would know about "recognised" and "unrecognised", and my question is all the more important—why do they join your Association?

Mr. Hubbard: It may well be that in the opinion of the leaders of the particular school or college from which the students come, the International Association has a sufficiently high standard.

2026. Would it be that it is more difficult to qualify in other bodies?—It is a matter of opinion I would say.

Mr. Taylor: It is more difficult.

2027. Do these 900 think it is more difficult?—It is more difficult in the case of the Institute of Chartered Accountants, because of the stipulation of service under articles. Why is there this multiplicity of accountancy bodies? If we may say so it is not our fault and we have high standards. Our aim is, if possible, some form of co-ordination to reduce the number of accountancy qualifications, and maintaining, and, wherever possible, raising standards.

Mr. Hubbard: It is a very good and salutary thing to have competition.

2028. It would be your opinion your qualification is at least as difficult to achieve as any of the recognised bodies?

—*Mr. Mines:* Subject only to the question of articles.

Mr. Taylor: The Institute of Chartered Accountants have no examination overseas, and for a time overseas candidates could only take our examination. The Certified Accountants, I see, are resuming examinations in a large number of centres half-yearly, but one of the reasons why the students have taken our examination has been because they cannot take that of the Institute of Chartered Accountants abroad.

2029. *Mr. Lawson:* The Chartered Accountants do not recognise service abroad either, do they?—No.

2030. *Professor Gower:* In connection with recognition for the second tier, as I understand it, you want the Board of Trade to recognise membership of particular bodies?—Yes.

2031. You want them to recognise bodies. Should they also retain the power to recognise individuals that they have at the moment under section 161?

—*Mr. Hubbard:* I think it should be retained, but I should say, to explain that point, that we feel as a professional body with a disciplinary committee, and so forth, we are really more competent to adjudge than any official of the Board of Trade, however good.

2032. But the official of the Board of Trade under your scheme has first of all to judge you?—No, he gives an authorisation now to a person qualified, maybe

an audit clerk in an office for so many years, but our standard is higher than that imposed for the purposes of section 161(1)(b).

2033. *Chairman*: There is just this I ought to tell you. We are asking a random sample of some 1,500 exempt private companies for the names and addresses of their auditors. I think you might like to know that. We are doing this with a view to getting the full picture of the existing position with regard to the qualifications of existing auditors of exempt private companies, and what effect from the point of view of qualified manpower any withdrawal of the section 161 exemp-

tion might mean. There is always that practical consideration.—True.

2034. So your membership should not be surprised or alarmed if they learn about this.—We should be delighted to help. I am quite certain of that.

2035. I think, gentlemen, that concludes all the questions we want to ask you. We are very much obliged to you for coming here to help us, and, if I may say so, I think you put your case very moderately and very clearly.—We would like to thank you, my Lord, and your colleagues for the opportunity of appearing before you. We appreciate it very much indeed.

(The witnesses withdrew.)

APPENDIX XVII

**Memorandum submitted jointly by the Accepting Houses Committee
and the Executive Committee of the Issuing Houses Association**

In the following Memorandum the Accepting Houses Committee and the Executive Committee of the Issuing Houses Association have combined to comment on the points raised in the Annex to the letter addressed to the Secretary of both bodies by the Secretary of the Company Law Committee on 15th January, 1960. Their comments are given under the various headings detailed in that Annex and represent a broad consensus of opinion on the questions although there is not necessarily unanimity in every case. Where the two bodies have no opinion to express, reference to the relative questions has been omitted.

Both bodies consider that in general the Companies Act, 1948, works well. They put forward the suggestions contained in the Memorandum to indicate how, in their opinion, the Act could be brought more into line with present-day requirements and practice.

There is attached to the Memorandum as an Annex, a report on Company Law which was submitted by the Issuing Houses Association to the Board of Trade in November, 1959. Both the reporting bodies adhere to all the suggestions put forward in that report, with the small exception that paragraph (a) of the recommendation under Section 195 on page 7 of the Annex has been slightly amended from the text previously submitted to the Board of Trade in order to bring it into line with the suggestion made on page 4 of the Memorandum under heading 3(a) regarding the separation of "quoted" and "un-quoted" companies.

1. Incorporation of Companies—Memoranda of Association*(a) Requirements as to minimum number of members, and other conditions of incorporation*

The present Act stipulates that the minimum number of members of a public company must be seven. It is entirely inappropriate that this requirement should continue to have to be satisfied in cases where a public company has become a wholly-owned subsidiary of another company, and, indeed, there seems to be no useful purpose served in ever stipulating a higher number than two members as a minimum. It is accordingly recommended that the stipulated minimum should be two members for all companies, both public and private.

(b) Limitation of objects to those stated in the Memorandum: obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects

The *ultra vires* rule has, in practice, failed to secure the winding up of companies on the grounds of lost substratum even in cases in which the principal object has been clearly defined in the Memorandum. Not only has this rule seldom been invoked in relation to the validity of debts incurred, but its applicability thereto, which in fact always seemed to be somewhat inequitable, has been greatly weakened by universal objects clauses. It is suggested, therefore, that provision be made that where debts are incurred that are beyond the scope of the objects contained in the Memorandum of the company they shall not be deemed to be invalid under the *ultra vires* rule. As an alternative, the usefulness may be queried of having any objects clause in the Memorandum of Association, particularly if the recommendations made under Item 5(a) regarding fundamental changes in the company's activities are acted upon.

The objects contained in the Memorandum can be altered by means of a Special Resolution, subject to application to the Court by dissentient members and this procedure appears to be effective. There is, however, no power to alter the capital clause apart from the circumstances provided for in Sections 61 and 66 and in a very limited way in Section 23. In the Memoranda of some companies there are borrowing restrictions and special provisions relating to the issue of new shares, both of which would normally appear in the Articles. It is recommended therefore that where a restriction appears in the Memorandum, it should be capable of being altered by Special Resolution of the class(es) of share involved. This could be done by amendment of Section 23(2) to permit a variation of the special rights of any class by a resolution passed at a meeting of that class.

(d) *Shares of no par value.* (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)

It is recommended that the recommendations of the Committee on Shares of No Par Value should be implemented.

3. Classification of Companies

(a) *Nature and merits of distinction between public and private companies, adequacy of restrictions imposed on the latter*

It is considered that the private company (the middle tier of the existing three tier system of public, private and exempt private companies) is falling into desuetude since there appears to be no need to have private companies which are not exempt private companies.

It is suggested therefore that there should be only two categories, namely, public companies and private companies. The latter category would comprise what are now exempt private companies, and would be subject to the same conditions as at present apply to exempt private companies. The former category would comprise what are now non-exempt private companies as well as public companies, and would be subject to the same conditions as at present apply to public companies, except for the recommendation submitted below.

Existing non-exempt private companies which as a result of the proposed change would become public companies, would be required to file a statement in lieu of Prospectus within a specified period from the commencement of the new Companies Act.

For the purposes of certain disclosures (see recommendations under 6(c) and 11), it would be necessary to split the public company group into two, viz. those whose securities or any of them are quoted on a recognised Stock Exchange, and those none of whose securities are so quoted. It is suggested that this division into "Quoted" and "Un-quoted" Companies should be made whether or not the existing "private company" is abolished.

It is recommended that the existing requirement that those companies which are incorporated as public companies must circulate a Statutory Report and hold a Statutory Meeting should be abolished as such Report and Meeting have ceased to serve any useful purpose.

(b) *Nature and merits of distinction between exempt and non-exempt private companies* (Sections 127, 129 of Companies Act, 1948)

Reference is made to the item on page 5 of the Annex headed "7th Schedule—Exempt Private Companies".

5. Exercise of Powers of Companies by Directors and degree of control retained by Shareholders

(a) *Fundamental changes in company's activities*

(b) *Disposal of undertaking and assets*

To control gradual or evolutionary changes in a company's business is impossible in view of the ineffectiveness of the *ultra vires* rule as applied to the objects laid down in the Memorandum of Association, and even if it were possible it would be undesirable.

With regard to changes of a more drastic nature, where new capital has been raised to finance such changes the subscription of the new capital by the shareholders will have implied their approval. It is, however, in respect of the re-investment of funds arising from the disposal or partial disposal of the undertaking or assets of a company that control by the shareholders should be strengthened.

It is suggested that, where the value of the assets to be sold in one or several associated transactions represents the whole or a substantial part, say, 75 per cent., of the value of the total net assets, the approval of the shareholders should have to be obtained. In requesting such approval the directors should be required to indicate whether the proceeds of sale were to be returned to the shareholders or, if not, how they were to be re-invested and this would no doubt be taken into account by shareholders when they decide whether to vote for or against the resolution. The difficulty of defining the value of the total net assets is recognised, but it is felt that in cases of doubt directors would in practice prefer to seek the approval of their shareholders.

(c) *Issue of shares*

In general, shareholders have a measure of control over the issue of equity shares by directors through the fact that the authorised capital of every company is laid down and can only be increased by the vote of the shareholders. It is now common practice for institutional investors to request Boards to undertake that authorised but unissued equity shares will not be issued in such a way as to alter the control of the company or the nature of its business, and the Boards of some companies have stated that the approval of shareholders would be sought in such circumstances.

Directors should have reasonable freedom to issue equity shares for a consideration other than cash, but where a substantial amount of equity shares is issued for cash, they should first be offered to the existing shareholders or alternatively, if this is not possible, a resolution should be passed by the shareholders permitting an issue outside the company. The circumstances in which a resolution would be necessary are rare but when they do occur the delay involved should not cause undue difficulty.

(d) *Borrowing money and charging property*

Unless the Articles of Association are specific on the matter, it is doubtful whether either the giving of guarantees or the taking of acceptance credits constitute borrowing for the purposes of the limitation of aggregate borrowings. We recommend therefore that paragraph 79 of the 1st Schedule to the Companies Act, Table A, Part I, be modernised to include within the limits the guaranteeing of any borrowings or issued share capital of third parties and also the taking of acceptance credits.

To comply with modern requirements, this model clause should also be amended—

- (i) by deleting the exception for temporary bank borrowings;
- (ii) by including the borrowings of subsidiaries within the overall limit;
- (iii) by relating the limit of borrowing to issued capital and group reserves and not merely to issued capital;

- (iv) by including as a borrowing the issue of a debenture (as defined in the Act) for a consideration other than cash.

Reference is also made to the recommendation under the heading "Borrowing Powers" contained in Page 5 of the Annex.

6. Directors' duties

- (a) *Should Directors' duties be stricter and more clearly defined, and if so, in what respects?*

In an Act of Parliament passed in 1844, the directors are described as "the persons having the direction, conduct, management or superintendence" of a company's affairs. The fact that over a century of experience has not modified that view is shown by section 455 of the Companies Act, 1948, which states that "director" includes any person occupying the position of director by whatever name called".

In our view this position should be maintained. Those who are in effective control of a company's affairs should be its Directors in law, whether they describe themselves as such or not. It should be made clear that the appointment of alternate directors must be registered with the Registrar of Companies.

- (c) *Directors' and officers' dealings in their own companies' shares*

We consider that the register of Directors' shareholdings (created by the 1948 Companies Act) is the best way of dealing with this point. We also consider that such registers should be kept up to date and open to inspection at all times (as against 14 days before the date of a company's annual general meeting, as now provided), and we refer to the recommendation on pages 6 and 7 in the Annex hereto under the heading "Section 195—Register of Directors' shareholdings, etc".

It might also be desirable to clarify the words "which are held by or in trust for him" which appear in section 195(1).

We consider that the register of shareholdings should be extended to include the holdings of Alternate Directors and Officers of the company within the meaning of the Act and also Directors and Alternate Directors of subsidiary companies.

It is also suggested that any option contract which may result in a future acquisition or sale of shares in a Company should be disclosed and recorded in the register.

- (e) *Should bodies corporate be allowed to be Directors?*

We consider that for a body corporate to be a Director of a company represents a contradiction in terms because a Director should be an individual who, as a matter of principle, always acts according to his own judgment and conscience in the best interests of the shareholders of the company on the Board of which he serves and no one should arrive at a Board Meeting bound by instructions from another party as to how to vote. Furthermore, it is important for it to be readily apparent to the shareholders and to the public that this principle has been preserved, and this can only be the case when they can see in the list of directors the names of the individual persons responsible for controlling the company.

It is therefore recommended that bodies corporate should not be allowed to be directors.

7. Shares with restricted or no voting rights

The existence of what are popularly described as "non-voting" shares (a term which is taken, for the purpose of this Memorandum, to include shares with restricted rights) has usually been the result of the growth of a private family business and its conversion into a public company.

Since the last war, the high rates of taxation prevailing have made it difficult for private companies to find additional capital out of retained profits or the resources of family shareholders, and it has therefore often become necessary to create public companies and to give the general public an opportunity to hold part of the equity capital by acquiring shares from existing family shareholders. This enables the company to raise further capital, either by the public issue of loan capital or preference shares or by "rights" issues of ordinary shares. The latter process, insofar as the family shareholders cannot find the cash to take up their rights, leads to a progressive reduction in the proportion of the equity held by the original shareholders, and (if all the shares vote equally) to an eventual surrender of control.

This situation has led in some cases to the creation of separate classes of ordinary shares which, though otherwise identical, do not vote equally, and this enables family shareholders to retain effective voting control of a company which substantially increases its equity capital, while the public who subscribe for the new shares get no increasing voice in the control of the company.

The pros and cons of this situation may be summarized as follows:—

Those in favour of non-voting shares say in effect:

- (a) A family business which has grown so rapidly that it requires outside capital will have been well run by its previous owners and it is usually in everyone's interest that they should continue to run and control it.
- (b) When voting control remains in the hands of the directors no take-over bid can succeed without their agreement and co-operation. The Board, thus protected, is better placed to plan the future long-term development of the business.
- (c) Any investor subscribing for or buying non-voting shares does so with his eyes open. Non-voting shares are usually quoted at a lower price than the corresponding voting share and many investors are quite content to buy a share in the equity at a lower price, forgoing the vote.

Against these arguments the opponent of non-voting shares would say:

- (1) If a family business takes in outside equity shareholders it is only right that they should be given a voice in its control proportionate to their stake in the equity.
- (2) Control in a few hands may result in preventing some other company from making a bid for control which might in fact be very attractive to the shareholders as a whole, and it also tends to protect Boards which have become complacent and inefficient.
- (3) Those shareholders who are entitled to vote would be in the position of being able to conclude a deal covering the voting shares only, thus selling control of the company without any assurance that the shareholders who have no vote will be given equitable treatment.
- (4) There can be no effective protest should a Board adopt a dividend policy more in the personal interest of the few in control than in that of the general body of shareholders.

There is clearly a good deal to be said for both sides in this problem. The general feeling of our members is against legislation prohibiting non-voting shares and we prefer to rely on the force of City opinion and expert financial advice to ensure that they are only created or retained in suitable cases where the admitted privileges which the system gives to a small controlling body will not be abused.

8. The protection of minorities

The statutory protection of minorities rests at present mainly on section 210 of the Companies Act, which provides that a shareholder has a remedy if he can satisfy

a Court that he or other shareholders are being "oppressed" by the way a company is being conducted; or on section 225, which provides that the Court can wind up a company if it seems "just and equitable" to do so.

Until quite recently no application for relief under section 210 had ever succeeded and the principal stumbling block appears to have been that relief could only be obtained under this section if the Court could be satisfied that "the facts would justify the making of a winding-up order".

Cases from time to time arise, particularly in private companies where there are restrictions on transfer of shares, where a minority of shareholders is unfairly treated either by the withholding of dividends or by a disproportionate payment of Directors' remuneration as against amounts distributed by way of dividends.

In this connection we have read the report of the Northern Ireland Departmental Committee (Command Paper No. 393) which deals in paragraph 12 with the provisions of the Northern Ireland Companies Act corresponding to section 210 of the 1948 Act and we support their suggestion that relief under section 210 could in future be granted by the Court without the applicant being called upon to justify a winding-up.

A statutory provision for board representation of minorities would probably present worse problems than the difficulty it was intended to solve.

In connection with this point, we refer also to the recommendations on pages 7 and 8 of the Annex under the head "Section 209—Power to acquire dissenters' Shares".

9. Protection of Special Classes of Shares

We consider that there is no point in attempting to legislate for the additional protection of special classes of shares. In our view adequate protection is now achieved by the combined efforts of Issuing Houses, the Stock Exchange and the investment protection associations of institutional investors. Legislation would necessarily be elaborate and difficult to draft.

Some aspects of this matter are affected by the operation of section 209 of the Companies Act which is referred to below under Item 16(g).

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies)*

The administrative advantages of the nominee system are so great that any attempt to do away with it would seriously affect the efficient working of the City's day to day business. On the other hand, it is realised that the public has a right to expect that it should be possible to find out if a substantial stake in a company is held in any one hand. To stipulate that nominees should be forced to disclose the names of their customers would be wrong in principle, as it would infringe the tradition of bankers' secrecy which it is vital for London as a financial centre of world importance to maintain. It would also be ineffective in practice, as nominees do not necessarily know whether their customers are the beneficial owners or are themselves nominees for others. It is submitted therefore that any person whether an individual or a corporate body who has acquired (or can by the exercise of any option or other right acquire) the beneficial ownership of more than 15 per cent. of the voting rights of a company should be under a statutory obligation to disclose the size of his holding to the company in question. Such information would then be entered in a Register which would be available for inspection on the same lines as those proposed for the Register of Directors' Shareholdings. There should be the usual safeguards to ensure that the holdings of associated companies or related persons are taken into account in calculating the 15 per cent.

(b) *Control through nominee directors*

In our view the term "nominee director" is a contradiction in terms but it is considered that the proposal submitted in 11(a) above should help to ensure sufficient disclosure as to control.

12. Share Transfer and Registration Procedure

We strongly support the simplification of share transfer and registration procedure, but, as we are represented on a Committee set up by the Stock Exchange which is at present considering this matter in its entirety, we have no comment to make at the present time.

13. Multiplicity of Directorships held by One Individual

A company can derive considerable advantage from the appointment to its Board of an individual who holds a number of other directorships and it is suggested that it would be a mistake to limit any company's power to make such appointments.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

The practice of carrying on business through associated and subsidiary companies is of great convenience to the business community and we are broadly satisfied with the existing law.

In order however that shareholders may have further knowledge of the activities of a company, it is suggested that there should be attached to the annual accounts a list of all its subsidiaries, showing separately any whose results have not been consolidated. (See also our recommendation on page 23 regarding the disclosure of details of investments in associated companies).

15. Loan Capital

(c) *Registration of charges*

Under section 100 the registrar of companies may, on proper evidence, enter a memorandum of satisfaction on the register of charges. It should, however, be made obligatory for a company to file such evidence with the registrar within 21 days of the termination of the charge.

16. Take-over bids

(a) *Procedure*

(b) *Securing disclosure of information on which shareholders can form an opinion*

(c) *Functions of Directors*

(d) *Disclosure of identity of bidder*

1. In considering the question of legislation concerning take-over bids we have been in the position that almost simultaneously the Issuing Houses Association has been asked to comment on draft regulations being prepared by the Board of Trade concerning "licensed dealers" and that these draft regulations have been extended to cover take-over bids made by such licensed dealers. These regulations do not affect the conduct of take-over bids by "exempted dealers" but it is obviously sensible that at any rate the broad principles underlying the regulations should be such that they can be adhered to by exempted dealers.

2. The present position is that any offer, whether for cash or by share exchange, can be made in one of the following ways:—

- (a) By an exempted dealer on behalf of a principal, in which case the contents of the document conveying the offer are at present dictated only by City practice. Exempted dealers include all Stock Exchange firms which, as the result of a recent change in Stock Exchange regulations, can now make take-over offers, provided they have the consent of the Council of the Stock Exchange. We understand that, in giving this consent, the Council is likely to insist that the offers contain the information laid down in the Board of Trade regulations for licensed dealers which are referred to in paragraph 1 above.

- (b) By a licensed dealer on behalf of a principal. Such offers will, of course, have to conform to the Board of Trade regulations mentioned above.
- (c) By any firm or company, (i) provided it submits the document for approval to the Board of Trade, in which case it will now presumably have to conform to the abovementioned regulations, or (ii) without such approval when making an offer for shares of any of its own subsidiaries.

3. It seems to us that, broadly speaking, the present arrangement should be maintained. We consider that the freedom at present given to exempted dealers to draw up and make offers in terms which have become more or less accepted City practice should be preserved and that any company should have the right to make an offer on its own behalf, provided it previously obtains Board of Trade consent to the issue of the document.

4. At present the law seems to require that the Board of an offeree company, if it writes to its shareholders recommending acceptance of an offer, has to obtain Board of Trade approval to its circular letter. It is suggested that the position here should be clarified, the principle being maintained that any such circular letter, if recommending acceptance of any offer, whether the consideration is cash or shares, must contain sufficient information on the offeree company to enable the shareholders to make up their minds concerning the offer. The scope of the information required has already been indicated in the Third Schedule of the draft Board of Trade regulations, which seems broadly to cover the position.

5. We suggest that licensed and exempted dealers, when making an offer on behalf of a principal, should accept statutory responsibility (on the lines of the responsibility of an issuing house for the accuracy of an Offer for Sale) for seeing that the offer contains accurate and sufficient information about the offeror company to enable the recipient to make up his mind.

(e) The financing of such transactions

We consider it is neither right nor practicable to attempt to introduce any measure of control over take-over bids by controlling the provision of finance for such operations.

(g) Application of provisions regarding compulsory acquisition of shares of dissenting minority (Section 209 of Companies Act, 1948)

Section 209 of the Companies Act has many unsatisfactory features, and we have, as will be seen on pages 7 and 8 of the Annex, already submitted certain observations on it.

17. Prospectuses—Statements in Lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

- (a) Adequacy of protection afforded to investors by existing law*
- (b) Usefulness and necessity of the existing provisions*
- (c) Certificates of exemption (Section 39 of Companies Act, 1948)*

A distinction is drawn in the 1948 Act between offers of securities to the public generally and more limited offers "not calculated to result . . . in the shares . . . becoming available for subscription . . . by persons other than those receiving the offer". The Act and the Fourth Schedule specify a number of points which must be covered by a public prospectus but in general the responsibility is laid on the directors of the company and others concerned not to issue a document which is misleading either in what it states or in what it omits and there are heavy penalties for those responsible for untrue or reckless statements. It is inherent in this system that there is no referee who will relieve those concerned from responsibility by pronouncing

on the documents in advance of their publication, although of course proof documents will almost invariably have been discussed with the Stock Exchange authorities, whose requirements will include a number of points not covered by the statutes.

Some of our members have had experience in recent years of issues of securities of large international companies made simultaneously in the U.K., Europe and in the U.S.A. In some of these cases it has been necessary to file a U.S. prospectus with the Securities and Exchange Commission, and this experience has enabled interesting comparisons to be drawn. The U.S. procedure makes available to investors a vast amount of financial and statistical information, much of which is not normally published by U.K. companies, but although this may be valuable to the security analyst, we doubt whether it assists the ordinary investor in assessing the merits of the issue. On the other hand the U.S. document excludes any expression of opinion, which deprives the investor of the forecasts of profits and expected dividends which are probably the most vital parts of the normal British document.

We do not think that the U.S. procedure would be appropriate in this country, and in general we are satisfied with the working of the 1948 Act as regards prospectuses. In our experience the directors and their advisers responsible for the issue of prospectuses in this country exercise the greatest care and sense of responsibility and we do not think that any procedure such as that in force in the U.S., extending the range of detailed information required by statute would afford any greater protection to the investing public, for whose interests the real safeguard is the honesty, integrity and good judgment of those sponsoring the issue.

The provisions of the Act are, in the main, concerned with prospectuses issued generally to the public, but it has to be noted that in recent years only a relatively small proportion of money raised by companies has been obtained as a result of offers to the general public, the greater proportion having been obtained by offers to existing holders of the company's securities. In addition to issues of equity capital as "rights" to existing shareholders it is also nowadays common to find large issues of prior charge capital being offered by means of a circular letter to existing holders of the company's securities. By virtue of section 38(5)(a) of the Act, the documents do not have to comply with the detailed provisions of the Act regarding public prospectuses and the consequent saving of expense, particularly the heavy cost of advertising, is, no doubt, the principal reason why this procedure is being increasingly adopted in cases where the existing holders of the company's securities represent a broad cross-section of the investing public. Although the degree of disclosure of information in such offers by circular varies considerably, the circumstances of each case vary considerably also and, in our view, further rules having general application would largely affect the outward and detailed presentation without necessarily adding to the safeguards for the investor. We do not therefore support any change in the law affecting issues by circular letter to existing holders of the company's securities.

Another question raised in recent years is whether the statutory rules affecting public prospectuses should be extended to cover cases where securities are offered not for subscription in cash but for other consideration, i.e. usually in exchange for securities in another company. The law appears to be governed at present by the *Union Castle* case (reference 1956 1 All E.R. 490) which supported the view that the words in the definition of prospectus (section 455(1)) "offering to the public for subscription or purchase" meant an offer for cash and did not cover an offer by way of exchange for other shares. For reasons similar to those set out above in relation to offers of new securities by way of a circular letter to members of an existing company, we should not support an extension of the definition of a prospectus to cover documents in relation to take-over bids or amalgamations by way of an exchange of shares. As will be seen from the recommendations under Item 16 (Take-over Bids) we think that these matters can be dealt with within the framework of the Board of Trade Rules.

The Appendix contains recommendations on the following points:—

- (a) The question of whether the protection afforded by section 50(5) against the revocation of applications starts to run before the time stated for the opening of the subscription lists.
- (b) The desirability of extending the protection of section 50(5) to issues being made under a certificate of exemption pursuant to section 39.

A matter of detail which causes some difficulty in connection with the issue of a prospectus lies in the reference in paragraph 9(2) and again in paragraph 14 of Part I of the Fourth Schedule to contracts not in the ordinary course of a company's business. There are differing opinions as to the meaning of this expression. To take an example of a steel company engaged in a large expansion scheme to build a new works—there may be several hundred contracts with a variety of suppliers of capital equipment ranging from a few hundred pounds to many millions. From some points of view, the erection of new works could be said to be in the ordinary course of a steel company's business but equally it can be argued that contracts for the supply of large amounts of capital equipment are outside the ordinary course of its day to day trading activities. The point is of some practical importance and a more precise definition would assist issuing houses; it is clearly impracticable to list a large number of contracts in a prospectus and in the experience of our members this point has frequently necessitated applying for a certificate of exemption pursuant to section 39.

In this connection we would point out that the grant of a certificate of exemption on a limited technical point such as this takes a prospectus right out of the requirements of the Act. The Stock Exchange has no power to grant a limited certificate of exemption applying only to a particular part of the requirements, and we would, accordingly, support an amendment in the law to give such power.

20. Reduction of Capital and Purchase by a Company of its own Shares

The fact that a company is not permitted to purchase its own shares is a fundamental basis of existing company law and we should oppose any change in this connection.

There has recently been a tendency for the Courts to withhold approval of reductions of capital in which there may be some element of tax avoidance. In our opinion this is wrong in principle since the sole object of company law in this matter should be the protection of creditors and the tax avoidance aspect should be dealt with in the Income Tax Act. It is suggested that the law should provide that in giving or withholding consent, the Court should be guided solely by the need to protect the interests of creditors and/or dissentient shareholders.

21. Accounts

General

The over-riding principle of the Act as regards accounts is contained in section 149(1) which states that both the balance sheet and profit and loss account should give a "true and fair view" of the company's financial position.

(a) Revaluation of fixed assets and use of any resulting surplus

In connection with the danger of understating a company's true financial position consideration has been given to the provisions of paragraph 5(1) of Part I of the Eighth Schedule which permits fixed assets to be stated at historic cost which, particularly in the case of freehold property, may be much less than current values. We should, however, not favour the introduction of a statutory requirement for periodic revaluations, as the true value of assets in a continuing business is broadly measured by the profits earned from their use and it is only in a limited number of cases that assets can be re-deployed to better advantage.

(b) Share premium account

Section 56, which requires the premium on the issue of shares, whether for cash or otherwise, to be taken to a share premium account, the use of which is restricted to certain specified purposes, does not state how the premium is to be calculated. No special difficulties arise in respect of cash issues but difficulties can arise in calculating the premium in other cases. In particular we do not feel that attention should be paid exclusively to market prices at the time of issue which may be temporarily and artificially inflated. We favour the addition of words to the section to make it clear that the calculation of the premium in such cases is to be at the Directors' discretion.

(c) Use of pre-acquisition profits of subsidiaries

Paragraph 15(5) of Part II of the Eighth Schedule deals with the calculation of pre-acquisition profits of subsidiaries in the case of shares only held for part of an accounting period. We accept the need to provide against the manipulation of distributable profits by the inclusion of revenue profits of a subsidiary which in reality form part of the purchase price. However, final dividends are paid many months after the end of a financial year and it is a practical requirement that shares issued in connection with a merger or take-over should as soon as possible rank for dividend *pari passu* with existing issues. We think therefore that consideration should be given to adding words to the paragraph to make it clear that shares can be acquired with effect from, but not from earlier than the beginning of the current accounting period of whichever of the companies ends its financial year on the later date.

(f) Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948

It is obviously of the utmost importance to maintain public confidence in the stability of the banking system. It must be remembered that from time to time banks have to bear the brunt of exceptional stresses or shocks which are not of their own making but are produced by events over which they themselves have no control. If there were no provision allowing the impact of such stresses or shocks to be concealed by being absorbed in inner reserves, built up in good years, there is, in our opinion, a danger that at such times depositors, and in particular foreign depositors using British banking services, might become sufficiently alarmed to cause harm to the economic position of the country. The fact that such alarm would not be justified would not necessarily prevent it from occurring and in an international centre such as London its effects could be more serious than in a centre of merely local scope. The arguments put forward by the Cohen Committee on this point in 1945 seem to us to be as cogent now as they were then; we strongly hold the view that any company carrying on a banking business must be allowed to have hidden reserves, and we would accordingly deprecate any proposal to curtail the special provisions in paragraph 23(1) of Part III of the Eighth Schedule relating to banking companies.

Private Companies taking deposits

Attention has been drawn recently to the fact that although a private company cannot invite the public to take shares in its capital it is nevertheless free to induce the public to invest large sums by way of "deposits" without the safeguard of being required to publish accounts. A Private Members Bill was recently introduced to deal with this point. The private banks (some of which do not publish their accounts) do, on occasion, advertise in a general way their readiness to do banking business and to accept deposits, although they do not solicit deposits by canvass or circular letter. While we should welcome any legitimate safeguards to prevent the abuse of private company status, we would hope that the drafting of any amending legislation would not affect general advertisements of the kind referred to.

Trade Investments and Investments in Associated Companies

We consider that the provisions for Group Accounts in the 1948 Act represented a considerable step forward in the presentation of accounting information to members of companies. Whereas in earlier Acts the emphasis was probably on the dangers of over-optimistic accounts, the principal danger today is apt to be that accounts

understate the true financial position of a company with the result that investors may sell their shares too cheaply. Where an investment in another company does not amount to more than 50 per cent. of its equity capital it may appear in the balance sheet at far less than its true worth and the profit and loss account will only reflect dividends actually received, which may be only a small part of the profits attributable to the holding of the reporting company.

We consider that where an investment in another company which is not a subsidiary represents say 25 per cent. or more of the equity capital of that company, there should be a requirement to disclose details of the investment to include (if necessary, by way of note) the proportion of assets (at book value) and profits attributable to the holding of the reporting company as shown by the latest published accounts of the company concerned. We should prefer this solution to any suggestion of extending the principle of group accounts to 50-50 companies, a solution which is open to the objection that the same assets and profits would be liable to be included in the accounts of two unconnected holding companies.

Paragraph 8(1) of the Eighth Schedule of the 1948 Act distinguishes between trade investments and other quoted and unquoted investments and the Schedule requires the market value of such other quoted investments to be stated in the Balance Sheet, although no value has to be stated in respect of trade investments even if they are quoted. There have been cases where unconsolidated trade investments have been shown in the Balance Sheet with no information as to nature or value, and in due course the proceeds of sale have turned out to be a large proportion of the total assets of the company. It is suggested that where the value of trade investments is material, the accounts should show by way of note the approximate value, based where the shares are unquoted on the underlying Balance Sheet values.

23. Provisions as to Returns

Reference is made to the comments on sections 52(1)(a) and 124 *et seq.* of the Companies Act, 1948, made on pages 1 and 2 of the Annex.

24. Company and Business Names

The powers available to the Board of Trade under section 17 of the Act appear to be adequate so far as new companies are concerned, but we feel that these powers might be exercised more stringently to prevent the unjustifiable use of such words as "bank" in the title of a company, and that the Board might have power to order a change of name, where a fundamental change in the character of a company's business has made its existing name misleading to the public.

25. Foreign Companies

There is an ambiguity in section 423(2) which exempts from prospectus requirements an offer of shares in foreign companies to any person "whose ordinary business it is to buy or sell shares or debentures, whether as principal or agent". It is not clear whether the word "agent" is merely descriptive of the person to whom an exempted offer may be made or whether it implies that a person acting in his capacity as agent may accept such an offer on behalf of his principals. We suggest that this be clarified.

26. Internal Management and Administration

These matters are dealt with in Part IV of the Act.

(a) Annual and other General Meetings

Reference is made to page 3 of the Annex under the heading "Section 131—Annual General Meeting" in which attention was drawn to the desirability of giving the Board of Trade additional powers to modify the effect of section 131 as to the period within which a company must hold its Annual General Meeting.

(b) Mode of passing extraordinary and special resolutions

In our view there is no point in retaining Extraordinary Resolutions (Section 141) and we consider that all matters at present required to be passed by Extraordinary

Resolution should be dealt with in future by Special Resolution. (See page 3 of the Annex).

(c) Securing proper disclosure of information in circulars seeking proxy votes

We are not in favour of statutory requirements as to the information to be contained in circulars seeking proxy votes, since the circumstances will vary so widely as to make any general regulations of only limited value. In the case of a quoted company this matter is largely controlled by the Stock Exchange to whom the documents will have to be submitted.

(d) Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g. by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company

We are aware of the difficulty represented by interlocking shareholdings in companies which can produce a self-perpetuating management and may well frustrate the legitimate interests of the remaining shareholders. We should support any measures which can be evolved to deal with this problem provided that they do not adversely affect the interests of companies holding shares in other companies as legitimate trade investments.

In view of the control that can be indirectly exercised by a Board the trustees of pension or welfare funds for employees should be debarred from exercising more than, say, 10 per cent. of the voting rights at General Meetings of the employer or any associated company.

The following are two further detailed points on which the Act, in our view, could be improved:—

- (i) *Section 132(3)* provides that requisitionists can themselves call a meeting if the Directors do not do so within twenty-one days from the date of the deposit of the requisition. It is possible, however, for the Directors to frustrate the requisition by themselves calling a meeting for a date some considerable time after the date of the notice, thus effectively preventing the requisitionists from airing their grievances at an early date. We suggest therefore that there should be a further provision that a meeting summoned by the Directors following upon a requisition must be held within thirty days of the date of the notice.
- (ii) *Section 136(1)(b)*. There is no limit on the number of proxies who can be appointed by a shareholder to attend a meeting of a public company. While we are not aware of any abuse of this section, it would be possible for a shareholder to frustrate a meeting by appointing a very large number of proxies. In view of the fact that there is a limit of one proxy in the case of a private company it seems to us reasonable to have some limit in the case of a public company.

Reference is also made to the Annex where recommendations are made on pages 2, 3 and 4 on various points coming under this head.

29. Any Other Matters within the Terms of Reference

As we have indicated in the Preamble to this Memorandum, we adhere to all the recommendations contained in the attached Annex.

The recommendations to which specific reference has not been made in the Memorandum relate to the following sections of the Companies Act, 1948:—

(a) Points of a Technical Nature

Section 86(7) .. Register of Debenture holders and rights of inspection (coupled with Section 125).

- Section 115 .. Closing of the Register of Members.
Section 193 .. Duty of Directors to disclose payment for loss of office
to be made in connection with transfer of shares in
company.
Section 200(2)(a) Register of Directors and Secretaries.
Section 200(4) Register of Directors and Secretaries.
Section 201 .. Publication of Directors' names in circulars, etc.

(b) *Points of Principle*

- | | | |
|------------------|---|--|
| Section 53 .. | } | Prohibition of financial assistance for purchase of own and holding company shares. |
| Section 54 .. | | |
| Section 58(a) .. | } | Redeemable Preference Shares. |
| Section 58(b) .. | | |
| Section 58(b) .. | { | Voting Rights. |
| | | Costs authorised by the Act. |
| | | Forms Order 6(2)(a) .. Notice given to dissenting or non-assenting shareholders under Section 209. |

EDWARD J. REID.

Chairman, Accepting Houses Committee.

H. J. S. FRENCH.

Chairman, Issuing Houses Association.

ERNEST G. KLEINWORT.

C. L. BAILL.

K. C. BARRINGTON

I. G. HALL

J. W. HATCH

7th July, 1960.

ANNEX

Report submitted by the Issuing Houses Association
to the Board of Trade in November, 1959

(This contains sundry recommendations put forward by a Sub-Committee appointed by the Issuing Houses Association)

The Companies Act 1948.

Suggested alterations which are recommended by the Sub-Committee

1. Points of a Technical Nature

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
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¹ *Memorandum of Association—
minimum number of members*

The Act at present stipulates that the minimum number of members for a private company should be two, and for a public company seven, a differentiation which is not considered to be essential.

That the section be amended to provide for a minimum of two members for each type of company, and, as a logical conclusion, to require two persons only to subscribe the memorandum of association.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
50 (5)	<i>Revoking of applications</i> This sub-section lays down that an application for shares shall not be revocable until after the expiration of the third day after the time of opening of the subscription lists. There is some doubt as to whether or not an application may be withdrawn before the subscription lists open, since there is a period of three days between the issue (i.e. advertising in most cases) of the prospectus and the opening of the lists.	That the language of the section should be made clear to show that, once an application has been lodged, irrespective of time, it remains irrevocable until the expiration of the third day after the lists are opened.
(7)	By virtue of this sub-section, the obtaining of a certificate of exemption under Section 39 means that the protection afforded by sub-section (5) is removed.	That there seems to be no logical reason why obtaining a certificate of exemption should have this effect, and the sub-section should be removed.
52(1)(a)	<i>Return as to allotments</i> The necessity to include a "description" for each allottee named in the Return of Allotments appears to be an error in drafting, since a description is not required to be inserted in the Register of Members. Where a company issues renounceable documents of title, the provisions of the section raise a problem as to the names which must be entered in the Return of Allotments. The period for renunciation almost always exceeds the time permitted for filing the return: consequently if the list is to comprise the persons into whose hands the shares ultimately fall, the return cannot be filed in the required time: conversely if it is filed as called for by the statute, it will be out-of-date, and valueless as soon as it reaches the Registrar.	That the phrase "and descriptions" should be deleted. That in order to remove this anomaly, the section should be more closely linked with the entry of the names in the Register, and the Return made up as at the last date for renunciation, with an appropriate period of time allowed thereafter for lodging.
96/7	<i>Register of Debenture holders and rights of Inspection (coupled with Sec. 125)</i> (a) These sections refer to the mode of keeping a Register of Debenture Holders without however requiring a company to put such a register in being.	(a) That, as the matter would appear to be an oversight, steps should be taken to remedy it.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
86/7	<i>Register of Debenture holders and rights of Inspection (coupled with Sec. 125)—contd.</i> (b) Although Section 113 imposes a time limit for the provision of a copy of the register of members, there is no such limit in Section 87 in regard to provision of a copy of the register of debenture holders.	(b) That in Section 87(2) there should be added a paragraph similar to the second paragraph under Section 113(2).
115	<i>Closing of the Register of Members</i> This section restricts the closing of "the register of members for any time or times not exceeding in the whole 30 days in each year". It was felt that this section should specifically state that the register in respect of each class of shares may be closed separately.	That the section be amended by the inclusion of such words as "or register of any class of members".
124 et seq.	<i>Annual Return Summary</i> (a) The practice, under the provisions of the Act, of giving details of Shares transferred since the last return is thought to serve no useful purpose. A simple straightforward list of Shareholders, together with the number of shares held by each at the date of the return would be more satisfactory both from the point of view of company administration and inspection of the file. (b) The section requires, in appropriate circumstances, the recording of amounts of Stock held by each member, and it should be pointed out in this connection that no special provision has been made for these companies whose stock is divided into units, in that the return should contain the amount of stock held by each member and not the number of Stock Units. The Registrar of Companies will accept an Annual Return showing Stock Units only. (c) Under the Act, an Annual Return is required to be made up to a date fourteen days after the Annual General Meeting although the reason for this is not apparent.	(a) That the giving of details of transfers is unnecessary since the Register of Members is open to inspection. (b) That statutory recognition should be given to the practice adopted by the Registrar of Companies by the possible addition of the words "or stock units" where appropriate. (c) That the Annual Return should be made as of the date of record of an ordinary dividend recommended at the Annual General Meeting, or, if no ordinary dividend be recommended, the date of the Annual General Meeting.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
131	<p><i>Annual General Meeting</i></p> <p>If a Company for good reason wishes to extend its financial year to a period of, say, fifteen or eighteen months, and thereby does not hold an A.G.M. in a calendar year, or there is a lapse of more than fifteen months since its A.G.M., it is contravening the Section and any member can apply to the Board of Trade to direct that a meeting be held.</p>	<p>That the Board of Trade should have power (in the same way that it has power under Section 148(1)) to modify the effect of Section 131 as regards dates of meetings.</p>
141	<p><i>Extraordinary and Special Resolutions</i></p> <p>This section differentiates between these two types of Resolution only in the length of notice required to be given, each requiring a three-fourths majority. Since the occasions on which an Extraordinary Resolution of a Company is required are relatively few, it is for consideration whether this type of Company Resolution should be dispensed with and the Special Resolution substituted where appropriate.</p>	<p>That, in view of their limited application, there is no point in retaining Extraordinary Resolutions, and the Act should be amended accordingly.</p>
193	<p><i>Duty of Directors to disclose payment for loss of office to be made in connection with transfer of shares in company</i></p> <p>Sub-section (3) provides that if (a) particulars of the proposed payment are not disclosed in the circular to shareholders or (b) the making of the proposed payment is not approved by the shareholders concerned before their shares are transferred to the purchasers, then any sum received by the director shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer. One view is held that the wording of the Act requires that (a) or (b) of Sub-section (3) must be complied with, but many lawyers consider that both (a) and (b) must be complied with.</p>	<p>The sub-committee were generally of the opinion that non-compliance with either (a) or (b) would have the result envisaged by the sub-section, but if there is any legal doubt whether this is the intention of the Act, steps should be taken to clarify the wording.</p>

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
200 Sub-section (2)(a)	<p><i>Register of Directors and Secretaries</i></p> <p>This sub-section requires the Register to contain particulars of "any other directorship", the Sixth Schedule (Contents and Form of Annual Return) Part I (6) requires inclusion in the return of such particulars as are required to be entered in the Register of Directors, while the note to Part II (6) of the Return limits the entries of other directorships to those held in companies "incorporated in Great Britain".</p>	<p>That the discrepancy should be rectified by the inclusion in appropriate part of the sub-section, and in the Sixth Schedule, of the words "incorporated in Great Britain".</p>
Sub-section (4)	<p>This sub-section requires a company to notify to the Registrar any changes in the particulars relating to an existing director when they occur.</p>	<p>That this is unnecessary, and that such changes should only require to be notified annually.</p>
201	<p><i>Publication of Directors' names in circulars, etc.</i></p> <p>Sub-section (1) requires Directors' names to be published in all trade catalogues, trade circulars, business letters, etc. Varying views are held whether this covers circulars to shareholders, and it is suggested by a member of the Association that disclosure in such documents should be made obligatory, with no exemption for companies incorporated before 23rd November, 1916.</p>	<p>That the section should make it clear that circulars to shareholders should not be covered by the section. No difference should be made in respect of pre-1916 Companies.</p>
1st Schedule Table A.	<p><i>Directors' Borrowing Powers</i></p> <p>Articles of Association commonly provide that the borrowing powers of the directors may be varied by ordinary resolution of the company, and such a provision appears in Table A. This information is of importance to the public, and it is thought that copies of such resolutions should be required to be filed with the Registrar of Companies.</p>	<p>That Section 143(4) should be amended to include any resolutions relating to Borrowing Powers.</p>
7th Schedule	<p><i>Exempt Private Companies</i></p> <p>The Schedule permits an exempt private company to retain its exemption and the consequent privileges notwithstanding the fact that one of its share or debenture</p>	<p>That it is thought the doubt might be removed by deleting the words "providing capital" in the heading to section 7(1) and the words after "business" in the</p>

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
7th Schedule— contd.	<p><i>Exempt Private Companies</i>—contd.</p> <p>holders is a body corporate provided that the body corporate is a banking or finance company and subject to certain conditions as to voting rights, the shares or debentures in question have been acquired in the ordinary course of business, and by arrangement with the relevant company or its promoters.</p> <p>The precise meaning of Section 7(1) is not clear. Is it intended only to apply to securities acquired by a banking or finance concern in the course of providing new capital to the company in question, or does the section cover existing shares in the company sold by its proprietors for private reasons?</p>	<p>middle of the fifth line down to and including the word "promoters" occurring in the sixth line.</p>

2. Points of Principle

53 54 *Prohibition of financial assistance for purchase of own or holding company shares*

Section 54 makes it illegal for a company to give . . . any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company. As it is now worded this section appears to prevent any arrangement by which a company pays an underwriting commission (a) to assist its shareholders when a call is being made on partly paid shares, or (b) when it is offering its own shares in exchange for those of another company.

That Section 53 should be modified to provide that, in these circumstances, payment of underwriting commission should be legal, and Section 54 should be appropriately altered to make it clear that it is not intended to prevent payments of this kind.

58 *Redeemable Preference Shares*

(a) This section gives a company limited by shares, if so authorised by its Articles, the power to issue Preference Shares which are, or at the option of the company are to be liable to be redeemed. It is suggested that the Act be amended so as to confer power on a company to convert existing issued Preference Shares into Redeemable Preference Shares.

(a) That there seems no reason why companies should not be empowered (subject to appropriate class consents) to convert existing issued Preference Shares into Redeemable Preference Shares, and that the Act should provide accordingly.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
58—contd.	<i>Redeemable Preference Shares</i> —contd. (b) It is suggested that the Act should provide that no redeemed Preference Shares may be re-issued without the consent of the company in general meeting unless the Articles specifically provide to the contrary.	(b) That, as the provisions of the Act are not clear, and as it is not certain what does actually happen in such cases, steps should be taken to clarify the matter.
195	<i>Register of directors' shareholdings, etc.</i> Sub-section (5) lays down:—The said register shall, subject to the provisions of this section, be kept at the company's registered office and shall be open to inspection during business hours (subject to such reasonable restrictions as the company may by its articles or in general meeting impose, so that not less than two hours in each day be allowed for inspection) as follows:— (a) during the period beginning fourteen days before the date of the company's annual general meeting and ending three days after the date of its conclusion, it shall be open to the inspection of any member or holder of debentures of the company : and (b) during that or any other period, it shall be open to the inspection of any person acting on behalf of the Board of Trade.	That the section should be amended to provide:— (a) (i) that in the case of a company any of whose securities are quoted on a recognised Stock Exchange the Register should be open to the inspection of any person and that such inspection should not be restricted, as at present, to members or holders of debentures of the company; (ii) that in the case of a company none of whose securities is so quoted, inspection should be restricted to members or holders of debentures of the company; (b) that the period within which inspection may be made should be unrestricted; (c) that the Directors should be under an obligation to notify the company of any changes in their holding of shares or debentures of the company within seven days of such changes and that these changes should be entered in the Register within three days of notification.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
209	<i>Power to acquire dissenters' shares</i>	
Sub-section (1)(c)	The sub-section has frequently been applied collectively to an offer for more than one class of share, although there are differing views as to the admissibility of this procedure.	That this is illogical since the terms are usually different, and steps should be taken to clarify the point.
(e)	The sub-section refers to "transfer to a company", but does not cover a transfer to a nominee, as is done in sub-section (2).	That a company's nominee should also be covered by this sub-section.
(iii)	There is no logical reason why the transferee must be a company.	That the sub-section should be suitably amended.
(iv)	The sub-section provides for a period of two months <i>after</i> the four months allowed for obtaining 90 per cent. approval, during which the company may give notice to a dissenting shareholder.	That there is no logical reason why notice should not be given within two months of the 90 per cent. approval <i>having been obtained</i> .
(v)	The sub-section does not make it clear whether an offer is made by the transferee if it is made by an exempted dealer (or other person authorised under the Prevention of Fraud (Investments) Act, 1958) on its behalf.	That this point should be clarified, and the appropriate provision made.
(vi)	Problems arise where there are alternative share and cash offers. For instance, the terms on which compulsory acquisition follows are not then clearly apparent.	That the provisions of sub-section (4) should be amended to give the bidder the option to deposit for account of dissenting shareholders either of the alternatives given in the original offer.
(vii)	Where a bidder already holds more than 10 per cent. of the shares the subject of an offer, acceptance is required not only in respect of 90 per cent. of the shares being acquired, but also by three-quarters in number of the holders. No similar requirement for acceptance by three-quarters in number of the holders is required where the bidder holds no shares or 10 per cent. or less.	It is difficult to justify this inconsistency and it is recommended that assent by three-quarters in number of the holders should be required in all classes of bids before the provisions for compulsory acquisition can be enforced.
(viii)	The sub-section provides that shares held by a subsidiary of the transferee company shall be excluded in arriving at the requirement of "nine-tenths in value of the shares whose transfer is involved" but no reference is made when the shares are held by the parent.	It is suggested that the exclusion of shares held by the transferee should be extended to those held by its parent and to those held by its fellow subsidiaries.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
Sub-section (2)(i)	<i>Power to acquire dissenter's shares</i> —contd. This sub-section is strangely sandwiched between sub-section (1) and sub-sections (3), (4) and (5) which otherwise all hang together. It could well be an entirely separate section of the Act, possibly coming before Section 209, since in practically every case it operates independently of sub-section (1).	That the position should be considered, and the suggested transposal effected.
(ii)	The sub-section now only applies where shares are transferred to another company or its nominee, but does not apply if they were transferred to an individual.	That there is no reason why the sub-section should not apply to a transfer to an individual.
(iii)	There is often considerable difficulty in deciding what "the date of the transfer" means, particularly in the frequent cases where one global transfer executed by the transferee is attached to a batch of transfers executed by separate transferors and often dated with varying dates.	That it should be made clear in every circumstance what the "date of the transfer" means.
Sub-section (3)	The words "pay or transfer" are in practice always read to include the allotment of new shares or loan capital. They do not, however, as a matter of plain English include such issues.	That the sub-section should make it clear that the allotment of new shares or loan capital is included in the term "pay or transfer".

Voting Rights

In view of the increasing attention paid to questions of control, the sub-committee were concerned at the power in the hands of a Board to influence the result of a vote at a meeting or at a poll by delaying the registration of transfers up to the full period of two months allowed by Section 78 of the Act or by closing the transfer books for a period up to 30 days before the date of the meeting or poll.

Under modern conditions there is no reason why the period during which transfers must be registered or refused should not be shortened very considerably. This is a matter which could be dealt with administratively by the Stock Exchange, failing which the Act should be suitably amended.

No Par Value Shares

The previously expressed views remain unchanged. Recommend that legislation, following acceptance by the Government of the official report, should be implemented without delay.

Section	Points raised by Members of the Association	Sub-Committee's Recommendation
Sub-section (3)—contd.	<i>Costs authorised by the Act.</i>	The sub-committee consider that various charges and costs laid down in the Act are not now related to current costs, and that these should be reviewed (e.g., Section 87 (2) and Section 113 (2)).
Forms Order (2)(a)]	<i>Notice given to dissenting or non-assenting shareholders under Section 209</i> The point was put forward that, under the provisions of this section of the Order notices under Section 209 sent to shareholders abroad must be served personally on them, and that it is not sufficient to send them by registered post.	That, if the interpretation of the Order means that such is the case, then the Order should be amended.

APPENDIX XVIII

Memorandum by the Society of Investment Analysts Limited

Introduction

The Society of Investment Analysts was formed in May 1955 with the object of improving the quality of investment analysis. It now has over 400 members who are all professionally engaged in the management and analysis of investments. Nearly half are employed by financial institutions and most of the remainder are with stock-broking firms: the membership includes independent consultants and financial journalists.

Even the expert investor finds it impossible to make an adequate appraisal of the worth of a share on the basis of company accounts that do no more than conform to the requirements of the present Companies Act. The expert can sometimes find other information at Busb House and elsewhere but only after taking much time and trouble; to the extent that this is possible other shareholders are placed at an unnecessary disadvantage. The Society's proposals are therefore aimed at increasing the amount of information which companies must provide with their accounts and ensuring that so far as is practicable the information is given on a consistent basis.

Few, if any, of the proposals are entirely outside current practice. Some reflect what is already obligatory in the U.S.A. where conditions are no less competitive than in the U.K. Many British companies already provide information on the lines we suggest; others provide even more. The Society urges that the law should oblige all companies to conform more closely to the practice of the best.

Evidence

1. It is often impossible to assess the progress of a company without knowledge of variations between years in sales or services rendered to its customers. Equally important factors are the materials and wages content included in amounts charged to customers. The Securities and Exchange Commission in the U.S.A. requires these matters to be disclosed.

2. It is suggested that the published accounts of every company should include a trading account disclosing:

- (a) Turnover;
- (b) Wages and salaries;
- (c) Materials consumed;
- (d) Under appropriate headings, any other material expenses.

3. Under current law the holding company of a group need not present a separate profit and loss account. It is sufficient, under the provisions of Section 149 (5), Companies Act, 1948, if the consolidated profit and loss account shows how much of the profit therefrom is dealt with in the accounts of the holding company. In this manner the actual profitability of a holding company engaged in trade can be hidden and information vital to the assessment of an investment withheld.

4. It is suggested when the holding company is engaged in a trade that it should be obliged to publish a separate trading account and profit and loss account.

5. Under Section 150 (2) (a), Companies Act, 1948, a company need not publish group accounts if it is at the end of its financial year a wholly owned subsidiary of another body corporate incorporated in Great Britain. It is possible that such a

subsidiary company itself has subsidiary companies subject to substantial minority interests. As the law stands today, since such a document does not exist, these minority interests have no chance of considering the consolidated balance sheet of the group of which they are members.

6. It is suggested that the exemption given under Section 150 (2) (a) be withdrawn.

7. Subject to the over-riding requirement that the balance sheet must give a true and fair view of the state of affairs, few balance sheets give any indication of the current value of trade investments unless quoted on a stock exchange. Further, Section 154, Companies Act, 1948, lays down that, apart from exceptional circumstances, a company shall be classed a subsidiary of another if and only if that other holds more than half in nominal value of its equity share capital. In recent years a number of companies have invested substantial sums in other companies under conditions which do not call for the inclusion of the figures of such companies in consolidated accounts. The cost of the shares is carried in trade investments and the dividends declared thereon included in income from trade investments. No indication is given in the accounts of the owning company of the proportion of the profits applicable to its holding which has been retained by the operating company.

8. It is suggested, if a company owns, or has a present or future right to acquire, more than 25 per cent., but not more than 50 per cent. of the equity share capital of another company or companies, or if the profit of such other company or companies attributable to the owning company exceeds 25 per cent. of the profits disclosed by the consolidated profit and loss account of the owning company, that, unless the balance sheets and profit and loss accounts of such other company or companies are included in the appropriate consolidated accounts of the holding company, there should be attached to the accounts of the first company a statement showing, in the aggregate:

- (a) The profits distributed by such companies to the holding company;
- (b) The profits retained by such companies to the extent they are attributable to the first named company's holdings of equity shares in such companies.

9. It is impossible to over-estimate the importance to the investor of the charge in the accounts for both United Kingdom and overseas taxation, and the effective rate of United Kingdom income tax applicable to the dividends he is to receive. If the requirements of paragraph 12, 8th Schedule, Companies Act, 1948, are followed completely, the division between United Kingdom and overseas taxation is not always apparent; neither need the basis of computing the charge for taxation in the profit and loss account be stated.

10. It is suggested that:

- (a) the basis of computing the charge for taxation should be specifically stated;
- (b) the amount so charged should be divided into:—
 - (i) United Kingdom income tax;
 - (ii) other United Kingdom taxes on profits;
 - (iii) overseas taxes on profits;
 - (iv) relief received or to be received in the United Kingdom in respect of (iii) above;
- (c) the effective rates of United Kingdom income tax applicable to the dividends declared in respect of the year under review should be stated.

11. The annual accounts of a company or a group are one of the most important sources of information available to present and potential members. In many cases it is impossible to ascertain from such accounts the trade or trades actually carried on: this difficulty is much aggravated by the present trend towards diversification.

12. It is suggested that every company or group should be required to append to their published accounts a statement, certified by the auditors as true and fair, indicating the main activities carried on and any material variations, by way of additions or otherwise, during the year under review.

13. No complete assessment can be made of the progress of a company by a comparison between two years. A cycle of five years is the minimum period necessary to plot a trend in profitability or financial stability. The Rules of the London Stock Exchange require that the prospectus for an issue of shares for which a quotation is sought should include a 10-year profit record.

14. It is suggested that every company should be obliged to submit with its annual accounts a statement, certified by the auditors as a true and fair statement drawn up on a consistent basis, summarising the salient features of the profit and loss accounts and balance sheets of the five years immediately before the year shown by comparative figures in the accounts under consideration.

15. A matter of primary importance when studying the accounts of a company is the amount of cash or cash assets created by the profits of any year and the manner in which such money has been invested.

16. It is suggested that every company should be required to submit with its accounts a "source and disposition of funds" or a "cash flow" statement on the following lines:—

Profit retained per accounts:—

Add:

Items, such as depreciation, charged before arriving at such profits and not requiring the payment of money.			
Income tax similarly charged and not immediately payable			
Proceeds from the sale of fixed assets	..	..	..
Proceeds of issues of share or loan capital	..	..	..

Deduct:

Expenditure on fixed assets	..	..	..
Income tax paid	..	..	..
Funded liabilities redeemed	..	..	..

Increase/Decrease in working capital

17. By Part III of the 8th Schedule of the Companies Act, 1948, Banking and Discount Companies are exempt from some of the accounting provisions of the Companies Act, 1948. The effect of these exemptions is to prevent the shareholder from ascertaining the true value of his investment and to hide the trading profit and the disposition of that profit. The exemptions are usually justified on the basis of "the national interest" but it is probable that the national interest is best served by showing the real strength of financial institutions. If weakness does develop it is more likely to be corrected promptly if it can be seen by all in the published accounts than if it can be concealed. Banks in the U.S.A. are obliged to publish operating accounts.

18. It is suggested that the exemptions granted to banking and discount companies be withdrawn except where by the nature of their business the provision of such figures would be meaningless.

19. Insurance Companies are also exempt from some of the accounting provisions of the Companies Act, 1948. Shareholders are thus in ignorance of the true financial status of their companies and prospective insurers are handicapped by lack of information. There are no such exemptions in the U.S.A. where insurance companies have to publish both operating accounts and the market value of their investments.

20. It is suggested that the exemptions granted to insurance companies be withdrawn except where by the nature of their business the provision of such figures would be meaningless.

21. Under paragraph 25 of Part III of the 8th Schedule to the Companies Act, 1948, the Board of Trade has prescribed that it is in the national interest that shipping companies be allowed freedom from complying with certain requirements of Part I of the 8th Schedule. Thus, in the case of shipping companies also, shareholders are prevented from ascertaining the true financial status of their company at the date of the balance sheet, or from receiving a true statement each year of the profits earned, prepared on a consistent basis. There are shipping companies, including one of the largest groups, who do not take advantage of the "Shipping Companies Exemption Order" and clearly must consider that they do not thereby suffer a competitive disadvantage. It seems difficult to justify the exemptions granted to shipping companies which appear to be founded on vague fears of foreign competition.

22. It is suggested that the exemptions granted to shipping companies be withdrawn.

23. Developments since 1948 have shown that earlier undervaluation and the effects of inflation have, in many cases, left shareholders in ignorance of the real worth of assets despite the greatly increased information now imparted regarding the basis of valuation. Publication of up-to-date values, such as those used for insurance would to a considerable extent reduce this gap in shareholders' knowledge without placing any company at a disadvantage *vis-à-vis* competitors. So long as profit and loss account figures relate to current values while a large part of the balance sheet is based on out-of-date ones comparisons of the relationship between the two are likely to be misleading.

24. It is suggested in principle that the published accounts should include an up-to-date valuation of the fixed assets at not more than five-yearly intervals. In view of the difficulty of incorporating such a requirement in legislation without also imposing an intolerable expense on companies it may be that this is a suitable subject for a special study.

25. The practice of issuing non-voting ordinary shares has increased markedly since the war. This device makes nonsense of the assumption that the management of a limited company is ultimately responsible to the shareholders. It can enable major changes to be made in the constitution or control of a company without the consent of the majority of the ordinary shareholders; such changes could be to the advantage of the management or of a few shareholders and detrimental to the interests of the remainder. The non-voting shareholder thus runs the same risks as any other equity investor but has no control over the management. The same applies, to a lesser extent, to special classes of ordinary shares having limited voting rights.

26. It is suggested that:—

- (a) The issue of shares carrying equity risks without having exactly similar voting rights to those of shares carrying similar risks in the same company should be forbidden by law.
- (b) Where such shares are already in existence the companies should be given a period of five years during which they will be required to take steps towards enfranchisement of the non-voting shares including shares with limited voting rights.
- (c) Any scheme towards this end to be subject to approval by special resolution by all the equity shareholders, voting and non-voting, at an extraordinary general meeting at which all shall have equal voting rights.
- (d) In order to protect minority interests shareholders of either category holding a total of 10 per cent. of the equity share capital should have the right, within a limited period, to apply to the Court to have the scheme set aside or modified.

- (e) Where a company has failed to enfranchise non-voting shares by the end of this five-year period the non-voting shares shall automatically be enfranchised and shall then carry the same voting rights as do the existing voting shares of similar type.

No Par Value Shares

27. In view of the recommendation contained in the Report of the Committee on No Par Value shares to the President of the Board of Trade in 1954 there is little that this Society can add to that Committee's report except to say that this Society if it had been in existence in 1954 would have given evidence in favour of companies being permitted to issue no par value shares should they so wish.

This Society can see many advantages of a purely practical nature in favour of no par value shares and furthermore would welcome any step which would prevent unsophisticated investors from deluding themselves that the par value of a share had any bearing on its true worth.

3rd June, 1960.

APPENDIX XIX

**Memorandum by The Association of International Accountants Limited
(By Guarantee).****Annual Return**

The submission of the lists of members of a company (at least every three years) and of transfers since the last return entails a considerable volume of work in the case of many companies. With the enormous numbers of transfers that now take place in the shares of the larger companies and the accepted policy of encouraging smaller, and therefore more numerous, holdings it is questionable whether the public right of reference to these lists (which are always to some extent out of date) is really worth the trouble and expense of compiling and storing them. It is suggested that these particulars might be restricted to individual holdings of 5 per cent. and upwards of the capital carrying voting rights.

Section 124
Section 131

In accordance with Section 131(1) every company shall, in each year, hold a general meeting as its Annual General Meeting and by Section 124 an Annual Return is required to be filed with the Registrar of Companies in the form laid down in the 6th Schedule. Although under a liability to hold an Annual General Meeting every calendar year, it is not uncommon for an exempt private company not to do so, but nonetheless to comply with Section 124 it files an Annual Return for that year. It is suggested that the Annual Return Form be so amended that a declaration could be made that no Annual General Meeting was held in that particular year to which the Return relates.

DirectorsSection 27
Section 54
Section 184

The present Companies Act contains provisions intended to prevent directors from becoming entrenched and from using the company's money for the purpose. Section 184 enables shareholders to remove directors by ordinary resolution. Section 27 prohibits a subsidiary company from holding shares in its holding company. Section 54 prohibits the use of the company's money to finance purchases of its own or its holding company's shares. If, however, control of another company is exercised through nominees, or by a holding of not more than 50 per cent., that other company is not legally a subsidiary, and Sections 27 and 54 are evaded. So, if Company A acquires a 40 per cent. holding in Company B and appoints its own directors thereto, and Company B then acquires a 40 per cent. holding in Company A, and these holdings are sufficient (as they often are) to control voting at the meetings of such companies, the directors are irremovable despite Section 184 and despite the fact that they themselves may hold few or no shares. Some amendment of the law here would seem desirable.

Shareholders' Standing Committee

It is suggested that provision be made for setting up a Shareholders' Standing Committee in the case of all public companies having a share capital; this Standing Committee to consist of, say, three Ordinary shareholders, one of whom would retire each year. Members of such Committees not to hold office for more than three consecutive years and not to be eligible for reappointment for a clear five years.

The members of this Committee to be elected by the company in Annual General Meeting. Their appointments to be in an honorary capacity, with provision for refund of out-of-pocket expenses only.

These Committees to be empowered by law to require full consultation in all matters affecting financial policy (as distinct from trading) and on all matters concerning the capital structure, financial control of subsidiaries, take-over bids, etc., and to report direct to the Company's Shareholders.

Section 159

Auditors

There is some inconsistency between sub-sections (1) and (2) of Section 159 respecting the appointment of auditors; the former states that the company shall appoint auditors at each Annual General Meeting, whilst the latter states that they shall be deemed reappointed except in certain circumstances. As a consequence companies are not consistent in their procedure; some continue formally to reappoint their auditors by resolution, others merely announce that the auditors continue in office.

In a recent case in the Central Criminal Court it was submitted that in certain circumstances an auditor is not an officer of a company and it seems desirable that this point should be made clear beyond doubt. At the present time there is no provision requiring a person nominated as a new auditor to give his consent to the nomination and it is suggested this might be provided for in any new Act.

It is further suggested that the auditor's appointment should be filed with the Registrar of Companies on the Annual Return; likewise the termination of his appointment and the appointment of a successor.

The only public knowledge about the auditors of a company depends upon the last accounts filed and in respect of an exempt private company no knowledge of this is made public. In the case of an exempt private company the disclosure of the name of the auditor may give a certain standing to a company's affairs. It would also allow an auditor a certain amount of protection where for one reason or another he has resigned from office and wishes the fact to be publicly recorded.

Two provisions contained in the draft Report of a Commission of Enquiry into Company Law in Ghana appear suitable for incorporation into English Company Law. The first point is that what is at present the accepted etiquette in the accountancy profession might with advantage be made a statutory provision (of particular value where an auditor is not a member of any professional body). That is to say, that before accepting appointment as auditor of a company an accountant should communicate with the retiring auditor and invite him to make any representations and supply any information about the company which he may care to make and supply.

The other point is a provision that the auditors of a company may be enabled to apply to the Court for directions in relation to any particular matter arising in connection with the performance of their functions and on any such application the Court to give such directions as the Court thinks just. The Court to direct the costs of any such application to be paid by the company unless deemed otherwise. This Association considers that auditors would welcome the right to apply to the Court in such circumstances, as it would help to enhance their independence and strengthen their hands in any disagreement with the management. At the

present time such matters may be referred to the Board of Trade but it is felt a statutory provision to apply to the Court for directions would be more satisfactory.

Where the accounts fail to include the statutory particulars as to directors' emoluments, compensation and loans, the auditors must include the particulars in their report so far as they are able; but they have no authority to require these particulars from the directors and though the latter are required to give the information to the company they are not required to do so in writing.

Audit of Exempt Private Companies' Accounts

Section 161

It is understood that proposals will be submitted to the Jenkins Committee to extend to exempt private companies all the existing provisions of Section 161(1) of the Companies Act, 1948.

Should that be so, it is submitted that the definition of an accountant as laid down in Section 52(4) of the Income Tax Act, 1952, should be followed, namely, "Any person who has been admitted a member of an incorporated society of accountants". To prevent any possible abuse of this definition it is suggested that a date could be fixed to limit this to bodies of accountants incorporated on or before an agreed date, i.e. 1st July, 1948.

This could well represent a useful step leading to closer integration of the accountancy profession, which in the opinion of many people is long overdue.

To compel all companies without exception to submit their accounts for audit by chartered or certified accountants would undoubtedly impose considerable hardship on many of the smaller private companies, and an even greater hardship on most of the smaller practitioners of accountancy by depriving them of a major source of their livelihood. Consequently, it is submitted that any statutory definition of an accountant for the purposes of the audit of exempt private companies should be framed to include all those in established practice as accountants and auditors as denoted by membership of an incorporated body of accountants established for the public practice of accountancy. It is believed to be the view of the Board of Inland Revenue that this definition has proved to be quite satisfactory over a long period for the purposes of the Income Tax Acts. Non-members of accountancy bodies would, of course, continue to apply for individual authorisation, as at present.

Whilst the provision for the authorisation of individuals under Section 161(1)(b) has enabled practitioners to continue to audit the accounts of public and non-exempt private companies it is considered derogatory for established practitioners in any profession to have to apply for a licence from a Government Department. Moreover, the conditions for the issue of these licences afford no guarantee of any accepted standard of proficiency and must be a doubtful safeguard to the public as there is no recognised procedure for disciplinary control as in the case of members of the professional accountancy bodies, whether "recognised" or "unrecognised" for the purposes of Section 161.

It is further submitted with respect that practising members of professional bodies not "recognised" under Section 161(1)(a) have shown, by their membership of such bodies, their willingness to conform to accepted standards of professional conduct and that this should be recognised by the approval of their organised bodies, as distinct from those individuals who prefer to remain outside any professional organisation and refuse to be bound by the ethical standards of the profession by which they earn their livelihood.

When legislating for the audit of public company accounts it could surely not have been the intention of Parliament to establish compulsory registration within the accountancy profession without affording any of the safeguards such legislation would provide for existing practitioners. That has, however, largely been the effect of recognition of certain accountancy bodies only by the Board of Trade. The alternative description to "recognise" must, of course, be "unrecognised" which, in the English language, implies a stigma. This adjective is freely applied to any body of accountants not "recognised" by the Board of Trade under Section 161 of the Companies Act, 1948. This precedent for "recognition" by the Board of Trade has been applied not only in this country but also in a wholesale manner throughout the world; as a consequence many avenues of professional accountancy practice—often for quite unimportant professional purposes—have been closed to all accountants other than members of the bodies "recognised" under Section 161 without enquiry as to whether this discrimination is warranted or necessitated by the circumstances.

In the absence of any willingness on the part of the existing "recognised" bodies to accept or initiate some form of registration in the accountancy profession it is respectfully submitted that membership of other organised bodies representing practising accountants should be approved—for the audit of exempt private companies at least—if it is decided to stipulate any professional qualification for auditing the accounts of such companies.

My Council would request the opportunity to give further and oral evidence regarding the Association's deep concern over these matters with particular reference to lengthy negotiations with the Board of Trade ever since 1945. The unfortunate outcome of these very long drawn-out discussions ultimately resulted in the failure of a Scheme for the absorption of eligible members of the three main "unrecognised" Associations into membership of one of the "recognised" bodies, after the most exhaustive enquiries and after the scheme had been approved by the Board of Trade and by the Co-ordinating Committee representing the "recognised" bodies.

Because a Bye-law of the proposed absorbing body required a 75 per cent. majority to pass the resolution adopting the Absorption Scheme, the proposal was lost by a small number of 161 votes; (some 3½ per cent. of the numbers voting); the figures being 3,241 in favour of the proposed absorption and 1,295 against.

For the above reasons my Council feel, therefore, these circumstances warrant particular attention being paid to any proposed extension of Section 161 of the Companies Act, 1948, which would so vitally affect the livelihood of members and the future of "unrecognised" Associations, not only in this country but in the many countries in the English speaking world where such Associations have practising members; this Association alone has some 3,000 students who are at present preparing themselves for the qualifying examinations.

Registration of Business Names Act, 1916

AS AMENDED BY THE BUSINESS NAMES RULES, 1938

From information available to the Council of this Association it would seem that the powers of the Registrar of Business Names, as well as the means available to him to enforce the provisions of the Act, could with advantage be strengthened.

It is believed the provisions of the Act are not so widely known as they should be and additional means of bringing its provisions (with particular reference to any amendments, of course) to the attention of the business community might be considered.

It appears that unless complaint is made by a member of the public, the Registrar has no adequate means of knowing if registration is being evaded and no means of checking or preventing abuses of the provisions of the Act unless and until application is actually made to the Registrar for registration.

For instance, words which the Act is intended to protect can be freely used for a wide variety of activities if the persons concerned are ignorant of the provisions of the Act or if they maintain that the activities they are carrying on are not for the purpose of private profit. It is understood that all manner of activities are carried on in this way.

For instance, the protection intended to be afforded to companies incorporated under the Companies Act to prevent the use of the same or a similar title to that of a company already incorporated is rendered far less effective by the manner in which activities may be carried on, even without registration, under the Business Names Act.

This obviously leaves scope for misrepresentation, or even fraud, by the use of titles incorporating words such as Royal, Imperial, International, etc., which are prohibited for use under the Companies Act, 1948, and under the Business Names Act itself.

It is therefore suggested that the scope for registration should be widened to embrace activities of the nature referred to above; that the powers of the Registrar of Business Names should be strengthened and that the means available to the Registrar's Department for enforcing the provisions of the Act should be expanded.

For, and on behalf of, the Association of
International Accountants, Limited (by Guarantee).
EDWIN P. HUBBARD (*Chairman of the Council*).
D. COLQUHOUN (*Vice-Chairman*).
CHARLES E. TAYLOR (*Secretary*).

17, DOMINION STREET,
MOORGATE,
LONDON, E.C.2.

Dated 25th May, 1960.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
SEVENTH DAY

Friday, 18th November, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. L. BROWN, F.I.A.

MRS. M. NAYLOR

PROFESSOR L. C. B. GOWER, M.B.E.

MR. C. H. SCOTT

MR. W. H. LAWSON, C.B.E., F.C.A.
(*Questions 2233 to 2401 only*)

MR. R. SMITH

MR. J. A. LUMSDEN, M.B.E.

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. S. R. HOGG, MR. D. B. TRACEY, MR. H. CRUMP AND MR. W. J. LUXTON
called and examined

2036. *Chairman:* Mr. Hogg, I understand that you are Chairman of the Company Law Committee of the Association of British Chambers of Commerce; Mr. Tracey, you are a member of the Company Law Committee; Mr. Crump is Secretary of the same Committee, and Mr. Luxton is Secretary of the London Chamber of Commerce.—*Mr. Hogg:* That is correct, Sir.

2037. I would like to say that we are greatly obliged to you for the memorandum submitted on behalf of your Association and for coming here to help us this morning. The members of the Committee of course have all had copies of your memorandum and have considered it, so it is not necessary for us to raise questions on every point. You begin by a general statement to the effect that you are very well satisfied with Company Law as it stands, and you would deprecate changes for the sake of change, and in your view the majority of companies are efficiently and honestly managed under the present law. Is that a fair statement of your general view?—Yes, Sir.

2038. Next, if I might turn to something more particular, I want to ask you about

the prohibition of large partnerships which is mentioned in heading 2 of our questionnaire. You are in favour of raising the maximum number of partners permitted above 20 or alternatively doing away with the prohibition altogether.—Yes, Sir.

2039. Could you tell me this. You express that view in quite general terms. Would you have it extend to industrial and trading partnerships as distinct from professional partnerships?—*Mr. Tracey:* I personally should. I have known cases where it has given rise to difficulty and where a company has had to be formed because of this restriction.

2040. Do you mean that there was actually in being an industrial or commercial partnership and it was found that they were exceeding the number and so had to form a company?—They were on the point of exceeding the number. They had got to about 18 and they were on the point of extending it to 25, and then this restriction was pointed out to them and a company had to be formed instead, which was not a satisfactory solution.

2041. I am much obliged; that is a concrete example where you say the limit

did prove a handicap to a trading partnership.—It was a group of companies that had a by-product, creosote, and it was a question of finding a suitable way of marketing the by-product, and they decided to form this company to do so.

2042. What were the members of the partnership before that—were they companies?—Yes, they were all companies.

2043. I am asking you this because most people who favour removal or relaxation of this rule do so in the case of professional people. There is a special difficulty there because a limited company cannot act as a doctor, cannot advise as a lawyer, and so on. I do not think it has been so far suggested that an alteration if made should extend to trading partnerships. But we now have the view of your Association at all events that it should apply equally to trading and professional partnerships.—Yes, Sir.

2044. The next is perhaps a rather more important matter and this concerns offers to purchase what you call the main assets or the main business of a company. I think it is a fair statement of your view to say that you think it would be desirable that the shareholders should be consulted before acceptance of any such offer, but that in many cases this would be impracticable for the reasons you state. These reasons are in effect that the necessity for getting a resolution of the company will involve delay in clinching the bargain, and furthermore that the publicity necessarily involved in summoning a meeting might rouse competitors to make a higher bid. Those difficulties lead you to the conclusion that, important as some of these matters are and desirable as it would be for the members to be consulted, the better way you think in the long run and on the whole would be to trust the directors in such matters to act in the best interests of the shareholders. That I think is the way you put it, is it not?—*Mr. Hogg:* That is so, Sir. I have had an actual case of a company suffering an enormous loss; they were losing about £1 million a year; and an offer came to take over the company, including its overdrafts, and I advised the board to take it. We were asked for an answer within 24 hours and if we had had to wait

to consult the members the offer would have gone off and the company would have been ruined.

2045. It might be laid down that the directors should consult the shareholders before accepting any such offer unless they were of opinion that it would be impracticable to do so, in which case a resolution of the board should be duly recorded stating the directors' decision not to consult the shareholders and their reasons for such a decision. There would be not much sanction to that, but if a procedure of that sort were carried out it should ensure that directors, honest ones anyhow, would have applied their minds to the question whether the shareholders ought to be consulted or not, and they could weigh the pros and cons in each particular case. Do you think that that would be worth a trial?—Yes, Sir, and that is fair to everybody.

2046. The next point under the same heading is this. You distinguish between the sale of main assets or the main business of a company and the change of its main objects, and you say in effect that the prior consent of the shareholders should be required as regards the latter, but for practical reasons, that is, the reasons we have discussed, not as regards the former. My difficulty there is that the two may be combined in one, may they not? The change in the main objects may happen along with and because of some disposition of assets, might it not?—That is so Sir, but we are really trying to say that if an investor has put up money in, say, a rubber estate and in the course of time the main asset is sold and the company is then full of cash, we think it quite wrong that the directors should then change over, say, to making boilers. We think that before such a change the shareholders should be consulted.

2047. The kind of case in which the company is no longer that in which the shareholder agreed to put his money; it has been changed into something different?—That is so. That has actually happened, for example, in the case of some companies which have been nationalised. Their business has been taken from them, they are full of money, and then the directors have said—"We will carry

on as an investment trust"—without reference to the shareholders. We think that is wrong.

2048. I believe difficulties of that kind arose with some of the cable companies?—It did actually happen in Cable and Wireless Ltd., and it happened in another quite big company. I was acting in the latter case, and eventually because of representations the Board agreed to repay two-thirds of the cash and keep one-third, whereas the original intention was to keep it all.

2049. That is very unsatisfactory. Have you any suggestions to make as regards the definition of "main assets", "main business" and "main objects" of a company. At what point does an asset become the main asset?—Is it the same point, my Lord, where if the main asset is sold the substratum of the business has gone and I believe in law the company ought to be wound up? Might not the same definition apply?

2050. Any change in the objects which would suffice to found a petition on the ground that the substratum of the company had gone?—Yes, Sir.

2051. I think there may be some difficulty there which is linked up with the wide form of the objects clause. One faction might claim that the substratum had gone but the other faction might say "No, if you look at object ZZ in the memorandum you will find we can carry on an ice-cream factory, for instance, and therefore we have still got something left".—That is the difficulty, my Lord.

2052. Anyhow, your test would perhaps rely to some extent on the doctrine about the substratum of the company having gone?—I think that is so.

Mr. Tracey: I think you have to distinguish between the company's main activity as a business and its main object in a legal sense. In practice I do not think it is so difficult to say what is the main object of a company, if you look at the company's activities. One is here concerned with the main purpose of the company in practice. The issue is whether you are changing that and not whether you are changing the main objects as disclosed in the memorandum of association.

2053. You would look at the memorandum of association and you would consider the history of this particular company, and for your part you would see no great difficulty in saying after you had gone through that process what the main object was?—You can see how the bulk of the assets is employed. Take, for example, a steel company. You can see from observation that the bulk of the assets of the company are steel-making assets. The company may have brick-making activities and lorries as well, but in practice, it is quite obvious from looking at the whole structure of the company, leaving aside what is in the memorandum, that its main purpose is steel-making. If it is going to switch from steel-making to something else, then the view of our members is that that should be referred to the shareholders.

2054. This question again is linked, is it not, with the width of the objects clause in the memorandum? Because in fact the kind of case we are dealing with is a case where the proposed change, radical as it is, is covered by the memorandum; that is the position, is it not?—Yes, Sir, but I think the difficulty goes even further because there is a very general view amongst business men that if a particular object is not covered by the objects clause of the parent company you can get round the matter by forming a subsidiary company, and no one bothers to enquire whether the objects of the subsidiary company are within the objects of the parent company.

2055. Then the parent company will have power to invest, will it not, in shares, securities and so forth, and so in exercise of that power it can take control of a subsidiary company and become its holding company by acquiring all its shares?—But is not the power to invest conferred by the memorandum usually a power to invest in companies having objects similar to those of the parent company?

2056. I think there must be some limit on it.—I think that is so.

2057. But that is a possible way of getting round difficulties of this kind?—Yes, I think in most cases it is an improper way because the objects of the subsidiary

company are not within the objects of the parent company. Unfortunately the general view is that it can be done that way.

2058. I think we have your answer on that question. Then the next point relates to the issue of shares. Some witnesses have suggested that at all events in cases where an increase in the authorised capital of the company is concerned the shares in question (apart from small quantities required for example to qualify a director or to meet the company's obligations to a pension fund) should, unless the company in general meeting otherwise determines, be offered in the first instance to the existing shareholders *pro rata*.—*Mr. Hogg*: That would entirely destroy the powers of directors to carry on their business in so far as they might want to buy another company and pay partly in cash and partly in shares. There again if the members of the purchasing company had first to be consulted, the whole transaction probably would go off. The protection, Sir, is the Stock Exchange. If the shares are to be quoted, the Stock Exchange do insist on a circular to all the shareholders setting out the facts about the company that is being bought, the profits, the assets, the net assets, and why it is being bought. If the company cannot issue shares then of course we stultify our own recommendation that a company can, and the directors shall have power to, manage the business of the company in every way.

2059. Of course the directors' powers are conferred by the articles of association of the company and are capable of being altered by special resolution. But the position I am envisaging is the position in which the directors want to issue shares for cash. They may want the cash for additional working capital or for the acquisition of some particular asset, but they want cash. The suggestion made, rightly or wrongly, is that the proper thing for the directors to do where an important proportion of the total share capital was being issued for cash would be to offer the shares in the first instance to the shareholders *pro rata* according to their holdings; the object of that being of course to protect the shareholders from having their shares watered down by an issue of

shares to outsiders. One can imagine the shareholders might say it was only fair that they should get a chance of subscribing for these shares.—We would agree entirely with that, Sir.

2060. But then one has to recognise that, if one accepts that, it would be the case that directors, when they had in mind some proposition involving the issue of shares which was inconsistent with a *pro rata* offer to the shareholders, would then have to go to the shareholders for their consent.—We entirely agree that an issue for cash should be offered *pro rata* to existing shareholders; but in the case of shares issued as part consideration for another business we submit that the directors should have power to issue those without reference to the shareholders.

2061. The two kinds of cases are rather difficult to distinguish, are they not? One can see that if the transaction was the purchase of assets, the shares being issued at so much to be satisfied in assets, then there could be no question of *pro rata* offering because there would be no shares issued for cash?—That is so, Sir. The mischief that is being aimed at is the directors allotting themselves shares for cash and not offering them to the shareholders; I think that is the mischief that prompts the suggestion which you have put to us, but that does not apply in the case of buying another business and paying part of the consideration by the issue to the vendors of fully-paid shares.

2062. *Mr. Brown*: Might I ask whether the witnesses' views there are irrespective of size, and if the capital were to be doubled by such an operation would that still in your view be approved?—In practice as a principle I think we submit that the directors are carrying on the business as honest men, and we think that it would make business extremely difficult if they had to consult their shareholders, however big the transaction.

2063. *Chairman*: Is not the real distinction between an issue for cash and an issue for a consideration other than cash, to wit the assets of the business?—That is so, Sir.

2064. In the former case you are going to spend the cash on acquiring a business, but your own members' cash is as

suitable for that purpose as anyone else's cash. It is not inconsistent with the *pro rata* suggestion that you should expend the cash when you have got it on buying a new business?—We would like to put it that the *pro rata* operation should only apply to an issue for cash; what is done with the cash has nothing to do with it.

2065. I think we have now cleared that up. The next point is the question of loans by the company otherwise than in the ordinary course of business, that is heading 5(e).—May I amplify our recommendation. This comes from an actual instance on which I am advising. A small syndicate bought 51 per cent. of the shares of a rubber company for cash and shares. That rubber company had over £300,000 of money at the bank. The syndicate, having got 51 per cent. of the shares, then called for the resignation of all the directors and officers, and the auditors, put in a completely new control and within a few weeks that £300,000 had been lent to friends and associated companies of the syndicate and was lost eventually. That, Sir, is the mischief that we are trying to cure. The difficulty is how to do so without restricting business unnecessarily.

2066. If there had been in force a provision that loans otherwise than in the ordinary course of business should require the consent of the company in general meeting, there is no doubt, is there, that in the example you gave the loans in question would be covered?—Except of course the company in annual general meeting would have ratified the loans because the syndicate had 51 per cent. of the shares.

2067. That was a matter of control. But still that would not absolve them, would it, from calling a meeting so that the shareholders could express their views upon it?—Quite, Sir. But the minority would have been out-voted and no better off, except that they would have been warned.

2068. That may be, yes.—If it were provided that in such circumstances the directors should be liable—personally liable for money improperly lent or money lent not in the ordinary course of business—that would meet the position.

2069. Whichever way you look at it the money would have gone?—That is so, Sir. We have tried to meet that by another recommendation, that where a company gets 51 per cent. control the 49 per cent. should have the right to insist that they are taken over as well. That is the recommendation we are making which would of course deal with this point at the same time if it were accepted.

2070. If a man who bought 51 per cent. were saddled with all the others whether he wanted them or not, might that not put a stop to many take-over bids?—To some extent it would, Sir, but in real life take-over bidders want at least 75 per cent.; in practice they usually try to get 90 per cent. so that they can compulsorily purchase the remaining 10 per cent. It is not good business to have an interest in a company with 49 per cent. outside interest.

2071. But it is a strong thing to put the bidder under an obligation to buy all the rest, and it is a strong thing I think to put all the rest at the risk of being bought out by the bidder.—I do not think, Sir, in real life it would stop business. I think that all the honest take-over bids would go on just the same; it is the dishonest ones which would be caught.

2072. What you are really saying is this, that in an example of the kind you gave really the only remedy would be for the bidder to take over the whole of the issued share capital; then he could do what he pleased?—Yes Sir, or alternatively directors should be personally responsible for money lost by improper lending, and let the Court decide whether or not a loan is a proper regular loan.

2073. *Mr. Watson:* Would your suggestion go so far as to recommend that where a company now holds 51 per cent. of another it should be compelled after the passing of the new Act to acquire the balance?—Our recommendation would only apply to situations arising after the passing of the Act.

2074. There are many such situations in existence to-day, are there not?—There are a few definitely, but the damage is already done I think; the money has gone.

2075. *Professor Gower*: As I understand it, you want the minority to have the option of being bought out; but you do not want to extend to the acquirer, if he has as little as 51 per cent., a compulsory right of acquisition of the minority, do you?—No, the minority should have the right to sell their shares to the offeror if they so wish.

2076. *Chairman*: I was not sure as to whether it was intended to work the other way as well?—No, my Lord. If the minority shareholder is satisfied to stay in, there is no more to be said, but he should have the right to protect himself.

2077. You say, unless the difficulty is disposed of in that way, you think the question of improper loans should be a matter in respect of which the directors could be made personally liable for any loss?—Yes, Sir.

2078. Under heading 6 on page 5 of your memorandum you deal with a different topic. It concerns directors convicted of offences involving fraud or dishonesty. You suggest that no person shall act as a director if he has previously been convicted of an offence involving fraud or dishonesty unless by leave of the Court. We already have section 188 of the Companies Act which I think goes some way towards covering your suggestion. That provides as follows:—

“(1) Where—

(a) a person is convicted on indictment of any offence in connection with the promotion, formation or management of a company; or

(b) in the course of winding up a company it appears that a person—

(i) has been guilty of any offence for which he is liable (whether he has been convicted or not) under section three hundred and thirty-two of this Act; or

(ii) has otherwise been guilty, while an officer of the company, of any fraud in relation to the company or of any breach of his duty to the company;

the Court may make an order that that person shall not, without the leave of the Court, be a director of or in any way, whether directly or indirectly, be concerned or take part in the management

of a company for such period not exceeding five years as may be specified in the order.”

That goes some way towards meeting your suggestion, does it not?—*Mr. Tracey*: I do not think it covers fraud generally; it covers fraud only in relation to a company.

2079. Your recommendation extends to any offence involving fraud or dishonesty and not merely fraud in the promotion or formation of a company?—Yes.

2080. *Professor Gower*: Your recommendations do go further than that, because section 188 only operates if the Court chooses to make an order. In practice nobody asks the Court to make an order and no order is ever made. You, I understand, want the disability to flow automatically from the conviction on any offence involving fraud?—I would agree with that, leaving it to the individual to apply to the Court to have the bar lifted.

2081. *Chairman*: It puts the onus the other way?—Yes.

2082. Of course, whichever way you put it the Court has power to lift the disability as I understand, but anyhow there has been a further suggestion made by the Board of Trade which may come nearer to what you would like to see. The suggestion is that section 188 should be extended so as to empower the High Court to disqualify any person convicted of an offence involving fraud or dishonesty, whether in connection with a company or not, and that the power to disqualify should cover acting as a voluntary liquidator. That covers your point that fraud or dishonesty need not necessarily be connected with a company. On the other hand, it does not make the disqualification automatic, subject to the success of any application by the individual to be excused the penalty.—*Mr. Hogg*: That is so, Sir. We would prefer it to be an automatic embargo with a right to appeal.

2083. Then he has to show cause why he should be allowed to act as a director again?—That is so, Sir.

2084. Then the next point concerns non-voting shares, which is heading 7,

and I think you would not be in favour of abolishing non-voting shares?—That is so, provided that on all documents they were described as non-voting shares.

2085. You see no sufficient reason for abolishing them as long as they are clearly designated for what they are on the transfer or certificate.—Transfer, certificate and balance sheet; not in circulars of course, but in all statutory documents.

2086. Then what is your view on this proposal? It is to the effect that non-voting shares should be given a right of voting on particular matters or in particular circumstances; for example, on a resolution to wind up or in the event of no dividend being paid for, say, three years. What would you say to that? It is by analogy as it were to the commonest form of rights of preference shares; the preference shareholder has no vote except on certain matters including modification of his rights or the winding up of the company, or if the dividend has not been paid for a certain length of time.—*Mr. Tracey*: Sir, to give a non-voting share the right to vote when the dividend has been passed for a period of time is going too far. The shareholder can look after himself in deciding whether to subscribe for the shares or not. The members of the Association would be in favour of voting rights in the case of liquidation or any resolution affecting the rights of those particular shares including the alteration of objects, by analogy to preference shares, but leaving out the question of voting where the dividend had been passed for any length of time.

2087. Then there is a suggestion that the non-voting shareholder, although not entitled to vote, should have the right to receive notice of and attend at the meetings of the company. I do not think a right to speak is suggested, but it has been suggested that it would be right that these people as members, although they cannot vote, should be able to go to the meeting and hear what is going forward.—*Mr. Hogg*: That, Sir, is a very good idea; we would support that.

2088. Next may we turn to your suggestion about cumulative voting for directors.

I think that is a fascinating suggestion, but one might start with this proposition, might not one, that it would be clearly wrong to adopt that system in so far as it operated, if it did operate, to give control of the board to a minority in voting power of the members of the company. I should have thought that that could not be right?—*Mr. Tracey*: Provided the minority were zealous I do not see why the minority should not be in control, if they happened to be zealous, and the majority did not look after itself.

2089. They would have a race as to who was to appoint directors first?—The majority might simply not exercise their rights. I do not see why in those circumstances the minority should not obtain control.

2090. That is your view, but the other view is tenable, is it not, that the reasonable thing is that the people who are in the majority as shareholders should also be in the majority on the board?—Provided they are equally diligent.

2091. I think in your memorandum on the subject it is submitted that in certain exceptional circumstances it would be possible for the minority to gain control?—*Mr. Hogg*: That is so, Sir, it could happen, but in the United States this practice is very common and has been found to work extremely well.

2092. There is this about it, that it would enable the minority to secure some degree of representation on the board?—That is so, Sir.

2093. Would there be much practical value if they were always in the minority?—Yes, Sir. Their director would know what was going on and would be able to take part in all the discussions at board meetings. At board meetings there is no such thing recognised as a director representing anybody in particular. They are directors as a body for the shareholders of the company as a body, and the director who had been put on the board by the minority would be able to exercise all the same powers as the other directors and the chairman, excepting the casting vote, and that would be a very valuable right.

2094. I think that must be so.—My colleague says that of course if he is a very strong personality he may well be able to talk the others round to his point of view.

2095. But arrangements of this kind would not be necessary in the case of a company carrying on its business in harmony, would it?—That is so, Sir.

2096. Would not that cover a very high proportion of all companies?—Yes, Sir, excepting in private companies. There is undoubtedly a great deal of manoeuvring on the boards of many private companies because the board are appointed by the family as a rule, and that frequently means quarrels. But in public companies 99 per cent. of boards meet perfectly happily, and the question of who represents whom does not arise.

2097. In some of those cases might not the introduction of a system of proportional representation in the appointment of directors lead to disharmony rather than unity?—Not necessarily, Sir. That would depend entirely on the personality of the chairman. If the chairman is competent and tactful, in practice all these difficulties are usually smoothed over, but it must be wrong for an important body of shareholders to be completely disenfranchised.

2098. I certainly see the force of that argument. How would you think of putting such a provision as this into effect? Would you put it in the articles of association, or would you make it a statutory obligation which ought to be valid whether it was in the articles of association or not?—No, Sir, I should leave it as an alternative; a company should be able to adopt the present system or cumulative voting, and the articles of association must say which, so that any shareholder would know when he bought the shares how voting would be conducted.

2099. If every shareholder knew when he bought his shares, how much simpler everything would be, but they come wringing their hands and saying—"I never looked at the articles, I did not know this company had proportional representation."—Then they have lost their remedy if they do not bother to look

at the articles. But the financial records at which an investor looks always mention all the relevant facts, such as capital, directors, auditors, bankers, and they also do show voting, and so you can look at the Exchange Telegraph card and see whether voting is by head or cumulative and make your decision accordingly.

2100. That rather suggests an ideal shareholder, and of course this is one of the basic difficulties in a discussion such as we are faced with here. How far are you going to make concessions to the weakness of human nature?—I do not think we can make concessions here, Sir. I agree that 90 per cent. of investors probably do not look at anything beyond the price and what the broker tells them. But this system operates in America very well, and it does mean that minority shareholders can always be sure that they will at least have one director on the board, and that is the ideal that we are aiming at.

2101. The point does remain that if the majority of the shareholders are stupid, lazy or lethargic they may find control slipping from their hands on the board. But you would accept that as part of the system?—That is so, Sir.

2102. I think that is all I want to ask you about that, except for points on the existing legislation. I understand that this system would only work when all the directors are voted for on the same occasion, is that right?—Yes, you might get a different result if it is staggered in the sense that say one-third retire each year.

2103. Section 183 provides at present that the appointment of each director is to be voted on separately. That would defeat you, would it not, because the majority and the minority would cast their votes *seriatim*, and the minority could be out-voted every time?—Yes.

Mr. Tracey: Theoretically this difficulty about appointment can be overcome by dividing the shares into two classes.

2104. Your point would be the system of retirement by rotation and so on would have to be moulded to suit the proportional representation method; that is what it comes to?—*Mr. Hogg:* Yes, Sir.

2105. The other point is that under the present Act by section 184 there is a power of removing any director at any time by an ordinary resolution.—Yes, Sir.

2106. So that proportional representation could be appointing directors and at the same time section 184 could be removing them?—I think, Sir, that section would also have to be adjusted.

2107. That must be the answer if you are suggesting a new system. You must assume that if it is acceptable it will be fitted into the existing legislation by whatever amendments may be necessary.—Yes, Sir.

2108. I think that is all the questions I have on cumulative voting. Then, next, the much debated section 210, protection of minorities. We had some interesting evidence from the Registrar of Companies, and I think it shows, if I may say so, that your view of the section is unduly pessimistic. Perhaps you might be interested to hear the figures. He has told us that there have been 58 petitions under the section since 1948, of which 34 could be considered successful in some degree for the petitioners; and that many other cases must have been settled without reaching the courts. He also gave his opinion that since the decisions in the cases of *Meyer* (in Scotland) and *Harman* (in England), which had shown that the section was intended to be widely construed, the section would prove even more valuable. So he thinks it is performing a valuable service as it is.—*Mr. Tracey*: I would not have thought the figures justified the conclusion—58 in 12 years; that is five a year, very few indeed.

2109. You would expect more?—When we discussed this in our Association there was a general feeling that the present situation was unsatisfactory. There were a large number of professional people present who had taken advice and for various reasons which they gave it had not been possible to proceed in any of the cases which they had in mind. They far exceeded 58—indeed they ran, I should imagine, into several hundreds. In fact, one member expressed the view that the oppression of minorities was something which was inherent and occurred at some time or another in the case of practically every private company in the country.

2110. In a sense every company must have a majority and a minority, must it not, and if there is any difference between the majority and the minority the view of the majority must prevail, unless it is a fraud on the minority in the sense in which fraud is used in company law; that is the position, is it not?—*Mr. Hogg*: Yes, Sir.

2111. So one cannot in all cases hope to please the minority.—May I give you a very simple example of what does happen? In a very large number of private companies they are family companies and the second or third generation are on the board. They are usually members of the family and they usually quarrel, and at the end of the year the directors will say—"We are only going to pay a dividend of 5 per cent., that is quite enough for them" (i.e., shareholders)—which they do, and then vote themselves enormous remuneration. That goes on all over the country in private companies. Every professional accountant knows this in his own office. That, Sir, is really the mischief we are trying to heal.

2112. Of course, you have got to take into account what salaries are enormous salaries, have you not? Take the case where one brother dies and the two survivors carry on the business. They give their whole time and attention to the business. If they take remuneration which is reasonable for the job one could hardly say they had acted outrageously.—That would be perfectly fair, Sir, if it was the rate for the job; what really happens is that it is often the balance of the profits.

Mr. Tracey: There is no reason at all why the remuneration should not consist of a basic salary and a commission or bonus, depending on profits, because the directors are not successful in their efforts unless they produce profits ultimately. The man may be a very able man, but he is not entitled to be paid a very large salary unless he has contributed to the profits of the business. The whole purpose of the exercise is profits.

2113. If he fails to do that I suppose you would say the proper course is to wind the company up?—No, we are very much opposed to the solution of winding up; we think winding up is not a satisfactory solution. We think the

minority should be protected in some way by application to the Court. It is a question of how far the Court is prepared to go in intervening in the affairs of a company. What we envisage here is that there should be a statement by the people complaining, that the board should put their point of view, and that some interval or adjournment should be allowed in the hope that the parties would arrive at a solution in which an order could be made by the Court with consent. We thought if the Court had power to order directors to attend personally it would have a very chastening effect on directors who were insensitive to the claims of minority shareholders.

2114. This all comes back to section 210, does it not?—*Mr. Hogg*: Yes, Sir.

2115. There have been a number of suggestions made for widening the scope of that section; one particular suggestion being the removal of the criterion of winding up. That is one of the criticisms I think, is it not, that the applicant has to make out a case under which, apart from hardship, a winding up order could be made?—*Mr. Tracey*: To go back to the original point, I think the members of our Association would like to make it clear that they think there are a very large number of cases which need attention, far exceeding the number known to the Registrar.

2116. There seems to be a fairly commonly held view that these two decisions of *Meyer* and *Harman* have tended materially to widen the scope of the section. Have you considered those cases?—No, Sir, I cannot say I have.

2117. The upshot of this is that you are in favour of a wider and a more frequently applied section 210; that is what it really comes to?—Yes, Sir.

2118. Then I think we can pass from that. The next is heading 9, protection of special classes of shares. You suggest that where there are preference shares with no modification of rights clause in the articles of association, articles 4 and 5 of Table A should apply. That suggestion has been made by other people, and the Committee has it under consideration. But there is another point I think germane to that. Do you think that

section 23 should be amended so as to make rights attached by the memorandum of association alterable in the same way as rights attached by the articles? You remember, section 23 allows alteration of the memorandum with respect to matters which could have been contained in the articles, but expressly excepts rights attached to special classes of shares by the memorandum. So the present position is you have to get a scheme of arrangement in such cases.—I should have thought it was an added convenience to be able to alter the rights attached by the memorandum as well as the rights attached by the articles.

2119. Of course the opposite view is that the rights were attached by the memorandum in the hope that they could never be altered. That is the other side of the question.—Yes, Sir, though I think that is a distinction which is not generally understood by the public, and therefore it does not serve any useful purpose, because they do not understand the difference.

2120. But if a shareholder has a right and does not know of it is that any justification for taking the right away?—I am not suggesting alteration should be made in existing cases. But, for the future, I think unchangeable rights of this kind are inconvenient and that our proposals would give adequate protection to special classes of shareholders.

2121. The practical position is that sometimes it is reasonable and proper to modify the rights attached by the memorandum and, as the law now stands, you have got to do it by a scheme of arrangement; this of course involves going to the Court, and involves expense too, but it does protect the holder of the shares whose rights are defined in the memorandum.—Supposing in future rights attached by the memorandum could be altered in the same way as rights attached by the articles, you would still need the shareholders' consent to do it. The shareholder is still protected because he can vote against it if he wishes.

2122. You mean there would be the protection of the separate meeting?—If the modification of rights clause applied to the rights attached by the memorandum

as well as the rights attached by the articles the shareholders' consent to modify these rights would still be needed.

2123. Then we can sum this up by saying that in your view the ordinary modification of rights clauses, such as articles 4 and 5 of Table A, give shareholders all the protection they could reasonably demand. Would that fairly sum up your view?—*Mr. Hogg*: Yes, Sir.

2124. So that there is no objection to making the rights attached by the memorandum alterable?—*Mr. Tracey*: None, provided shareholders' consent is still required.

2125. Then the next point is about Board of Trade inspectors, and you point out the importance of speed in coming into action. Would you agree that, while speed is very important, the mere fact that the appointment of an inspector has been made is likely to damage the credit and reputation of the company?—*Mr. Hogg*: Yes, Sir, I agree to that.

2126. And might it not follow from that that something in the nature of a *prima facie* case, or at all events, something more than a mere *ex parte* unsupported statement should be required before an appointment is made?—That is so, Sir. All we are suggesting is that the machinery should, in practice, be speeded up as quickly as possible. At the moment it does seem an awful long time before anything happens. I am not saying the time has not been well spent, but it should be treated as a matter of extreme urgency.

2127. Of course a factor which tends to take up time is the examination of whatever material there is against the appointment of an inspector?—True.

2128. I have no doubt the Board of Trade are doing the best they can.—I am sure they are.

2129. But that might possibly be improved upon?—Yes, Sir.

2130. The next point is one of considerable importance and it has been much discussed, and that is the disclosure of beneficial interests in shares. You share the view of many other people that it would be most desirable to have

machinery for the disclosure of beneficial interests if practical machinery could be devised?—Yes, Sir.

2131. But you agree that the practical difficulties are considerable?—Yes, Sir.

2132. The suggestion you make, as I understand it, puts the onus on the beneficial owner to make the disclosure to the directors so soon as he has become beneficial owner of more than 10 per cent. of any class of share?—Yes, Sir.

2133. That I think resembles one of the recommendations in the Cohen Committee's Report, with the substitution of 10 per cent. for 1 per cent. One is attacking the beneficial owner, not the nominee holder; but where is the beneficial owner's name to be found; where is his name written?—Nowhere, Sir, but the onus is on him to approach the company. The fact that he has put his shares in the name of a bank hides it as far as the company is concerned, but if anyone has bought 10 per cent. or more of the capital on the Stock Exchange, he should have a duty to advise the company that he has done so.

2134. But if the company does not know who he is and the directors have no means of finding out who he is, it would be difficult to enforce.—It may be difficult, but it at least would put the board on inquiry. What happens is that the board suddenly finds that Mr. X through ten or fifteen nominees has bought 20 per cent. or 30 per cent. of the share capital, and he then comes along with proposals.

2135. You say the general state of affairs would be disclosed in transfers which come before the board, do you?—No. The transfers would only show the names of the nominees.

2136. Quite; that is my view.—We get someone buying the shares of the company, and once he has got 10 per cent. in whatever name he has put them, we say he should have a duty to advise the board that he has got 10 per cent. or so many shares.

2137. You put that obligation on him, and you would say if he does not perform it he is breaking the law; that is how you put it?—That is right, and his voting power should be restricted.

2138. We will come to that later. I am thinking now of the sanction, as they call it. I am only suggesting that if the beneficial owner lies sufficiently low he will not be found out.—He will be found out in the end, Sir, because if he is buying control or buying a big block of shares he is buying them for a purpose, and sooner or later it is bound to come out. Then it would come out that he has had 10 per cent. for a long time, which is a position he would not wish to be in if he had a duty to disclose it.

2139. Then consider the other aspect of this—the perfectly innocent man who has beneficial interests in the shares of a company and has no intention whatever of using these for any nefarious purpose; he might not even know he has 10 per cent.; if he has interests under trusts with wide investment clauses he may not know what the total is at all?—That is so, Sir, but could there not be some form of excuse for a perfectly innocent breach?

2140. That would introduce a complication, would it not?—It might happen, Sir, in a few cases, but I think it would not happen in many. In a company with a large capital there are not many big shareholders; the big shareholders are institutions. A big holding in most companies would be 10,000 or 15,000 shares out of 500,000. I do not think you will find many individuals or trustees, excepting for pension funds or institutions, owning anything like 10 per cent. of the capital.

2141. So that the class affected by your suggestion would be a limited one?—Yes, Sir.

2142. I am still not quite happy about the innocent man. You suggest that the beneficial owner who fails to comply with your proposed legislation should be subjected to a heavy penalty?—*Mr. Tracey*: I am afraid my approach has been entirely different. I have never seen what justification there is for the directors finding out and getting this information before anybody else. I take an entirely different view.

2143. You take another view; but to pursue the view that Mr. Hogg is putting

forward, one does get the position, theoretically at all events, where somebody holding 10 per cent. of the share capital of a company in point of beneficial interest is exposed to a heavy penalty because he has not reported his beneficial interest to the board.—*Mr. Hogg*: That is so, Sir; I cannot deny it.

2144. Speaking for myself, I would be most disappointed if a letter came to me from a company and I opened it expecting a dividend and I received a summons for having more than 10 per cent. of the beneficial interest.—Could we say, Sir, that the penalty should only operate by leave of the Court?

2145. Yes, we are getting round to the inspector again, are we not? Because you remember the section of the present Act under which an inspector is empowered to do this very thing; he can find out to whom shares truly belong.—Yes. The only mischief we are trying to cure is the cases which are coming to light from time to time now; someone suddenly announces to the board—"I now control 45 per cent. or 51 per cent. of the share capital; I want to see the board, I want to appoint directors, I want to sell the properties, I want to control the company"—and up to that point of time the board had not a clue anyone was interested. That is the mischief we are trying to meet.

2146. *Mrs. Naylor*: How would the board of directors meet that mischief except by going out and buying shares on the market themselves because they knew there was a very powerful competitor in the market?—That does happen, excepting that where they have a very powerful holder the directors could not possibly enter into competition with him.

2147. *Chairman*: Ought they to do so, anyhow?—No, they should not do so in any case.

2148. What we are coming to is that there is no objection to one of these large operators buying all the shares he can in the company in the market provided his name is disclosed?—That is so, Sir.

2149. Once he is doing it under cover so that people do not realise what is happening then he has committed an offence?—Yes, Sir.

2150. *Chairman*: What relevance does the question of acting in one's own name as opposed to acting in the names of nominees have from the point of view of the directors or the shareholders or anyone else?

Mrs. Naylor: Why should he not be anonymous? What is the moral case against anonymity?—Many of these financial schemes are not necessarily in the interests of the company as a company. They may completely change the whole of the company's history. You may find the company is going to be amalgamated with all sorts of other businesses which it knows nothing about, and the damage is done; the directors are quite helpless.

2151. Are they less helpless if it is known who is acquiring the stock?—They are less helpless to the extent that if they receive a notice that X has bought, say, 10 per cent. of the share capital they could write to him and say—"We see you have acquired these shares; would you come in and have a talk with us". They would ask him to come in and tell them what is in his mind. At least they would know there was something in the offing. At the moment the board of directors knows nothing whatever about it until it has happened.

2152. *Mr. Brown*: Would you suggest that if the directors had this information they might in appropriate cases think it right to advise the other shareholders so that they would be warned and would not necessarily sell their shares at too low a price? Would you have that in view?—That might possibly happen.

2153. *Chairman*: Of course there are other transactions, are there not, besides buying control which may be aided by the use of nominees?—Yes, Sir.

2154. An operator, having gained control of one company, may finance it in some way through a company controlled by a nominee or, shall we say, a financier having obtained control of one company proceeds to lend large sums of money to another which apparently is an independent concern but the shares in which are held by him through a nominee.—That is so, Sir.

2155. I can see the potential mischief of a transaction of that kind.—We

admit, Sir, this is not watertight, but we feel it is better to have something than nothing. But we admit one can drive a coach and four right through it if one wants to.

2156. Of course one has to remember that in discussing legislation one is discussing legislation which will apply to every company up and down the country, great and small, well managed and badly managed.—That is so.

2157. So that a procedure which might be feasible for one type of company might not be feasible for another.—That is so, Sir.

2158. Now, Mr. Tracey! You were showing signs of mutiny just now.—*Mr. Tracey*: The view that has been expressed by Mrs. Naylor is my view also. I have never understood what the justification for insisting on disclosure of beneficial interest really was. I cannot see what benefit it can be to anybody except to enable the board to defeat the objects of the person trying to take the company over; and presumably the person trying to take the company over is interested because he is able to employ its assets in a rather more profitable way. It seems to me to be defeating what may be a very good purpose.

2159. You see no harm in an individual doing this through a nominee?—No, Sir. If there is to be disclosure I should have thought that the nominee was the person on whom to impose penalties, because he is in a position to know who is the beneficial holder, and he is not benefiting personally unless he holds shares also beneficially. If he is a pure nominee he is not getting anything out of it and I should have thought there were very few individuals who would be prepared to incur legal penalties where they were not benefiting themselves.

Chairman: This would give all the bank managers in the country a nervous breakdown!

2160. *Professor Gower*: And besides, if the take-over bidder is operating through a variety of nominees none of them will know he has gone over the 10 per cent. mark.—That is so. My view is that it is impracticable and that it will not

work satisfactorily, and I cannot really see the moral sanction for it.

2161. Mr. Hogg's point presumably is there is no harm in a man taking over control, but he ought to do it openly, and not conceal the fact that this is what he is doing, is not that it?—*Mr. Hogg*: Yes.

Mr. Tracey: It is an objection to secret methods then?

2162. Yes. It is one thing to allow a take-over of a company but the law should not permit it to be done under a smoke screen?—*Mr. Hogg*: I would agree with that.

2163. *Mr. Lumsden*: Would not Mr. Tracey agree one of the main purposes of doing it under a smoke screen and through a large number of nominees is to acquire the shares at a lesser price than would have to be paid if it were done openly, thereby defeating the interests of the existing shareholders of the company?—Yes, that is a very good point. It is taking advantage of a lack of knowledge on the part of the holders of the shares.

2164. *Mr. Brown*: If the directors are aware a holder has more than 10 per cent. and call him in to ask him what he is about, he does not have to answer, or even come in.—But they would at least know something was in the wind.

2165. Something might be in the wind.—*Mr. Tracey*: Is not the reply to Mr. Lumsden's question that the shares may be worth more in the hands of the bidder than in the hands of the existing holders, and therefore the bidder is entitled to the profit that he makes.

2166. *Professor Gower*: Surely what he is proposing to do is, let us say, get 20 per cent. as cheap as he can, and then make a take-over bid for the rest. Surely there is something to be said, on the grounds of general equity, for all the shareholders being told about this possibility as soon as possible so that they do not then sell at the cheaper price? Is this not relevant information which shareholders ought to be given before they decide whether they will sell on the market?—That might apply where he

is buying privately, but not where he is buying through the Stock Exchange, for he is then buying at market price.

Mr. Brown: His purchase will affect the market price.

2167. *Professor Gower*: But presumably he will go on doing this as long as he thinks he can get shares at a lower price than the one he must offer on a take-over bid. There is this point, if you make the man make a general offer as soon as possible it works to general equity so far as all the shareholders are concerned, and that would be a good thing, would it not?—By employing nominees the bidder attempts to conceal from the holders the fact that he wishes to buy all or nearly all their shares; that is the element affecting the price that is hidden and it may be nothing relating to the company or the real value of its assets.

2168. *Chairman*: One can try an analogy by taking some entirely different kind of property. Imagine that I am the fortunate controller of a company possessing a chain of 600 grocery shops up and down the country, and there is one particular place, Little Bedstead, where I have as yet got no branch. A corner site comes into the market, just the thing I want, and I know that if other people know that my chain store is after it they will hold me up to ransom. I therefore do it through a nominee, and when the contract is concluded I say "Thanks very much, please transfer the property to United Groceries Ltd.". Have I done anything wrong?—*Mr. Hogg*: No, Sir, not a bit.

2169. If I have not done anything wrong in that case why should I have done anything wrong by buying shares through nominees?—*Mr. Luxton*: If a notice came in to the directors that an undisclosed buyer had bought 10 per cent. of the shares, it would certainly put them on inquiry, and if they knew that their balance sheet was very much underestimating or undervaluing the assets, it would surely be a very good thing for them and for the shareholders if the next balance sheet really did reflect the asset values. There are many companies, where the asset values in the balance sheet do not in any way reflect the true

value of the company, and anyone who bought up the shares secretly could take advantage of the shareholders because they did not know the true position.

2170. *Mr. Brown*: Is not the remedy for such undervaluation of assets in the hands of the directors who can state a more realistic value?—Yes, and quite a lot of big companies do every so often revalue the assets, but many companies do not.

Mrs. Naylor: Perhaps the companies Mr. Luxton is thinking about do not make large enough profits to wish to make the balance sheet values bigger than they are? Perhaps they are not making profitable use of their resources.

2171. *Chairman*: I think I have only got one other point on this, and that is the time factor. It may not take an active operator very long to gain control through nominees. Do you think your machinery of disclosure could be brought into action soon enough to prevent any plan of securing control through nominees?—*Mr. Hogg*: That, Sir, is very hard to answer, but an operation of any magnitude would probably take some weeks. If you are going to set out to get 30 per cent. of the capital of the company you might spend two or three months on it, it would be done slowly because otherwise it would immediately put the price up; if there were persistent buying day after day the jobbers would mark up the price immediately, and so an operation of this magnitude would be done over quite a long period of time.

2172. And do you think that would be time enough?—I think so.

2173. *Mrs. Naylor*: What about buying options? When should they be reported?—The bolder of an option can call the share at any time within the period of the option, within one day, or three months, or whatever the option time is. It should be reported when it is bought, and not when it is exercised.

2174. *Chairman*: I do not think we can carry this subject further. It is a point of importance and many other suggestions have been made of ways and

means to enable disclosure to be enforced.—I am sure they have, because it is a very, very debatable subject, and it has been debated for many, many years.

2175. And at all costs one must really avoid inconveniencing the general run of honest shareholders and directors.—Yes, Sir.

2176. You would agree to that?—And at the same time avoid putting any difficulties in the way of usage of nominees for perfectly straightforward purposes. We would never suggest that there should be no such thing as nominee shareholders because nominees are a very essential and useful part of ordinary legitimate business.

2177. Then the next is under Heading 15, which deals with loan capital and you invite somebody to define a debenture. That is a task from which I recoil with some horror, because I do not know if you have studied the cases about that, but almost any document evidencing a debt has been held to be a debenture.—As I understand it, Sir, the word debenture goes back to about the sixteenth century when it was used when an army requisitioned horses and fodder and they gave what we would call an I.O.U.; it was called a debenture. Most people think a debenture does carry a charge although it may not. We suggest that the word should never be used for a simple debt which does not carry a charge.

2178. Surely what they used to call naked debentures are not wholly unknown?—We think the word is a misnomer, because it does imply to the uninitiated that it is a mortgage.

2179. *Professor Gower*: The Stock Exchange will not let a naked debenture be so described. Surely they insist upon calling it an unsecured loan?—Yes.

2180. *Chairman*: The vast majority of debentures in the narrow sense are secured.—Yes, Sir.

Chairman: No doubt the Committee will consider that point, but I think it is very difficult.

2181. *Mr. Watson*: Have you any evidence of unfortunate results emerging

from this lack of knowledge that a debenture may not carry a charge?—No, Sir, I cannot say I have.

2182. *Chairman*: The next point concerns exempt private companies, and I gather your view to be that an exempt private company, like any other company under the Act, should have a proper annual audit by auditors qualified under the Act?—Yes, Sir.

2183. If you go so far as that, do you see any objection to these audited accounts being filed at Bush House?—There is a rooted objection by exempt private companies to filing a balance sheet. The decision by a majority of our Association was that exempt private companies should not file a balance sheet, although there was considerable discussion as to whether that exemption should continue once they were trading and incurring liabilities; but the Association decided by a narrow majority that the law should remain as it is at present and that is therefore our recommendation.

2184. Now I think that is everything I have in mind to ask you, except to refer to the matter of the title of Chamber of Commerce, which is a matter to which you attach great importance. I would just like to ask this: so far as incorporated chambers of commerce are concerned, are you satisfied with the existing position?—*Mr. Luxton*: Yes, Sir. In practice we find no difficulties at all as far as chambers that are incorporated are concerned, because the Board of Trade before they agree to incorporate them with that title make a number of enquiries, and they have truly to represent the area, and they have to be viable from the point of view of finance; so that I think the provisions so far as incorporated chambers are concerned are quite satisfactory. The difficulty arises because there are quite a number of unincorporated chambers of commerce, and there is no protection there at all. Any one or two people can set up a chamber of commerce, can carry on what is alleged to be a chamber of commerce. Another problem is that by practice the word "commerce" has been limited in our thinking in the movement to people who are engaged in commercial activities, industrial activities, rather than in retail

trade. By practice one now regards the chamber of trade as being essentially a retail organisation, whereas the chamber of commerce covers in most cases all forms of commercial and industrial activity. In some cases the latter do include retailers, in other cases they do not. The main protection that we would like, is that there should be the same sort of inquiry by the Board of Trade before an unincorporated body is permitted to use the name Chamber of Commerce as there is now under the Companies Act in respect of an incorporated body. The Registration of Business Names Act is limited at present to people carrying on a business for profit and it cannot therefore be used to control the use of the title Chamber of Commerce. The chamber of commerce is a body set up for the promotion of commerce. It is not set up with a view to making a profit. We think the Act should be amended so that unincorporated chambers of commerce would come within its scope.

2185. You are interested in chambers of commerce in industry and in commerce rather than in retail trade?—Yes, we are.

2186. And this I suppose will extend to all branches of commerce within a particular area?—Yes.

2187. I think you would agree, would you not, that there must be many institutions and associations up and down the country which make no profit but which seek to further the activities of a certain section of industry, and going out of commerce you may have other "non-profit" concerns carrying on various social activities and none of these at the moment I think is liable to registration.—They are not, in the same way as the bodies that are not carrying on a business are not registered, and so there is a very big loophole as far as any form of protection for the chamber of commerce is concerned. This could very well lead to abuse, especially in the light of the position of the chambers of commerce on the Continent where they are State organisations in a very large number of cases; foreigners coming here regard the chambers of commerce as being bodies which have authority. In Pakistan, for

instance, the Government has had to step in because of abuse of the name Chamber of Commerce. If some means could be found to protect the name Chamber of Commerce in respect of unincorporated bodies it would very largely meet our case.

2188. If we could get down to some concrete proposals you have about this, it would suit your requirements, as I understand it, if the Registration of Business Names Act were extended so as to confine the use of the title Chamber of Commerce to associations complying with certain prescribed requirements?—Yes.

2189. So that it would be put on the Board of Trade to consider applications from self-styled Chambers of Commerce to be recognised. The Board of Trade would then investigate their activities and grant or refuse registration in much the same way as it acts now in the case of an incorporated body?—Yes.

2190. And that would meet your every wish, as I understand it?—It would certainly go a very large way to meeting our problem.

2191. But, of course, one can only do what is desirable so far as it is practicable, and I am told that the administrative difficulties of these investigations could be very considerable.—You see there is only one chamber of commerce for each town or each county, and once it has been formed it has been done.

2192. *Mrs. Naylor:* Assuming no rivals are set up.—That is one of the problems at the moment. In the London area although the Board of Trade has recognised the London Chamber of Commerce as being the chamber of commerce for London, there are all sorts of other organisations being set up in the London area which are largely retail bodies, and the same has applied in some other areas—Birmingham and the bigger cities. There is conflict.

2193. *Chairman:* Is there not the danger that if registration of chambers of commerce was provided for by the Registration of Business Names Act by means of amendment, the Board of Trade would find itself called upon to adjudicate upon

claims by one association strongly objected to by another?—I think once they have recognised one organisation in a particular area on the grounds that it truly represents that particular area as far as industry and commerce are concerned, and the annual return, and so on, shows that it continues to do so, it would not be difficult to refuse any other organisation which tried to set up in conflict.

2194. In other words the effect of registration under the Act would be to give a monopoly to a particular existing association in the use of the words "Chamber of Commerce"?—I think that would be so. Once you have an organisation which truly represents an area, there is no reason why it should not have a monopoly.

2195. It is rather a sweeping suggestion.—That is in fact what happens under the Companies Act as far as the incorporated bodies are concerned. Once the Board of Trade, for instance, had recognised a body representing, say Nottingham, they would never recognise another Nottingham Chamber of Commerce.

2196. They would have to be satisfied that this association did represent some proportion, I suppose, of people engaged in commerce in the area?—Yes. Once they had recognised an organisation it would eliminate the need for any other organisation.

2197. I think we have your point now, and it will in due course receive consideration, with what result I cannot pretend to say.—Thank you.

2198. Those are all the questions I wish to ask but members of the Committee will no doubt wish to put some questions.—*Mr. Hogg:* My Lord, have I your permission to speak about heading 6, Directors' Duties?

Chairman: By all means.—You will see from our memorandum that we feel that it is eminently desirable to try and give the force of statute to what are the duties of a director, but we found a difficulty in framing the words. However, I have found the Companies Act, 1948, of the State of Victoria in Australia has met

this position to some extent. It is section 107, if I may read it, and subsection (1) provides quite simply that a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office. Subsection (2) provides that an officer of a company shall not make use of any information acquired by virtue of his position to gain an improper advantage for himself or cause detriment to the company. That would go a long way towards meeting the objection many of us have to the decision *Percival v. Wright* upon which our London Chamber of Commerce have submitted a separate memorandum. I was Chairman of that committee too. We many of us strongly feel that the decision *Percival v. Wright* is unjust and unfair, and if we could have something in the Act on the lines of subsection (2), I think it would go a long way towards helping us.

Chairman: It would have more or less a moral effect. I am much obliged for that suggestion.

2199. *Mr. Watson:* I would like to come back, if I may, to the comments by Mr. Hogg on section 210. I gathered that you were concerned about the situation that emerged—I gather from what you said quite frequently—where in private companies the directors vote themselves enormous remuneration—I think that is what you said—and very small dividends.—Yes, Sir.

2200. And you would regard this as oppression of the minority?—Definitely.

2201. Would it meet your case if there were some instances of oppression defined in the legislation, and that under-distribution of profits or the decision to divide profits unreasonably were specifically referred to?—Yes.

2202. And you are clear in your mind that up to now no action has followed upon representations of a situation of that kind?—That is so, Sir. Actually nothing ever does happen. There is usually a most terrible row at the meeting, and then nothing happens, but oppression has taken place, and all of us in accounting life meet this quite frequently in our

offices and these things do not ever get to the Court.

Mr. Tracey: In the case I mentioned earlier when criticism was made of the directors' remuneration, and of the smallness of the dividend, it was pointed out to the directors that the proper thing was for part of their remuneration to depend upon profits. The reaction of the directors was to give themselves long term service agreements, ten to fifteen years at fixed salaries, with no reference to profits at all. The articles in that particular case enabled the directors to do so.

2203. You think that legislation should empower the Board of Trade to investigate situations of that kind?—I would prefer application to the Court. The other case is where the company insists on ploughing back profits though there may be elderly shareholders who are more interested in distribution of profits. The company ploughs back profits because it wishes to expand, without investigating the possibilities of raising capital outside the company.

2204. I see. Thank you very much.—Could I just add one more thing? Under section 210 the Court can order the purchase of the shares of the minority but I do not think that is a solution because it is very difficult to say what the value of shares should be. I know cases where the people who have been oppressing the others have not got the money with which to pay for the shares. Moreover, in arriving at the price the difficulty is that you have to assume a state of affairs which never existed; you have to assume that there has not been oppression, and that the board have been much more active than they have been in fact in conducting the business; you have to prove the profits would have been greater, and you have to prove the company has extremely good prospects which are not fully reflected in the price that is being offered. It is a very difficult matter to arrive at a price which really does have regard to all the relevant factors.

2205. Yes, I can see that. I was thinking more of the distribution of profits to existing shareholders, and what you seem

to have in mind is that the Court should be able to direct a company that it must pay a higher dividend, or that it must revise the terms of the remuneration of directors?—What we had in mind here was there should be an opportunity for the board to state their case. Those being oppressed may be entirely mistaken, and there should then be an opportunity for both sides to get together, and if they cannot get together the Court would make an order, but the preferable thing is for the Court to make an order by consent which has been agreed in the meantime. If the Court has to make an order because the parties cannot get together, then it has to have a statement of their view from the board which will enable the Court to make the appropriate order.

2206. *Mrs. Naylor*: I am wondering whether society really owes a duty to provide Courts to act as arbiters in family quarrels over family businesses? Such companies already have considerable privileges under the Act. I think I could put up a case for the public quoted company—in the national interest you want to encourage sales, you want to encourage investment; but what is the moral justification for requiring the community to provide Courts to settle these points in the case of private family businesses?—Some of the private companies are very large; indeed they are much bigger than some of the public ones. In the first place there is the interest of the employees, and there are the interests of the community the company purports to serve. I think that is the reason why the Court should intervene, and they should, I would have thought, intervene to redress an injustice in a case where somebody through no fault of his own has found himself in a difficulty. It is not always a family quarrel. It may be the widow of the man who has built up the business and she finds the business being conducted in an unsatisfactory way by people who are no relations of hers at all. That is I would have thought the commonest case.

2207. You frighten me with your talk of a quarter of a million of these oppressed minorities. You said somebody had suggested that there was an oppressed

minority in every private company in the country?—I think the comment by our member was that this is an abuse which is inherent in private companies, and exists at one time or another in nearly every private company.

Mr. Hogg: It is very common.

2208. I can imagine that in a few cases the outside objective person might see the appropriate solution, but I think in quite a number of cases it might not be easy for them to do so.—I am sure that if the section enabled the Court to order the directors to state their point of view, it would have a very chastening effect indeed. In my own personal experience, reading paragraph 59 from the Cohen Report has had a very chastening effect—where directors had been paying excessive remuneration to themselves they have been very startled indeed to see that that was one of the things the Cohen Committee had in mind as a form of abuse.

2209. *Mr. Scott*: I would like to ask a question on unissued shares. As I understand your view it is that where directors propose to issue shares for cash they should be offered *pro rata* to the shareholders, and that would not apply to shares which they proposed to issue for considerations other than cash?—That is so.

2210. And I take it that if the directors wished to act otherwise that would have to be resolved by the company by ordinary resolution. If so, do you see any objection to that being done at the time the shares were created? In other words if the company authorised an increase in the share capital as they do at present by an ordinary resolution, and at the same time resolved that the shares should be at the free disposal of the board, would you see any objection to that, even if they did not issue them immediately?—If the board have a general power to do what they like with those shares, they could issue them for cash to themselves, which is the one thing we do not want them to do.

2211. You would not allow the company even to have the right to say the shares were to be at the disposal of the board?—What we are trying to say is that shares issued for cash should be

offered all round, and not to a selected body.

2212. That is ordinary shares?—Yes.

2213. Not preference shares?—No.

2214. Then you would say equity shares may only be issued for cash to members *pro rata*. Even if the company chose otherwise to resolve?—If the members were called together and the whole circumstances were explained to them, and they resolved that they issue them to the directors, I would have no objection. The objection is to cases where directors have issued them to themselves and the shareholders have only heard about it when they have seen the balance sheet.

2215. In other words you would authorise an issue of cash for equity shares to persons other than the shareholders *pro rata* if a specific authorisation to each such issue was given by the company in general meeting?—Yes.

2216. You mentioned the question of improper loans, in other words a loan made by a director otherwise than in the ordinary course of business. Your recommendations would not extend to such loans if they were sanctioned by the company in general meeting?—If the company in general meeting authorised it, we should have no objection to it.

2217. Your recommendation would not then meet the point which you mentioned earlier, which was where directors obtained 51 per cent. of the votes; in such a case, improper use of the company's funds for borrowing and lending to another company would be authorised by a resolution by virtue of the directors' 51 per cent. holding.—It does not meet it, but it does bring the whole thing out into the light of day.

2218. On voteless shares, do you suggest that, assuming voteless shares were to have a vote by law, in the event, as was suggested in discussion, for example of winding up or if a dividend had not been paid for six years, they should automatically have a controlling vote in those circumstances?—It might be possible. If their voting rights were very powerful, and there were sufficient of them; cases do happen where preference shareholders do control the company.

2219. Exactly. You would not see any objection to the law permitting voteless shares, as it does at present preference shares, to have the preponderant vote, assuming voteless shares were given votes in certain circumstances?—I do not think we would.

2220. How many members does the Association of British Chambers of Commerce have?—*Mr. Luxton*: The Association has 99 affiliated chambers.

2221. Do you have any discipline or control over your members?—The Association really is a policy co-ordinating body. It does not direct its chambers, and the chambers affiliated to it are completely autonomous bodies. It really exists to co-ordinate policy.

2222. Would you be, as an Association, in a position to make recommendations to the Board of Trade as to the desirability of any organisation being allowed to call itself a chamber of commerce?—Yes, and in the case of incorporated chambers the Board of Trade does normally approach the Association, and that is one of the safeguards.

2223. *Professor Gower*: One question following on from Mr. Scott's question. As I understand it you do not want preemptive rights to be accorded to existing shareholders, except in the event of a cash issue of shares, and obviously they could not in fact be given in other circumstances. On the other hand it would be possible, would it not, to provide that shares should not be issued for a non-cash consideration, or at any rate there should be no sizable issue of shares for non-cash consideration, unless the company in general meeting approved. That would mean that in any case where a business was to be acquired the agreement would have to be expressed as a conditional one, conditional upon the shareholders' approval. At the moment this happens when the company needs to increase its authorised share capital, but does not happen necessarily when the company does not need to increase its authorised share capital; so at present the question of whether the shareholders are consulted depends purely on the chance of whether the company has sufficient authorised

shares available. What are your objections to legislation providing that in those circumstances the shareholders should always be consulted?—*Mr. Hogg*: Only that the powers of the directors are being definitely lessened, and in practice it frequently would be found that an opportunity of purchasing a good business had been lost.

2224. Is that true? I have known a number of cases where conditional agreements of this sort have been drawn up. I have never experienced any difficulty in getting the shareholders to ratify the conditional agreement. I have never experienced a case where the other side have refused to enter into the deal on this basis. You have?—No, I admit I have never had a case of any difficulty, but I am very anxious indeed not to limit by legislation the powers of directors.

2225. I wonder whether in the case you gave earlier, Mr. Hogg, where you said the other party had insisted on signing an agreement within 24 hours, would they have accepted a conditional agreement?—No, they would not. I tried. The other side just would not have it. They said: "The deal is on today or tomorrow, or it is off."

2226. *Mr. Brown*: Would that position arise if the law provided that the deal could not be other than conditional?—In the case which I am mentioning they would not have taken over the undertaking, because the liabilities were immense.

2227. *Professor Gower*: May I ask one other question? In connection with the disclosure of beneficial ownership, when there is, say, a pending take-over bid, the Chairman put to you the analogy of the man who wants to buy a corner site and does it through nominees. Could I put to you another analogy which I think is rather closer? Let us suppose that there is an estate, the beneficial ownership of which is divided into 100 undivided shares. I want to buy the whole estate, and I propose ultimately to approach the trustees for this purpose, but I realise the total of all the undivided shares will be worth, and will fetch, less than the estate

as a whole, so I decide that I will try and buy up as many of the undivided shares as I can before approaching the trustees. I therefore, through various nominees, approach some of the beneficial owners and succeed in persuading them to sell their shares to me. This, surely, is really the analogy with the company, is it not? Would you regard that sort of behaviour as rather sharp practice?—No.

2228. You still would not?—No, I do not see anything wrong in that.

Chairman: In practice, of course, the purchase of an undivided share would now be a purchase of a share in proceeds of sale, and would have to be notified to the trustees, or else the purchaser would find himself ousted by someone who got his notice in first.

2229. *Professor Gower*: He could buy and have a binding contract.—*Mr. Tracey*: What the buyer tries to conceal is the fact that he is an extremely keen buyer.

2230. That he really wants the whole thing?—Yes.

2231. I want to make sure whether you would regard that as sharp practice?—I do not see why he should not conceal the fact that he is a very willing buyer.

2232. *Mr. Brown*: The question of shares with no votes is one on which there are quite a lot of conflicting views. You start your memorandum with the words "Since non-voting shares have their legitimate uses" and I think it would be very helpful if you would describe the area in which their use is legitimate.—*Mr. Hogg*: They do have a considerable value. A small block of voting shares controlling a company with a large block of non-voting shares is undoubtedly a source of strength against a take-over bid, and there is nothing wrong or illegitimate in that. The founders of a business like Marks & Spencer introduced non-voting shares, and nobody in that business could complain that the voting shares are improperly used or the management is bad. In fact it is a very fine thing for the shareholders of Marks & Spencer that the control is in

the hands of quite a few people who are extremely experienced, and who have undoubtedly done a wonderful job over the course of 30 years. And the same thing applies I think to Lyons. Therefore there is considerable advantage, and a perfectly legitimate advantage, in having a non-voting share as well as a voting share. Those are just examples that come to my mind straight away.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

MR. W. R. BALLANTYNE AND MR. R. D. FAIRBAIRN *called and examined*

2233. *Chairman:* We are very much obliged to you for your useful memorandum, and for coming to help us with your evidence today. For the purposes of the record you are Mr. W. R. Ballantyne, Chairman of the Committee of Scottish Bank Managers, and General Manager of the Royal Bank of Scotland, and Mr. R. D. Fairbairn, General Manager of the Clydesdale and North of Scotland Bank Ltd.—*Mr. Fairbairn:* That is correct, Sir.

2234. The Committee have, of course, read your memorandum so it will not be necessary to ask you questions on every point. We will select the points on which it seems discussion might be useful. First of all, you say under Heading 1 that you would like to see the minimum membership of private companies increased from two, and you would like that in order to avoid the administrative difficulties which can arise from death or incapacity. How far would your views be met if it were made obligatory to have two directors of a private company?—It is only a practical difficulty, but it arises sometimes in dealing with cheques and authorities for the release of securities, etc. Sometimes there are only two members and one dies, and the banker is then faced with the difficulty of not having a proper mandate for the release of funds and the uplifting of securities.

2235. If you had a minimum of three members, would you be better off in that respect?—Yes. Normally we have a

Mr. Tracey: And where shares are held overseas too, very often they are non-voting shares without any objection at all.

Chairman: Those, gentlemen, are all the questions we can think of with which to trouble you and we need not keep you further. We are very much obliged to you for coming today, and for being so helpful. Thank you very much indeed.

mandate of two directors—that is very common—and if you have three members the chance of suddenly being left with less than two is very much less than when there are two.

2236. If you had two and are left with one, why are you worse off?—If we require two signatories and one dies, there is a hiatus when you have really no mandate.

2237. The signing powers would be given to them jointly?—That is the arrangement in the majority of cases at present.

2238. But the immediate difficulty could be got over by authorising the two members, or either one of them, to draw on the account?—That is right. Sometimes we have a mandate to that effect and there is no difficulty.

2239. It may interest you to know that we have had suggestions that it is nonsense to require a minimum of two members, and that one ought to be quite enough. I take it you would not subscribe to that view?—From the practical point of view, no.

Mr. Ballantyne: We do say later in our own memorandum that we are not against the one-man company. But from the practical aspect we take the view that, the fewer members a company has, the more likely one is to be faced with a situation in which there is a hiatus during which no one is left to carry on the affairs

of the company. If there are two members, the company might be left suddenly without anyone to carry on its business if they should both die. It is only a practical point, and we do not attach a great deal of importance to it.

2240. You would prefer, say, three to two; or would you have seven for all companies, private as well as public?—I think we were thinking here of more than two. Three would meet the point that we make.

2241. As regards *ultra vires*, that very vexed question, you would be in favour of abolishing the *ultra vires* rule so far as companies' dealings with third parties are concerned?—Yes.

2242. You would retain the objects clause but for the purposes of internal management only?—That is our submission.

2243. That links up with what you say about the borrowing powers of directors later in your memorandum.—And also in regard to section 54. We take the view throughout that the rights of third parties dealing with the company without notice of any irregularity should not be affected by the irregularity.

2244. Of course, if your preferred view about *ultra vires* were accepted, that would carry with it the complete answer to your difficulty about directors' borrowing powers, would it not? Because the company would have all the powers of a natural person to borrow money.—That is true.

2245. So that would solve the difficulty you raise later on about what is meant by temporary loans obtained from companies' bankers and so forth. Most of these difficulties would disappear because a company, under its general power, could borrow as much as it liked.—Yes, but we make a separate submission in case you are not prepared to recommend our general solution. In other words, if the doctrine which we propose with regard to the *ultra vires* rule is not incorporated in any future Companies Act, then we would like some alteration to be made in the provisions regarding the borrowing powers of directors.

2246. You have doubts about what is meant by temporary loans from companies' bankers in the ordinary course of business, and the express notice that the borrowing limit has been exceeded. Those are the two points you want clarified if the *ultra vires* rule is not abolished?—Yes.

2247. On the assumption that the *ultra vires* rule were abolished, you might get this situation. You might get directors seeking to borrow from a bank in the teeth of a resolution of the members that they were not to have any authority to borrow any more. How would you view that on the footing that there was no *ultra vires* rule? Could the bank go ahead and lend the money well knowing that the members of the company had voted against it?—No. I know of no case where the members of a company have said that the directors must not exercise their borrowing powers, or are only to exercise their borrowing powers up to a certain limit. But in any such case, I am quite sure that a banker, who had notice of the resolution, would not lend to the directors of the company in excess of the limit specified by the members.

2248. I was trying to test the scope of the abolition of the *ultra vires* clause. Would it mean that you could wholly disregard what went on inside a company, and simply rely upon the fact that the company had all the powers of a natural person?—Mr. Fairbairn: Does this presuppose eliminating from the articles of association—as distinct from the memorandum—all reference to directors' borrowing powers?

2249. Yes.—It does? At present we look always at the directors' borrowing powers as set down in the articles, and we are a little afraid of the interpretation of article 79 which was introduced in the 1948 Act. We are a little afraid of it, because of the word "temporary" and because of the word "loans". We in Scotland nearly always lend on overdrafts whereas in the City and West End loans are more frequently used. As we work on overdrafts and as we are not sure that temporary loans covers overdrafts it gives rise to uncertainty. We would like

to suggest that, if you are going to incorporate a reference in the articles of association to directors' borrowing powers, the article should be phrased a little wider so that we are not put in any difficulties. We are uncertain, too, of the phrase "in the ordinary course of business".

2250. And your desire to have the matter cleared in this way would remain on the footing that the *ultra vires* rule remained as it was?—Presuming that the members wanted to limit the directors' powers in the articles, we would still pay attention to the articles.

2251. Even if the *ultra vires* rule were abolished, you would still have notice of and obey any restriction in the articles?—I would feel that way, yes.

2252. I do not want to take up much time on this, but the other view, of course, is that if you abolish the *ultra vires* rule then the company, *vis-à-vis* a third party, will have all the powers of a natural person and no one dealing with the company will be concerned with any limits put on borrowing or anything else.—So far as it is not qualified by the articles. If the articles qualified that in any way, we would have to pay attention to it.

2253. I think I have your point.—*Mr. Ballantyne*: I would like to answer your question in this way and I am here speaking personally rather than on behalf of our committee. I would prefer the complete abolition of the *ultra vires* principle. But if a bank were faced with knowledge that members of the company had taken steps themselves, by resolution or otherwise, to limit the powers of the directors, then, I say the bank, having notice of these steps, would have to give effect to them.

2254. So the abolition of the *ultra vires* rule would not make an absolutely complete curtain, so to speak, between dealings with the outside world and dealings inside the company?—I would put it this way, that any overt act on the part of the members of the company to limit the directors' powers would have to be recognised. But in the normal case, which is the one we really deal with in

our everyday work, we would prefer to deal with a company on the basis that it possesses all the powers of a natural person.

2255. It is a very difficult topic, but I think I follow the view you take on the matter, and I think we can probably pass from that now. The next one is heading 3 of your memorandum, which is the classification of companies, and there you discuss the position of the exempt private company. You know, of course, that the chief privilege of the exempt private company is the exemption from filing accounts, and you discuss the matter and say that "as a practical solution it is suggested that an exempt private company should be required to file, with its annual return, either its accounts or a statement that its audited balance sheet shows no loans to directors. In the latter event, a declaration should also be filed with the annual return that the accounts have been audited as at a date within the past two years". Supposing that alternative was adopted, and the exempt private company preferred not to file its accounts but instead preferred to do the other things mentioned in this passage of your memorandum, do you think that would be very satisfactory to creditors of the company? Would they not prefer to see the balance sheet rather than have an assurance that the accounts had been audited?—I think they would prefer to see the accounts filed, and I think we, too, would favour, other things being equal, a requirement that all companies of whatever kind should file accounts. We would prefer that, but we do recognise that there may be special reasons why the smaller limited company does not want to put its full accounts and affairs in view of the public. It was largely as a compromise that we suggested this intermediate step.

2256. It is not the course you prefer. It is a course you think might be fallen back on?—Yes.

2257. It was put, I think, by one of our witnesses that publication of accounts of exempt private companies would afford material for local gossip. If a neighbour

could go to Bush House and make a search, he might make some interesting deductions from the accounts as to what was going on in the Jones family.—If I were speaking personally, I would say that every company should, in return for the benefits of incorporation with limited liability for its members, be required to file accounts.

2258. We have your view on that very clearly.—*Mr. Fairbairn*: I think we should make it clear that we as bankers generally have no difficulty in obtaining the accounts of a private limited company, whether they are filed or not. We are reluctant to lend unless we see the balance sheet, and that is our policy.

2259. We have been told that, too, by various societies. They say that if the balance sheet is not published they go round to the party concerned and say "Will you let us see your balance sheet?" If he says "No", they say "Very well then, we cannot do business with you."—As the years pass this reluctance to show the figures to the banker gets less and less, and it is now almost uniform for us to see the balance sheet and profit and loss accounts of all our customers, exempt, private or public.

2260. But you are expressing your views on the general principle, really?—Yes. On the other hand, if you made compulsory the filing of exempt private companies' accounts, I think you would find a lot of people would not form private limited companies, because they would not want their affairs to be seen, and certainly that would be so in a small community like Scotland.

2261. Do you see any advantage from your point of view in making them file their accounts?—Personally, no.

2262. You see no advantage so far as you are concerned?—From a banker's point of view, no.

Mr. Ballantyne: Except this one, that sometimes you may be concerned with a company which is not your customer, and it is on these occasions that you might want to see the accounts of that company.

Mr. Fairbairn: If the Committee could do anything to speed up the production of some of these private limited companies'

accounts, that would be a help. They drag well behind in many cases. Sometimes it is the accountant's fault, sometimes it is the nature of the business.

2263. Do you think, if there was an obligation to file, that might make them a little more brisk?—I think so. It would have that effect.

2264. Then there was a point under heading 6, as regards directors' interests, and you make reference to the case of *Victors v. Lingard*. The point, as I understand it, is whether a director is to be considered as interested because he has given a guarantee for a loan made to the company. I think that roughly is the point, and you point out that the difficulty which arises is probably met by article 84 (2) (b) of the current Table A, but you would like to see that article made statutory; that is to say that the giving of such a guarantee is not to amount to an interest.—*Mr. Ballantyne*: That is the submission. It is not every company that incorporates Table A, and it is our submission that the principle in article 84 (2) (b) should be given statutory effect.

2265. So that it would apply to every company, and not only to those which adopted that bit of Table A?—Our submission is that it should apply to every company.

2266. What do you think of the view that this is essentially a matter for the articles of the company, rather than for the statute?—*Mr. Fairbairn*: We made the suggestion to simplify matters. We have to pay regard to the decision in *Victors v. Lingard*, where a security was given to an English bank after the guarantees were executed, and the security was set aside. We are very careful now, where we have the guarantees of a director, and further security is subsequently taken. The situation is quite common in the case of private limited companies. We see that our position is covered when we are taking subsequent security, going to the length of having authority provided by means of a resolution passed at a general meeting. But this is just a question of convenience. We can live with the law as it is, but it would be more convenient if this were written into the Act.

2267. I quite appreciate your point and the reason for it, but of course there is this possible view that a dispensation of that kind in favour of a director is a matter for the articles of the particular company, rather than for the statute itself.—Yes.

2268. Is there anything further that you would like to say on that aspect of the matter?—*Mr. Ballantyne*: I do not think that a company when it is formed has always got all these possibilities in mind and, as *Mr. Fairbairn* has said, it would make things very much easier for us if this was given statutory effect. If you have the *Victors v. Lingard* circumstances in the case of a company which has not adopted Table A, you have got to inquire into the proceedings at the meeting of the board of directors at which the decision to grant your security was taken. You have got to inquire whether the directors, who have given the guarantee, had voted on the resolution to grant the security. Or, as *Mr. Fairbairn* has suggested, you have got to go beyond the directors and get a resolution passed by the members of the company in general meeting, which is troublesome.

2269. Then there is heading 11. I gather you think that the present state of affairs, in relation to nominee shareholdings and disclosure of beneficial interests, should not be disturbed. That is to say, you do not think there should be legislation compelling shareholders in one way or another to disclose the beneficial ownership of their shares, if they themselves are not beneficial owners.—That is so.

2270. There is quite a strong body of opinion to the effect that it would be very desirable for beneficial interests to be made known, if practical means for achieving that end could be devised. What is your view on that; that is to say, the question of principle, first of all?—*Mr. Fairbairn*: I think I would agree with that, Sir. I think it is desirable that the directors of a company should know of any substantial bolder trying to attack them by continual acquisition of their company's shares. The advantage lies with the aggressor, that is the man who

hides his identity through nominee holdings. To ask the banks, who have a very large number of nominee holdings in public and private companies throughout the country, to make a return, would be an enormous task; and I do not think you would achieve much by doing that, because the man who wants to defeat you will spread his holding through several nominees, be they limited companies or personal friends. He can do it in 101 ways to get round the law, and I do not think it is the answer.

Mr. Ballantyne: It would place an intolerable amount of work upon the bank nominee companies to have this forced upon them. We recognise the desirability of there being some means for a company to find out who are the persons beneficially entitled to the shares in the company, but from the practical aspect we do not think that the responsibility should be placed upon the nominee companies, the majority of which are nominee companies of banks. We do, ourselves, make a suggestion in the last paragraph of our submission, that the Board of Trade be given powers, on the application of a company, to ask holders of 5 per cent. or more of the capital to disclose whether they hold the shares as beneficial owners or in a nominee capacity and, if so, for whom.

2271. Where any individual holds 5 per cent. or more of the issued capital of a company, then he should be compelled to disclose whether he holds those shares beneficially or not?—Yes. That power would be given to companies who were worried about the situation and who would in those cases be able to apply to the Board of Trade. If the company did not care then it could just leave things as they were.

2272. Supposing somebody held 5 per cent. of the shares divided amongst several nominees, he could evade the arrangement then.—Yes. I think one could evade any such arrangements whatever they might be. The Coben Committee recommended that the beneficial owners of shares—above a percentage of total shares in issue—should themselves declare their interest to the company, but they suggested a percentage of 1 per cent., which I think is too low.

2273. Some people have suggested that one should look to the beneficial owner, and put the onus on the person who holds the beneficial interest in shares not in his own name, above x per cent. of the company's capital, to disclose.—*Mr. Fairbairn*: I think that is right, Sir. I think that is the way to tackle it. It is a very difficult problem and any means of detecting evasion is going to be elaborate. If the beneficial owner of, say, 5 per cent. or more were to lose his voting rights in respect of shares held in excess of 5 per cent. unless he declared his interest to the directors, it would act as a deterrent. The directors would then be aware of what was happening. I know it would be possible to get nominees and friends to help, but if the directors could at a later date open up an investigation through the Board of Trade, it would introduce an element of uncertainty into the operator's mind and it might deter him. I think a deterrent is what you really want.

2274. I cannot help wondering on that suggestion, whether some astute contender in a company squabble might not turn it to his advantage by alleging that certain shares infringed this rule.—The large holder would normally have declared his interest and the directors would know of any new operator when he declared his interest of 5 per cent. He would be out in the open at that stage.

2275. In this scheme you go to the beneficiary, and not to the man on the register?—That is right. The onus is on the owner of the shares, and if he does not declare his interests he knows that his votes in excess of a certain percentage might be lost.

2276. It has been represented to us that, to attack nominees and expect them to account for all their beneficial interests, would involve a great deal of work, but if you require the beneficial owner of the shares to disclose his interest that makes matters more simple.—To declare all our beneficial interests would certainly be a tremendous task for us. In Scots law we cannot get an equitable mortgage over shares by mere deposit of the share certificate. In England you can. The English banks have submitted figures to your Committee showing that their

nominee holdings for security purposes are 4.68 per cent. In our own bank 44 per cent. of the shares in our nominee companies are held for security purposes, simply because we cannot get an effective security in Scotland unless we register in the name of our nominee companies. This is a handicap and an expense to us, but it must be done to comply with Scots law. In relation to our size, therefore, we make more use of nominee companies than the English banks.

Mr. Ballantyne: Mr. Fairbairn's remarks go beyond our submission in the memorandum. Our committee went no further than to say that to require nominee companies to disclose the beneficial ownership of all the holdings which they hold in various companies would be an intolerable burden, but we have suggested that, if there is any demand for disclosure by nominees as distinct from beneficial owners, it should be confined to those cases where the company itself makes application to the Board of Trade. It would put a limitation on the number of cases where we were asked to provide lists of beneficial owners. Mr. Fairbairn goes a stage further in suggesting that, instead of putting the responsibility on the nominee company or the nominees, you should put it on the beneficial owner. But whatever regulation you introduce, there are people who will find ways and means round it, because even today, where there is no requirement for disclosure of a beneficial ownership of shares which nominee companies hold, you do find beneficial owners spreading their holdings over a large number of nominees to cloak from the company the fact that there is a big concentration of shares being built up in one beneficial ownership. Even now when a company cannot be aware that a particular person is buying its shares, because the shares are being placed in the name of a nominee company, that person often, in order to cloak the situation still further, spreads his purchases over a large number of nominee companies or nominees.

2277. I suppose evasion is always possible, but on the whole you are both in favour, I think, if possible, of some scheme such as Mr. Fairbairn proposes; that is to

say, you go for the man who is a beneficial owner?—If it is workable, yes.

2278. Yes, subject to the practical difficulty. I think you would probably know as much as we do about the use of nominees, syndicates, gentlemen's agreements, and all the various methods which ill-disposed people can adopt. One wants to avoid harassing or inconveniencing the ordinary shareholder who has no thought of gaining clandestine control of a company, or something of that sort.—We want to avoid inconveniencing nominee companies which are merely providing a service in the way of ordinary legitimate business; they cannot know the intentions of all their customers.

2279. What is your view in principle about the expedient of the Board of Trade appointing an inspector to investigate ownership of shares? Do you think it is a good type of legislation or not?—There are certain safeguards in our recommendation: the powers of the Board of Trade would only be exercised when the company itself made application, and it would be entitled to do that where there was a holding in one name of 5 per cent. or more of the capital and the company wished it to be investigated.

2280. You do not think, because it can only be put into motion in that way, that it is an unduly oppressive measure?—No. I do not think so.

2281. Rather strong views were expressed against the appointment of inspectors to investigate ownership in the report of the Northern Irish Committee on Company Law Amendment; they thought it was an unwarrantable intrusion into legitimate operations, so there is that view about it.—*Mr. Fairbairn*: We have not seen it used very often.

2282. And more people say it ought to be used more freely, but then you get the view I am just putting that it ought not to be used at all.—Is it not used less frequently than it should, because it is too late?

2283. The inspector makes his report long after the operation which has given

rise to concern has been completed?—That is right.

Mr. Ballantyne: Our submission is that the application to the Board of Trade would be made by the company and the Board of Trade would immediately require the holder of the shares to declare whether he held them beneficially or as a nominee, and, if as a nominee, for whom. It is no more than that, and that need not be something which takes a long time. Some regulation of that kind should be capable of working almost automatically.

2284. Then, given the requisite vote in favour, the Board of Trade could investigate the matter?—Yes.

2285. Then the directors would get the danger signal through the obligation on the nominal holder to report his interest?—Yes. The nominal holder would report whether he held the shares beneficially or as a nominee, and the company would then decide whether there was any other action it required to take.

2286. Under heading 12 you refer to the specific designation of accounts on a register. I ought to know, but I am afraid I do not—what is a specific designation?—This arises because nominee companies and trustee companies, having holdings of shares in one company for a large number of different customers and trusts, have recently commenced the practice of asking the companies to open different accounts for different blocks of shares, and to designate those accounts in a certain way. If you take Royal Bank of Scotland (Nominees) Ltd., they might wish to have, for example, an A-B account, a C-D account and an E-G account in the register of a company. Some companies have restrictions as to the form of designation they will allow but accept them, while other companies say that they cannot designate accounts because of the prohibition against recognising trusts.

2287. You say that there should be something in any new legislation to say that these specific designations will not amount to recognition of a trust?—It is

merely a designation as against the recording of a trust interest. It is a great convenience to a trustee nominee company to get separate dividend warrants for its different trusts, and to have the different accounts designated in such a way that the dividends can be easily identified.

2288. I follow that, but apart from any amendment of the law, would not the answer as to whether there was a notice of trust or otherwise turn very much on what was said in the designation?—Yes.

2289. Supposing it had Brown Trust for Jones, or something like that. If, as it were, it indicated the existence of a trust, although it did it in sort of telegraphic terms, it would be rather difficult to avoid saying that that was taking notice of a trust.—*Mr. Fairbairn*: It is a matter of convenience for the banks. We receive one dividend warrant for, say, 2,000 beneficiaries, and it is a very difficult and tedious job to split it up. This makes splitting up more easy.

2290. *Mr. Brown*: It is simply passing on the splitting up from the bank to the company.—That is true.

2291. *Chairman*: You regard this purely as a matter of convenience?—A small point of convenience, yes.

Mr. Ballantyne: I think the companies, themselves, place different interpretations upon the statutory provisions at the moment. Some say that they cannot open these separate accounts and designate them in the way desired because of the statute; others do it regarding the designation as not being notice of a trust.

2292. Under heading 14, which is carrying on business through associated and subsidiary companies, you raise a point which perhaps does not really belong in that section—but that does not matter—directed to the case of companies trading under names other than their true names, and you say that is a matter of complaint, and that this practice should be expressly forbidden and the penalties increased. Does not section 108 of the Companies Act to some extent meet your point? Section 108 obliges a company to paint its name on the outside of

every office, or place in which its business is carried on, in a conspicuous position in letters easily legible. Then its name has got to be engraved on its seal and then it has to have its name mentioned in legible characters on all business letters of the company, and so forth. If a company does not so paint or fix its name the company or every officer will be liable to a fine not exceeding £5 and if a company does not keep its name painted or fixed in the manner so directed the company and every officer of the company who is in default shall be liable to a default fine. Then if a company fails to engrave its name on the seal and to have its name mentioned in legible characters on business letters and so forth, it is liable to a fine not exceeding £50. What do you suggest we could add to that?—*Mr. Fairbairn*: Our committee finds that there are one or two cases here where a company acquires a firm and the company is not revealing the position in accordance with that section. The cases are, I think, few but increasing; the fine is probably the answer.

2293. Of course, companies trading otherwise than under their true name are now within the Registration of Business Names Act, so that is another way in which this abuse might be checked, I suppose.—Yes. They do not always register.

2294. The great difficulty about the Registration of Business Names Act is to get compliance with its requirements.—*Mr. Ballantyne*: There are cases where the statutory regulations are complied with, but where the company taken over by another company is continued, not in that company's name but in the old name. It trades in the old name, although somewhere in the building, and possibly also on the notepaper, etc., the name of the acquiring company appears. But it still trades under the old name, such as *Walter Ballantyne—dropping the "and Co. Ltd."*—when the business is now owned by *Robert Fairbairn and Co. Ltd.* There are cases like that, but I do not think it gives rise to any practical difficulties as far as we bankers are concerned.

2295. I gather that you were in fact occasioned some embarrassment when

the company came to open an account and it appeared they were doing this; that is to say, trading under a name other than their registered name?—In the case in point, for example, Robert Fairbairn and Co. Ltd. might want to open an account in the name of Walter Ballantyne, for the business which they continued to carry on in that name after having put the company of Walter Ballantyne and Co. Ltd. into liquidation.

2296. In that kind of case, could you not say "We cannot do business with you unless you comply with the Registration of Business Names Act, or else give up using this subsidiary name"?—Yes, I would agree. It is just a question of embarrassment.

Mr. Fairbairn: He would probably change his bankers at that stage.

2297. But it would be important to you, I suppose, because if a concern is infringing the Registration of Business Names Act it perhaps may have difficulty in collecting its book debts if the disqualification imposed by the Act is in fact enforced. Then I take it you have no specific recommendations to make about this point, beyond increasing the penalty?—*Mr. Ballantyne:* No.

2298. The next point is one which, of course, has been the subject of much debate over a good many years, and that is the exemptions afforded to banks, amongst other institutions, as regards the contents of their accounts, and in particular the keeping of secret reserves. On that I gather you say that the Cohen Committee thought it proper that banks should enjoy this exemption, and nothing has happened since to invalidate that view.—That would be our submission, that nothing has occurred since the time of the Cohen Committee to invalidate the view taken by that Committee on this particular matter.

2299. If one could look at the matter again, is it a fair summary of your case that banks must accumulate reserves, that public confidence in our banks is due to the knowledge that they have large reserves, and that this confidence would be shaken

if temporary fluctuations in the value of those reserves had to be disclosed? Is that how you put it? Tell us in your own words if that is not a fair summary.—

Mr. Fairbairn: We feel very strongly that this privilege to bankers should be continued, as the conditions ruling now are even stronger in support of this than they were at the time of the Cohen Committee. I think it is clearly in the public interest that the banks should remain strong and I think, too, that the public interest comes before the interests of the shareholders in this respect. Continuity in the level of profits is essential to give confidence to the public here at home, and also to our foreign banking friends. They look to the strength of the British banking system, and have a large amount of money with us, and we must be strong in their eyes. The profits are in fact subject to fairly substantial variations because of the substantial fluctuations in the value of gilt-edged securities, and again our profits are subject to variation dependent on our bad debt experience with the amounts which we lend. The amount which we lend now is very much higher than the amount lent at the time of the Cohen Committee and we are lending substantially more in individual sums. I think it is important that the fluctuations in our fortunes, both in gilt-edged securities and in our overdrafts, should be kept within the bank's affairs.

2300. I gather that not so many years ago the depreciation in the value of gilt-edged securities was so great that the accounts of some banks necessarily showed that their secret reserves were exhausted. Did that ever happen?—Not to my knowledge. I think a 1 per cent. drop in the gilt-edged market costs the British banking system at the moment something like £15 to £20 millions, and I think I am right in saying that during the past 20 years we have seen a fluctuation of as much as 25 points in some of the stocks which the banks hold. It is a big sum for the banking system to carry.

2301. Has it been consistently possible during the last 10 years to iron out these fluctuations by means of a secret reserve, or did you ever come to the point where the reserve was exhausted and everything

had to be shown on the open account, so to speak?—No. Banks have on occasion shown their Government securities at book value in their balance sheet even though this figure was in excess of market value at the time. The market value was shown. That has been accepted.

2302. Would not that show that there was no hidden reserve?—No.

Mr. Ballantyne: In the case of some banks, it was quite clear that the contingencies reserves were capable of taking care, even in those days, of all the depreciation suffered on their gilt-edged investments.

2303. The banks always succeeded in maintaining their position?—In the case of some banks, at any rate, they continued the practice of showing their investments at or under the market value, making up the deficiency out of internal reserves which were not exhausted, and that would not have been possible if it had not been for the provisions of the 1948 Act and earlier Companies Acts, giving the banks this exemption. I think it is essential and very desirable that the results which the banks report should not show wide variations from year to year. I regard it as essential that there should be a stability shown by the results which they publish.

2304. You do not agree that any banks have exhausted their reserves at any point during the last 10 years or so?—I would not know, because while some banks showed their investments at more than the market value, I do not think it can be taken for granted from that fact that they had exhausted all their contingency reserves. The mere fact that they did not at that particular time write down the investments to their market value did not necessarily mean that they could not have done so if they had used up all the contingency reserves. Contingency reserves are there not for one purpose only, but for a number of different purposes—for the purpose of meeting diminutions which may take place in the value of investments and exceptional losses through bad debts and for other purposes. It is quite possible that the banks, showing

a deficiency on their gilt-edged investments, were keeping back some contingency reserves for these other purposes. I cannot say.

2305. Then there are various particular points to be put against these exemptions. For instance, it is suggested that the shareholder of a banking company is at a disadvantage in considering a take-over bid, especially when one banking company is offering to take over the shares in another in return for shares in itself. Do you think there is any substance in that?—I would say none, because I do not think a take-over bid for a bank could be carried through in this country today without the consent of the Bank of England. There are practical considerations, I think, which would rule out any possibility of a take-over bid for any of the large banks, without the consent of the Bank of England. In regard to the interests of shareholders, I think that it is much better for them to see a steady, stable position rather than one which fluctuates widely from year to year. In other words, if we were called upon to disclose all these contingency reserves it would probably mean that in a year in which there had been a considerable fall in the value of our investments, no matter how we showed this in our accounts the financial journalists would put the figures together and show that the dividend being paid by the bank in that year was not covered by the profits earned. I think that the shareholders' interests would be affected adversely rather than the reverse if the exemption were abolished, because you would have much more violent fluctuations in the banks' results, and therefore in the value of their shares.

2306. The Trades Union Congress say that this exemption, among others, prevents employees from bargaining effectively.—I would not agree.

2307. The argument I take to be that, if it was a question of increasing pay or conditions of service, a more convincing case could be made out by the Trade Union if they could say "Look at all these millions of money that you have got tucked away. You could easily pay us some more".—In other words, the capacity of the industry to pay higher

salaries would be apparent. But the wages in industry generally are not altogether regulated by the capacity to pay.

2308. Some people think they ought to be, I believe.—The fundamental position would not be changed, even if the reserves were disclosed, because they would still be required to cover the same contingencies as they are covering today. They would be disclosed instead of being not disclosed. On the point that the Trade Unions make, it would follow that if, in any year, there was a capacity to pay higher salaries, they would have to accept the proposition that in a bad year the capacity to continue paying those salaries would be no longer present.

2309. *Mr. Smith:* They might be much more likely to accept that if they could have the evidence that that was the position. At the moment, they get the assertion that this is the position every time, but never the evidence the other way.—In my experience they have refused to accept the proposition.

2310. I would not doubt that, but the point that the T.U.C. is making is that you get public criticism that the trade unionists and the trade unions have not taken a responsible attitude towards the costing and economics of industry, and at the same time they are being denied the information on which they can take that responsible attitude.—*Mr. Fairbairn:* Bank salaries compare more than favourably with their equivalent in other walks of clerical labour.

Mr. Ballantyne: There are many factors which determine the level at which reserves should be held, and the mere fact of disclosing that a certain reserve exists is not in itself sufficient to show the true position without saying also that there are contingent liabilities on the other side of the account against which these reserves have got to be set. There is a contingent liability for possible depreciation of the investment portfolio, and a contingent liability in respect of a very large amount of advances, which might at any time result in fairly substantial bad debts. You see, it is only the banker himself who can determine the proper level at which these reserves

should be maintained, and that is how the present exemption is exercised. A banker needs to build up reserves to cover these exceptional contingencies which do arise from time to time, and we therefore make an allocation out of each year's profits to provide for them. I think it would be quite misleading to give a figure of the contingency reserve, without at the same time clearly indicating that it is not a free reserve available for disbursement to the employees or otherwise. It is there to meet a particular risk, which is inherent in the business.

2311. *Chairman:* Then there is another complaint suggested, that the bank's customers, since they cannot ascertain the bank's profits, cannot judge whether they are being charged too much for the services they receive.—The services are provided on a competitive basis.

2312. Some banks periodically, amongst the entries put down in the pass book, show bank charges.—*Mr. Fairbairn:* Yes, but if the public do not like the charges, they do not need to have an account. The profits the bank make have little to do with it. If the public do not care for the charges which we make they can seek alternatives. For example, they can go to the Post Office and send their money by Money Order, and see if they can get it cheaper. The services which the bank has to offer have to compete with other services of an equivalent nature. The profit that the bank is making has really very little to do with it. It is important to the bank, of course, but not to the customer.

2313. You do not think much of that one?—No, Sir.

Mr. Ballantyne: We would not agree. We consider that banking services are being provided today by the banks in this country at a very low cost to their customers.

Mr. Fairbairn: On this whole question we think that the national and public interest is paramount. It overrides all other arguments regarding the disclosure of the bank's figures.

2314. There is only one other thing. You have some references to misleading

names of companies, and so forth. I take it that your main preoccupation is to prevent such words as banker, bank and banking being used as part of the name or description of concerns which ought not to be so called?—Yes.

Mr. Ballantyne: We recognise the difficulty in this matter, but we take the view that the use of the words bank, banking or banker should be confined to a concern doing what we term ordinary banking business.

Mr. Fairbairn: That is the receipt of money on deposit and on current account, and the honouring of customers' cheques, although there are some people who do not do that and still call themselves bankers and are of first-class standing. We think the use of the term banker should be strictly controlled by the Board of Trade.

2315. Should it be done in some way by reference to assets? You might have a concern which is carrying on varying activities, but which has not got very much in the till.—It would be difficult to do that.

2316. Over the years one remembers unfortunate episodes in the City, where very often some concern called a bank featured a good deal, and it may have been simply a creature of the great operator of the day.—Yes.

2317. Have you any suggestions as to how one could make sure of a sensible control of the use of these words?—I think you must exercise control over the use of the name through the Board of Trade. Nobody should be allowed to form a company, call himself a bank, and advertise for money without the closest scrutiny and permission of the Board of Trade.

2318. Perhaps it is easier said than done, but clearly it ought to be done?—I agree, Sir.

Mr. Ballantyne: We said that we recognised the difficulties.

Chairman: Those are all my questions. Mr. Lumsden, have you any more questions?

2319. *Mr. Lumsden:* In your memorandum you suggested that it should be

permissible to have a floating charge in Scotland. You added that there would at long last be power to appoint a receiver and manager at short notice, and with the minimum of formality. Since that memorandum was sent to the Committee, there has been the report of the Law Reform Committee for Scotland, before which I think you gave evidence, which has recommended that power should be given to create a floating charge by a limited company in Scotland, under more or less the same arrangements as in England, with the important exception that the Committee did not recommend that there should be power to appoint a receiver, or a receiver and manager. They say "We have come to the conclusion that the advantages which might follow from empowering the holder of a floating charge to appoint a receiver or a judicial factor are outweighed by the complications which would result from the introduction of another officer. We are satisfied that the holder of a floating charge would be adequately protected if his security crystallized only on liquidation." I would like to ask you if on reconsideration you accept the recommendation of this Committee, or whether you still wish to press for power to appoint a receiver and manager and, if so, why?—We are very disappointed to see the recommendation in this form, and we do not accept it as a satisfactory solution of the problem. We still wish to press for legislation providing for a floating charge with the right to appoint a receiver and manager. We do not see why the laws of Scotland and England should not be the same in the field of commercial law, and we think the advantages of a floating charge are not fully achieved unless there is power to appoint a receiver and manager.

2320. Could you elaborate that a little bit? What benefit does the receiver and manager bring?—When things start going wrong and it is obvious they are starting to go wrong, the holder of the floating charge can immediately appoint a receiver and manager to take over the administration of the assets of the company in the first instance for the benefit of the holder of the floating

charge but very often, as experience has shown, the creditors of the company benefit as well.

2321. It is the quickness by which the floating charge can be put into execution through the appointment of a receiver and manager that gives it its great virtue?

—*Mr. Fairbairn*: Yes. I would like to support my colleague on this. We fought very hard to get a floating charge into the law of Scotland; and having had considerable experience of banking both in England and Scotland, there is no doubt whatever in my mind that this will prove to be of great advantage to the Scottish business community. We certainly endorse what the Law Committee for Scotland have recommended but we cannot but record our extreme disappointment that they have not seen fit to recommend a receiver and manager. My colleague has made a point about quickness but I think there should be added to this that in Scotland there is either a liquidation or the company goes on; it is one thing or the other with no interim period. This will not be altered by the proposals put forward by the Law Committee. We want to be in a position to put somebody in to see if the company can be saved from liquidation. We are not looking at it from the point of view of security. From the point of view of security the recommendation gives all we want. We are disappointed that we cannot have an interim period during which a receiver of ability could manage the company to see if it could be put on its feet.

Mr. Ballantyne: Mr. Fairbairn is making the point that liquidation is final and it is very rarely you see the recall of a liquidation. Whereas the receiver may be able to stop the rot and the company, instead of being liquidated, can be saved and made strong again.

2322. *Professor Gower*: Mr. Ballantyne, I do not think I quite understood one of your answers in connection with this problem of secret reserves. The Chairman asked you about the question of a take-over bid. He suggested it might be unfair on the shareholders being taken over, who would not know what the reserves of the companies were.

Your answer was that there could not be one without the consent of the Bank of England. I could not quite see the relevance. You are not suggesting the Bank of England, before they consented, would make sure the shareholders were getting a fair deal? That would not be the role of the Bank of England, would it? —No, I think the answer was probably not quite relevant. I have never thought, that in banking, you could have the kind of take-over bids you have in industry generally.

2323. You can have mergers and the problem would be really the same there. If you have a merger of two banks the problem would arise as to how the new bank is formed, what allocation of shares there should be to shareholders? —Yes, but that is usually on a basis of agreement between the two boards of directors. I was thinking, when the Chairman asked the question, of the take-over bid which is the smash and grab raid you sometimes see in industry, where the shareholders of a company sometimes sell out because they are offered something more than the market value of the shares without knowing the real worth of their company. That does not usually apply where you have an agreement between two boards of directors for an amalgamation on the basis of disclosed positions.

2324. No, but it is the case nevertheless that in that situation the shareholders would not have the same detailed information. They would have to rely much more on the advice of the respective boards than would the shareholders of an ordinary commercial company which had full balance sheets and profit and loss accounts for a number of years. —But do not the shareholders of other companies subject to take-over bids have to rely on the advice they get from the directors as to whether they should accept the bid or not?

2325. *Mr. Brown*: The advice of the directors is not always accepted. —I did not see any practical difficulty in relation to take-over bids in banking.

2326. *Professor Gower*: There have certainly been take-over bids for concerns calling themselves banks. How far you would regard them as real bankers in

your sense, I am not sure.—We are thinking of different kinds of bankers, I think.

2327. *Professor Gower*: But they might be banks that got the exemption, might they not?

Mr. Brown: The Bank of the Middle East?—That was a proper bank.

2328. Yes, and a proper take-over merger.—*Mr. Fairbairn*: I think it all gets back to the national interest being of far greater importance than the sectional interests of the shareholders. You cannot get away from that argument.

2329. *Professor Gower*: Clearly we would all agree, but the case that has to be made out is that it is in the national interest, not merely that banks should be strong, not merely that they should seem to be strong, but that this is best accomplished by not allowing it to be seen how strong or weak they are.—The question of secrecy in this country is very important because you have eleven clearing banks and five Scottish banks co-operating with the Bank of England over credit restraint and financial policy. Our profits are affected to a very considerable extent by the policy of the government.

2330. But everybody realises they would never be allowed to fail. Is it really suggested, if for one year your bank showed a loss, all the depositors would rush to take their money out?—No: but we are not alone as far as concealing profits is concerned. In trading companies there are secret reserves if you like—in the shape of undervaluation of assets. Here, too, the shareholders must be guided by their directors as to whether or not the price they are being offered is fair.

2331. But the fact does remain that in the case of banks concealment obviously goes considerably further. You can make transfers to your reserves without saying you are doing so.—Yes, we are not, however, the only country in the world that allows its banks to have secret reserves. So far as I know all the

Commonwealth do so. In the United States of America there are exceptions but there the banks are very numerous, mostly small in relation to the economy and the failure of one or two has no impact.

Mr. Ballantyne: And the depositors are insured up to ten thousand dollars, with the result that you have people placing deposits up to ten thousand dollars in a number of banks. It is quite common in the United States for people to spread their deposits in this way. That would support the view that the national interest is the paramount one here, but I still say that it is not necessarily at variance with the shareholders' interests.

2332. *Mr. Lawson*: Could I ask one question on that subject of public interest? I suppose the main purpose of the provisions of the Companies Act regarding the disclosure of matters in the accounts is to enable the shareholders to exercise the ultimate control over the company, which is their right and responsibility. As regards banks, are you saying that shareholders are nevertheless in a position to exercise that control although they have much less information than they would have in an industrial company, or are you saying that it does not matter in the case of banks that the shareholders are not able so effectively to exercise control?—*Mr. Fairbairn*: We maintain that the shareholders have the same power of control through the directors of the company. There is no difference.

2333. But are they in a position to exercise that control intelligently if they have not got information as to the true profits or losses of the bank?—I think so.

2334. That almost leads one to the conclusion that a great deal of the provisions of the Companies Act requiring information from industrial companies are not necessary either.—I think you are assuming the profits which the bank show are wildly different from its true profits.

2335. I was assuming that.—No, We always have regard to our experience during the year. If we had to show the whole of our profits we would not, I think, be able to build up the reserves

which are so necessary. If you look back a number of years you will find that the surplus of the banks in relation to total liabilities is less now than it was previously. It is even more necessary now that the banks should be allowed to carry on, building up their strength.

(The witnesses withdrew)

MR. E. C. ASTIN, MR. C. G. LAMB, MR. W. NORMAN PEET and MR. J. MCNEIL GREIG
called and examined.

2336. *Chairman:* We are much obliged to you all for coming here this evening to help us. You represent the National Association of Trade Protection Societies (N.A.T.P.S.); and you, Mr. Astin, are Chairman of the Committee of Management?—*Mr. Astin:* That is correct, Sir.

2337. You, Mr. Lamb, are a member of the Committee of Management?—*Mr. Lamb:* Yes, my Lord.

2338. And Mr. Norman Peet, you also are a member of the Committee of Management of the International Association for Promotion and Protection of Trade—are you a member of the Committee?—*Mr. Peet:* I am not a member of the N.A.T.P.S. Committee, Sir, but attend as a committee member of a constituent society. I am acting as leader of this group today.

2339. Then Mr. Greig, you are Secretary of the Association?—*Mr. Greig:* Yes, Sir.

2340. Your Association is an unincorporated body, I understand, established in 1848. Could one of you summarise very briefly the activities normally undertaken by your Association?—*Sir,* the Association was formed at that time to co-ordinate the activities of a number of trade protection societies up and down the country. These trade protection societies carry out on behalf of their members investigations into the credit standing of persons with whom their members propose to trade, and the N.A.T.P.S. co-ordinates their activities, assists them to find correspondents up and down the country, persons who can give them information; in addition they

Chairman: Those I think are all the questions we have to trouble you with, gentlemen, and I would like to say again we are extremely grateful to you both for your memorandum and for coming and giving evidence here. Thank you very much indeed.

exchange information amongst themselves and that, I think, is their prime function.

2341. I take it that it is important from that point of view that they should be able to identify the actual individuals with whom members are trading?—*Indeed, Sir.*

2342. I gather you regard the provisions of the Registration of Business Names Act as adequate for the purpose as statutory provisions, but as falling somewhat in actual enforcement, if I may put it that way.—*Yes, Sir.*

2343. And you would like it to be made more effective. I think you will agree that the Registration of Business Names Act really proceeds on two principles. First it requires public registration of the true names and so forth of people trading under names other than their own, so theoretically at all events there is a register to which any party interested can go, and he can find that XYZ Tea-rooms, for example, is in fact owned by Mr. and Mrs. Jones. That is one side of the system which is the registration side. Then the second branch of it, the Act demands individual disclosure. That is to say, it requires the proprietor of the business to exhibit his certificate of registration, which will disclose his true name, in his principal place of business; and if he uses the business name on business letters or similar documents he must also disclose his true name. Could you say to which of these two branches of legislation you attach the greatest importance?—*I would think, Sir, we attach an equal importance to both. The trouble is, I think, that if a person does not register his business name then he will not put his*

name on his letter heading, showcard or whatever it may be. One seems to follow the other. If he fails in one he tends to fail in both.

2344. I put that question, though I quite appreciate your answer, with this in mind. We understand from the Board of Trade that there are enormous practical and administrative difficulties in keeping this register in the way it ought to be kept if the intention of the Act were to be fully carried out. There are many difficulties and of course the chief is, I think, want of compliance, the number of cases in which the Act has been ignored. Then there are a number of cases where the people have ceased to trade and do not send in particulars. There are deaths and so forth, casualties in partnership firms, which are not reported. So I think it is admitted by the Department that this register is by no means all that it should be, and it would be impossible really to make it anything like perfect. On the other hand the keeping of the register is an expensive undertaking and in these circumstances I think it is desirable that we should really see how much of this legislation is necessary. What would you think of this kind of proposal, that the register should be discontinued but that the requirements that the true name should be exhibited in the principal place of business and that the true name should be shown on all letter heads and so forth was preserved?—Sir, I think it is clear that if one could ensure, or reasonably ensure that most people complied with such a requirement, this would be helpful. But one of the uses which one can make of the Business Names Registry is where the firm which you have done business with ceases trading and it leaves that address. You do not know where it has gone. It does not register any change of address. It simply ceases. On the original registration you do have the private addresses of the previous proprietors and by that means you may be able to trace them. I think it is clear that if the register were discontinued the necessary information would not be available to us in those sort of circumstances.

2345. You would have to go to the register for that.—And of course if the

register was not there we should not be able to get it.

2346. It is fairly frequent, is it not, that the name for one reason or another is not on the register?—It is, Sir.

2347. So far as you are concerned you would like to see both branches of the legislation continued?—Yes. I do not know whether any of my colleagues would wish to add something to this.

Mr. Peet: My comment would be that Mr. Greig is quite right, we would wish that both branches should be continued. But we are a little critical of the lack of enforcement on the part of the Board of Trade under this Act. I gather from what you said, Sir, they are slack in enforcement, and indeed it is not readily possible. It does seem to me the second suggestion, that the names should be on showcards and the like—if that were properly enforced—it might be better than the first one, not properly enforced. I do not quite know what the Board of Trade can do and cannot do, therefore I cannot express a firm opinion as to which would be the better. I can only throw out the suggestion for consideration by your Committee, Sir.

2348. You think it might be better to do that, if it could be done efficiently?—Yes. Half a loaf of bread, Sir, properly baked, would be better than a whole loaf partly baked.

Mr. Greig: As against that, it seems to me if they cannot enforce the present regulations which give half a large loaf, we might end up with half a small loaf.

2349. Reliance would have to be placed either on periodic inspections, a blitz every now and then on a certain neighbourhood, checking up on the names on shop fronts and seeing whether the names were the true names of the people inside? It would have to be that type of enforcement?—Yes, Sir. It is quite clear the Board of Trade are in great difficulty in knowing how to enforce this. It is easy for us to say that it should be better enforced, but obviously the practical difficulties are enormous.

2350. I am told there are 700 registrations a week, which indicates a terrific

volume of work, and it is, they say, extremely difficult with the poor degree of co-operation from the public to make the register effective.—The co-operation from the public might be materially increased if the Board of Trade in fact took action against rather more people than they do. There are, no doubt, innocent souls who do not know the provisions: but there must be a number of cases coming to the attention of the Board of Trade where the persons involved ought to know that they are required to register and are too lazy or remiss to do it. If in a proper number of cases the Board brought a prosecution, might this not awake the general body of people to the necessity for registering? There is very little publicity now given to it because there are never any cases.

2351. The conclusion you reach is that what you would like is the Registration of Business Names Act effectively administered or, failing that, the discontinuance of the registration side and the continuance of the requirements as to displaying the true name at the place of business, and displaying the true names also on business letters? That is really your position?—Yes, Sir. I think we would deprecate the removal of the first half, but if the Committee came to the conclusion this was the right action, we do hope you would keep the second half at least.

2352. I understand from the Board of Trade that registration, at all events in practice, does not give any protection for the use of a name; that is to say it is impossible in general to make the surveys in the register necessary to ensure that no-one has registered a name similar to one already registered. How much importance do you attach to that aspect of registration, or does it not really concern you?—Sir, I think it would be clear that it may concern us from time to time. One does get a very large number of similar names in use. Generally speaking, a trader, if he is trading in Brighton and there is already, say, a "Supa-Babywear" trading in Brighton, would not adopt the same style because obviously it would be stupid for him to do so, unless he had some evil intent. On the other hand a name such as this might be repeated a number of times in other parts of the country and

having regard to the number of registrations and the difficulties of enforcement we have already referred to, it is hard to see how the Registrar can do more than he does now. I imagine he does his best to avoid identical names in a given area, does he not?

2353. He does his best with them.—We were discussing ourselves today the possibility of the Registrar of Companies and the Registrar of Business Names checking their names between each other, and we came to the conclusion that that would be much too vast a job—we did not know how many business names were registered but we thought about 600 companies were registered a week and we decided the Registrar just could not do it anyway. I think my colleagues would agree that we came to the conclusion that the Registrar was doing his best and could not do more.

2354. The position is that a trader who complained of somebody else using a name like his own would have a remedy in the Courts, and he gets no additional protection by the fact of registration. It looks as though that must be left in that way. Following upon that, the Board of Trade have called our attention to what you were mentioning just now, the position of the Companies Register, and there again the figures of registrations are extremely high and, one may say, they are almost running out of names. To find a distinctive individual name is extremely difficult. They make the tentative suggestion that possibly the Registrar might be expected only to refuse identical names, or names practically identical I suppose, but to go no further than that, and again to leave people, dissatisfied as to the use of a name by somebody else, their remedy in the Courts.—Sir, I hope the Board will not do any less than they are now doing. I think they are usually very good on the registration of company names. It is very rarely that they allow a name to be really similar to an existing name. We did have an instance I remember three or four months ago where two companies happened to be registered pretty well in the same week with the same name, so far as we could see, unless there was a misprint. This very rarely happens. But I hope they will not more

or less throw their hands in and say they have run out of names, they can do no more, and let it rip.

2355. They are doing their best, but year by year the magnitude of the task of comparing one name with another all through the register becomes greater, and that is a question of staff and accommodation and so forth. But so far as you are concerned, you would like to see the Companies Register going on as it does at present?—Yes please, Sir.

2356. Then it really becomes simply a practical matter of administration, how far it is possible to maintain the present standard. That seems to be the position?—Yes, Sir.

2357. The bodies of whom the Registration of Business Names Act requires registration are firms, partnerships and so forth carrying on business for profit. But a private association—like your own, I suppose—is not a proper subject of registration. It is suggested to us that this state of affairs is capable of abuse and that there are probably a good many rather undesirable unincorporated associations formed ostensibly for one object or the other, on which no check is kept by anybody; but I do not know if you have formed any view as to how legislation might deal with associations of that kind. —Sir, this is not a matter which we have considered. My own view would be to entirely agree with you that there might well be these bodies which ought to be registered; but I do not know whether my colleagues have considered this matter perhaps.

Mr. Lamb: I should say, Sir, that rather than cast the net wider it should be drawn closer on the present legislation and that more enforcement should take place. You mentioned that there was great difficulty in carrying out the provisions of the Registration of Business Names Act, because of staff I think you said. Rather than increase their duties by extending the Act in the way you mentioned I respectfully suggest, Sir, more attention should be paid to the enforcement of the existing Act. Up and down the country we continually come across cases where people have traded in names other than their own. They have obtained credit and

then gone off. We say that more supervision should be placed on that aspect of trade, Sir.

2358. In what way? How would one do it?—If the Business Names Act were enforced as it should be, then if it were brought up to date, the people who are not trading in their correct names should be made to register. You made one practical point which I appreciate, that it would perhaps be incumbent upon someone, presumably the Department concerned, to go to these shops and see who was trading there and obtain the information. There might be another way in as much as we as protection societies have these concerns brought to our notice. If we advised the Department that XYZ trading at High Street, Balham, was not registered, steps should be taken to see that the people concerned were registered under the Act.

2359. Yes, or prosecuted for not registering, I suppose?—Yes, but we are not so keen on prosecution as to be able to identify the man who is trading at that address. He has to give his own private address, and in the event of legal proceedings being taken, if he has left his business address then we can go to his private address and, as you will know, have a summons served and enforce our judgment there on his private assets.

2360. Have you ever lodged a complaint with the Board of Trade about any unsatisfactory and unregistered firm?—No, not under the Business Names Act, my Lord. I cannot remember ever having done so.

2361. That would be the test, would it not? If you had reported a clear case to the Board of Trade and they had taken no action they might be exposed to criticism; but you cannot yourself recollect any case in which you did make a representation to the Board?—No, I do not remember.

Mr. Greig: I think it is right to say, Sir, we have from time to time in past years done this and the Board has always had the matter set right. It may take some time but they look into it if one tells them about it.

Mr. Peet: I have a case, Mr. Chairman, I would like to cite because it shows the

attitude of officialdom to this matter. A little time ago there was a man carrying on business in Cardiff as a bookmaker. Some people called at the Police Station and complained that although they had won money they were unable to collect. The police looked into it and found they were unable to prosecute directly on information received, perhaps because of the Gaming Act, but in the course of the investigation it was found that this man was not trading in his own name, so as a result they brought proceedings, a sort of last ditch stand: if you cannot get him for anything else, get him on this.

2362. *Mrs. Naylor*: Does Mr. Peet think officialdom was wrong in this case? —No, I think it was right in this case. My point is that officialdom is not really interested in prosecutions under the Business Names Act unless there is some other offence involved and it cannot get the person for that.

Mr. Greig: I agree, the only case I know which was prosecuted under the Business Names Act, concerned a gentleman who ran some sort of bogus book reviewing scheme. The idea was that the public were inveigled into buying expensive books by a trick. The only way the authorities could get him was under the Business Names Act. They prosecuted. But it seems to me they will only move where fraud is involved.

2363. *Chairman*: Gentlemen, what is the service rendered by the Registration of Business Names Act worth to you? That is to say, how would you view a very considerable increase in fees for registration, searching and so forth?—

Mr. Astin: I would say, Sir, that we agree that the registration of business names is very necessary but we do feel that the question of prosecution and the penalties and so on should be enforced by the Board of Trade. Subject to this I do not think anyone would object to slightly larger fees.

2364. The thing looks like coming to a purely practical question of staff and accommodation and so on, and that I take it might mean an increase in fees to make it pay its way, but failing that, not produce too big a deficit.—*Mr. Greig*: Obviously it would depend on

how big the increase involved was, but within reasonable limits I would think it was still worth while. Mr. Peet is by way of being a user. Does he feel he would for instance be justified in paying five shillings instead of a shilling or whatever it is?

Mr. Peet: Yes, Mr. Chairman, I am an industrialist and my colleagues are secretaries of particular associations, but I am the chap who does the paying in the first place. We are not talking about retail credit obviously and therefore the sums involved are comparatively large compared with the charge. I am not certain what the fees are. I take it they are a matter of a few shillings. I would say there would be no objection whatever to the increase on the few shillings they must be. I am sure we would pay it with pleasure if this thing could be tightened up.

2365. Are you interested at all in the position of foreign companies carrying on business here, as regards registration of names? If you just are not interested we need not take time over it.—*Mr. Greig*: It does arise from time to time, Sir, but I could not say we were vitally interested in it.

Mr. Peet: I am not interested, Sir.

2366. I need not pursue that then. Those are all the points I have to raise on the Registration of Business Names Act but there is an important question which arises with regard to exempt private companies. From the point of view of your Association and its members, that is to say, ascertaining the credit-worthiness of people your members are proposing to deal with in the way of trade, what importance is there, if any, in the filing of accounts?—*Mr. Greig*: I should say it was an invaluable aid, Sir. One is in some difficulty here I suppose because the trade of this country has been carried on for many years without the accounts being available, but it is I think interesting that where large credits are involved it is very frequently the practice of potential creditors to seek a balance sheet from their would-be customers before they grant the credit. Therefore obviously it would be of great advantage to a creditor if he could get the information without having to go to the customer.

2367. And thereby possibly avoid giving offence to the customer?—Indeed, Sir.

2368. So you do think that if the exempt private companies were required to file accounts like all other companies, there would be a real advantage to people dealing with those companies?—I think, beyond any doubt, Sir. It seems to be a practical rather than a theoretical problem. The theoretical answer is yes, beyond a shadow of doubt it would materially assist credit granters to have this information, but I suppose again it is a question of the cost of staff and the amount of space involved. But if the Registrar of Companies could do it—presumably he could—I think it would undoubtedly be of the utmost value.

Mr. Peet: Mr. Chairman, I support Mr. Greig, of course, in his comments. The simple answer to the question is just yes, that it would assist enquiries into the credit-worthiness of companies. But there is the other side and that is the matter of secrecy of private exempt companies. I am a director of several private exempt companies and if they were not exempt of course some information would be available to, for example, my competitors. That conceivably could suit my competitors and therefore would not suit me. But it does seem to me that the information to be lodged could be limited. I would not expect, for example, that the Board of Trade would insist upon the submission of a profit and loss account, but merely a balance sheet which shows the assets and liabilities. In the case of small exempt private companies of course it is quite common for the directors to be the shareholders. I think that is so probably in the case of most such companies, and the practice then, in my experience anyway, is that at the end of the year the directors decide, having looked at the profits earned by the company, how much remuneration they will draw, and proceed to draw it. That figure, of course, will not appear on the balance sheet but in the profit and loss account, and result in an ultimate balance appearing in the balance sheet. So it seems to me that not a great deal of trading information would be given by submission merely of the balance sheet, but that on the other hand a potential

creditor could establish thereby very readily whether that company was solvent or insolvent, and that is the sort of information a potential creditor really wants.

2369. Then what is your view about the auditing of exempt private companies' accounts? As you know, a company that does not enjoy the exemption has to have its accounts audited by an auditor coming within the Board of Trade requirements, whereas the exempt private company is not obliged to have as auditor a person qualified in any particular way to fulfil the duties of auditor.—*Mr. Greig:* Sir, I would have thought it was very desirable, perhaps my colleagues will not agree, but personally I would have thought it very desirable, not only from the general trading point of view but from the point of view of the private company involved, to ensure that the auditor is properly qualified and knows what he is talking about and is thus able properly to advise the company.

2370. We have had it put to us that there may be tax questions arising which may be of very great importance to the exempt private company, which might be overlooked by an inexperienced or unqualified auditor.—Absolutely, I entirely agree with you.

Mr. Astin: I support that, Mr. Chairman.

2371. Then one gets the exempt private company elaborately defined in the Seventh Schedule to the Act, and now, if your views are accepted, we get down to the object of this very elaborate definition which would be to exempt a company from filing a profit and loss account and exempt it from a ban against loans to directors, and nothing else. Are not the remaining privileges really too small to warrant the separate existence of such an elaborately defined company?—*Mr. Lamb:* The question arises, why should they be exempt?

2372. That is the question. Of course the conventional answer we have had is that they should not be exempt because they enjoy the benefit of limited liability and ought also to bear the obligations of that status?—Yes.

2373. But the reason why they were exempted I think was—you gentlemen may be able to help me on this—that it was thought by the Cohen Committee that small family companies ought to be accorded a degree of privacy in these matters, denied to other companies.—

Mr. Greig: Personally, Sir, I have never been very attracted by that argument. The creditors are still going to grant them credit and they are still going to seek the protection of limited liability and I feel, if they still wish to seek the protection of limited liability, they ought also to give the information. I wonder whether Mr. Peet has anything to add.

Mr. Peet: I must agree, Sir, but as I made clear earlier, private family companies are entitled to some privacy. I think we all agree to that. But again I should have thought, if the information submitted was restricted to the balance sheet, that privacy would by and large have been observed. I am not suggesting a profit and loss account should be submitted, but a balance sheet. It is of course true that one can examine balance sheets year by year, and no doubt a skilled accountant would get some information from so doing, but I should have thought it could be wrapped up by his colleagues in such a way that he would usually get little of value in regard to private matters. I am afraid I have not a cut and dried answer to this question. I wish I had. I am touching on it loosely and I am sorry about that, but at any rate that is my point of view.

2374. What troubles me, Mr. Peet, is the extraordinarily high proportion of all private companies that tries to bring itself within the fold of exempt companies. It is 80 per cent. or something of that order of all the private companies in the country, so one cannot help wondering whether the Cohen Committee knew that they were including in this exemption such a high proportion of companies as have found it possible to qualify. Can you reassure me on that point?—I must say, Sir, as a private company director I have sought exemption everywhere, where possible, rather from the angle of not disclosing anything to competitors. I must admit I am not fully aware, if I do not claim exemption,

whether I have to submit a profit and loss account or not.

2375. Yes, you would have to do the same as every other company.—That would be the objection in my view, Sir. That is no doubt why most of the 80 per cent. have gone for it. I think it would be wrong to compel companies to submit profit and loss accounts for public inspection. The potential creditor wants to know whether the company is solvent; that can be determined best from the balance sheet, and it is the balance sheet that should in my view be published. In other words there should be no exemption from submitting a balance sheet.

2376. *Mr. Brown:* Mr. Peet, from your remarks I take it you would think, if the balance sheet were filed, the exemption from filing a profit and loss account would be of such importance as to keep the whole lot of exempt companies going?

Chairman: You would file the auditor's certificate with it?—Yes, Sir, and I think the directors' report, which is normally filed only by a public company.

2377. There are four of you gentlemen and you have not spoken entirely with one voice. In those matters in which you have not spoken with one voice, which do you regard as the authentic pronouncement of your Association?—I would suggest Mr. McNeil Greig be accepted as the voice of the Association, Sir, if he will agree.

2378. There is one other point on exempt private companies. One rather gathers from the enormous numbers of them, and I think from what the officials of the Board of Trade responsible for these matters would say, that these companies get the exemption simply on an *ex parte* statement making out a *prima facie* case that they come within the extraordinarily complicated provisions of the Seventh Schedule. Do you know what sort of sieve is applied to make sure only the companies properly qualified are exempted?—*Mr. Peet:* No, Sir, I do not. When I sought exemption in the case of my companies I was advised by a chartered accountant. I hope he advised me correctly.

2379. You make a statutory declaration, do you, as to certain conditions?—*Mr. Greig*: I think that is right. So far as I know, there is no sieve. So far as I know, they take the word of the company for it. Presumably they would only investigate a company if they had reason to suspect.

Professor Gower: I came across one case, Mr. Chairman, where the subsidiary company of a public company (the name of the subsidiary company clearly revealing its connection with the public company) for five years, contrary to the advice of their lawyers, signed the necessary declaration that they were an exempt private company. It was accepted as such and never found out, except that it happened to come to their lawyers' attention again and it was stopped; but it was never spotted by the Registrar.

2380. *Chairman*: Apparently the statutory requirement is that a director and a secretary should sign the certificate to this effect:

"We certify that, to the best of our knowledge and belief, the conditions mentioned in subsection (2) of section 129 of the Companies Act, 1948, are satisfied at the date of this return and have been satisfied at all times since 1st July, 1948 (or if the company was registered after that date, the date on which it was registered)".

Having regard to the extreme complication of the requirements for exemption, I wonder how many of the declarations which have been given in the case of 80 per cent. of all private companies are really warranted. I suppose it is a question you really cannot answer?—

Mr. Peet: No. I should have thought, Mr. Chairman, that most of those companies would have been advised professionally in that matter. It is an auditing point really and I would think the auditor would know whether it was right or wrong for that document to be signed, and advise accordingly.

Mr. Greig: Furthermore the sort of companies one thinks might be wrong in signing a declaration are much more likely to be advised by properly qualified auditors. A small company which would come within the ambit of the

exemption, and therefore might perhaps not employ such a qualified auditor, would probably be exempt anyway.

2381. *Mr. Lawson*: I do not think it really comes within the sphere of the auditor, you know, unless there is some item such as a loan to a director or something of that kind. The auditor is frequently not consulted about the actual registration of the accounts.—*Sir*, I may be wrong but certainly in my Association we frequently consult our auditors on things which may not come strictly within their ambit.

2382. Fortunately many people do, but it is not technically within the auditor's duty.—No, but I should be surprised if very large numbers of companies were wrongfully exempted. I have no information on it but it would surprise me if that was so.

Chairman: Of course it is really a matter of guesswork in a way. The regulations are extremely complicated and the number of companies who find their way through them is extremely large, and what one gets by putting those two things together one really cannot say. Well, gentlemen, those are all my questions. I do not know if any of my colleagues would like to ask you anything.

2383. *Mr. Smith*: In an earlier reply you referred to the ability to obtain credit and then disappear. Does that suggest that credit is given without first checking the credentials of the person seeking the credit?—No, *Sir*, I do not think it implies that, but the small unregistered firm does disappear from time to time. It does not happen all that often but it does happen, and when it does the Business Names Register can be very useful. But I am not implying it happens with great frequency.

2384. If the credentials were checked before credit was allowed, surely that would give the creditor all the information he needed?—*Mr. Lamb*: Very often credit is given without enquiries being made. In other words the goods have been supplied and then payment is sought for those goods, the bill not having been paid. If the registration has been made then we have two courses of action, one

at the address of the company and the other at the address of the person who is registered under the Act.

2385. Very often then there is no check of the credentials before credit is extended?—It frequently happens that goods are sold without the supplier first coming to an organisation like ourselves, especially when trade is bad. The supplier will take a risk; he will say "I want to sell these goods", and he will sell those goods on the strength of perhaps the appearance of the premises or the man himself who is ordering the goods—or in many cases the woman, and it is very easy sometimes for an attractive woman to obtain credit.

Mr. Peet: I would add that, assuming one does do the correct thing and take up trade references and so forth and place a reasonable assessment thereon, occasionally one is going to be wrong. In other words one is going to authorise credit where later one learns one should not have done. That is another answer.

Mr. Smith: The point I was making—and taking account of what Mr. Peet says—was that if there is a check one element of that check presumably would be to see whether there had been registration under the Business Names Act.

2386. *Mr. Scott:* The point of registering under the Act is that you can keep a check on where people live and they can be found if they default?—*Mr. Lamb:* It is indeed.

2387. That is, as far as you are concerned, the main object of the Act?—Yes. The creditor is entitled to know, I think, whether the man to whom he supplied the goods is somebody of substance, whether he has a permanent domicile.

2388. Do you find that a number of small firms or partnerships, for instance the X.Y.Z. Tearooms, have never heard of the Act?—I do not know whether they have ever heard of it, but there are quite a number who do not register.

Mr. Greig: I think it is fair to say in many cases they have not heard of the Act—effectively, anyway. I suppose if

you said "Have you heard of the Business Names Act", they might say "Yes, I think so, what does it do?"

2389. They never consider it applies to them?—I would think that is true in many cases.

2390. *Mr. Lawson:* Could I get quite clear the reason for your objection to providing a profit and loss account in the case of an exempt private company. Is it that so many of these companies are perhaps one-man concerns and therefore that man's neighbours and all round would be able to see from the profit and loss account what his income was?—*Mr. Peet:* That is one of the objections. Besides neighbours there are competitors, and I would not think it would be right for a competitor of mine to go along and inspect my profit and loss account and discover whether my business was good or bad. If he went along and found it was good he might be tempted to open up in opposition. If he found it was bad he would be tempted not to open up in opposition. I do not think he ought to have that opportunity.

2391. *Mrs. Naylor:* Is much use made of the files of companies at Bush House in checks?—*Mr. Greig:* Yes.

2392. And are they satisfactory?—We are at the present time in my own association—not in the national association, as I said this was an association of associations—making anything up to 100 company searches a day; it varies between 60 and 150.

2393. Those are valuable?—Indeed.

Mr. Peet: In my own concern, an industrial one of course, if the inquiry is of any importance we invariably want the files of the limited companies at Bush House searched so that we can see who the shareholders are, who the directors are and the normal information that they disclose. I believe it would be normal practice throughout the industry so to do.

2394. *Professor Gower:* You have been very critical of the trade and their lack of

knowledge of the Business Names Act. There is a provision, however, whereby under the Act the public can enforce it itself. It says that no contract shall be enforceable by a firm that is in default. No use seems to be made of this in practice, or very little. Do you ever advise your clients that they should refuse to pay such and such a firm until it has registered? Surely if you did that the Act would become very much better enforced. —*Mr. Astin*: With all due respect, we act on the other side.

2395. I appreciate that.—I have known a case where this has been done in the courts—several years ago—and the Judge has upheld the decision under the Business Names Act. I think that everybody has forgotten about it because there is no enforcement anywhere in the country.

2396. Let us say you find that a firm has not registered and you say "We are not going to pay unless and until you do register"—surely that would be effective? —It has occurred.

Mr. Greig: Generally speaking the boot is going to be on the other foot as far as we are concerned because we are trying to collect payment from the small trader; we do not act for members of the public and presumably it would generally be members of the public who would have that defence open to them.

2397. One of your members may come to you and say, they are thinking of having dealings with a particular firm and ask about them. If you find the firm is not registered you presumably say so and you might add that your member should not have dealings with it until it is; or better still, that he should buy goods from the firm and then refuse to pay for them. —*Mr. Peet*: I have been aware of this position for some years, the matter of non-payment of an account to a supplier who is discovered not to be registered. I would regard that as not cricket. Regarding supplies to a non-registered concern, I am a little conscious here they might be in difficulty; they might try to collect their money and somebody might say "You will not register, we will not pay".

2398. *Chairman*: As to the disqualification imposed by section 8 on a party in default, my experience, I think, rather coincides with yours. I have heard the point taken by counsel generally rather apologetically, and if there is a way round it I think the Court is quite disposed to take that way round on the ground, as you say, that it is not cricket—like the Statute of Limitations or the Gaming Act.—May I refer back to Professor Gower's points? He suggested, I think, that private prosecutions could be made under the Business Names Act. I did not know that.

Professor Gower: I think they can. What I suggested was that if people enforced their rights under the Act the Act would then be more widely observed. I am merely defending the Board of Trade in that they are not the only people who do not exercise their powers.

2399. *Mr. Lumsden*: One point in pursuing this argument of the benefit of the register to your members is that if a trader has disappeared you can trace the real owner through the register; but I think I am right in saying that registration is only made by a trader if he is trading under a name that is not his own name. Does that not mean that if a trader who is trading under his own name disappears you have no remedy, and are those not the great majority of cases and you are keeping a register to give you a remedy in a comparatively small percentage of cases? —*Mr. Greig*: One gains the impression, rightly or wrongly, that the people who disappear tend to be the people who are not trading under their own names. Whether I am right I do not know, but that is the impression one gets.

2400. *Mr. Watson*: Mr. Peet has told us of the considerable importance and advantage he experiences from registering companies as private exempt companies. Supposing that private exempt companies had their exemption taken away from them and were made to file balance sheets and profit and loss accounts, I wonder if Mr. Peet would tell us what he would do about it? Would he continue to keep these companies in being or would he wind them up? —No, I do not think

I would wind them up. I think I would take the view that the benefits of the Companies Act are such it would be better to comply with the requirements of the new Act.

2401. *Professor Gower*: If you were given the option of converting them into unlimited companies with exemption

from filing accounts, would you convert them?—No.

Chairman: Those are all the questions we have to put to you, and I should like to thank you all again for coming here and helping us. We have had a most interesting discussion and I am very much obliged.

(The witnesses withdrew)

APPENDIX XX

Memorandum by The Association of British Chambers of Commerce

Introductory

The evidence is submitted from the point of view of business men rather than from that of those skilled in company law. The Association is content to leave purely legal points to the evidence which others will no doubt tender to your Committee, and who are better fitted to do so.

The Association wishes to record its general view that the Companies Act, 1948, is in the main working satisfactorily. The great majority of companies are well and honestly conducted and change in the law for its own sake is to be deprecated. This is not to suggest that no change can be made but rather to make the point that where statutory restrictions are called for no unreasonable fetters should be placed on efficient and honest businesses.

1. Incorporation of Companies—Memorandum of Association

(a) Requirements as to Minimum Number of Members, etc.

The Association has considered whether there is any useful purpose in the distinction between private and public companies. It may well be that the practical effect of requiring seven members for a public company and only two for a private is negligible. Nevertheless, it is not suggested that any change should necessarily be made because in practice no difficulties seem to have arisen.

(b) Limitation of Objects to those stated in the Memorandum: Ultra vires Rule, etc.

The Association agrees that modern objects clauses are extremely wide.

What is said under heading 5 (a) below "Fundamental Changes in Company's Activities" has a considerable bearing on whether such wide objects clauses should be allowed to continue. Subject to this it is thought that the permitted width of objects clauses has worked reasonably well and there is no ground for recommending any change in the present law.

If, however, a change is contemplated, one suggestion was put forward and received some support that the objects clause should on registration be restricted to the actual or contemplated activities of the Company widened as far as reasonably necessary to enable such activities to be carried on, with power to alter or enlarge the powers by Special Resolution of the members.

If wide objects clauses are acceptable, then it is not thought that any great importance attaches to the *ultra vires* rule, which is now practically a dead letter, but no recommendation for change is put forward.

(c) The Company as a Legal Entity distinct from its Members

The Association supports the continuance of the legal position that a company is a distinct person separate from its members.

(d) Shares of No Par Value

The Association gave evidence to the Committee on No Par Value Shares, the Gedge Committee, in support of the idea of such shares. It has considered the subject afresh and as a result records that it is still of that opinion. This decision is not unanimous but by a substantial majority, and subject to the understanding, which we believe was always the intention, that it should be within the unfettered discretion of any company whether to adopt this system or to remain on the existing basis.

The minority fear that the system could be abused, while the majority consider that if the legislation is carefully drawn that danger need not arise. It is not thought necessary to repeat the arguments on the subject, for they are to be found in the evidence which the Association jointly with other bodies gave to the Gedge Committee.

2. Prohibition of Partnerships with More Than Twenty Members

The limit of twenty members applicable to a partnership is believed to be causing inconvenience and should be raised or altogether removed.

3. Classification of Companies

Nature and Merits of Distinction between (a) Public and Private Companies and (b) Exempt and Non-exempt Companies

It is not found that exempt private companies should be required to file a balance sheet, but considerable support was given to a suggestion that exempt private companies which have traded (thus incurring liabilities) ought to be required to file a balance sheet.

A point of detail is put forward as follows:—

Where a private company is the parent of a wholly owned subsidiary or subsidiaries then employees of such subsidiary or subsidiaries should be classified as employee shareholders of the parent company for purposes of being omitted from the maximum number of fifty shareholders. This change should apply whether the employee shareholders had acquired their shares before the company became a subsidiary or after it was taken over by the parent.

(A somewhat similar point relating to the provision of funds for the purchase of shares by employees of subsidiary companies is set out under heading 20.)

4. Donations by Companies for Charitable and Political Purposes

No change is recommended.

5. Exercise of Powers of Companies by Directors, etc.

(a) Fundamental Changes in Company's Activities

(b) Disposal of Undertaking and Assets

Where the Board of Directors of a company receives an offer to purchase its main assets or its main business it may well be desirable that the shareholders should be consulted, but very frequently the purchaser will not allow adequate time and there may be good reasons why the deal should be concluded without the publicity that consulting the shareholders entails. Therefore, the Association feels that the shareholders must be prepared to trust the directors as regards such a sale.

Where, however, the directors propose a change in the main objects of the company consequent on and perhaps using the proceeds of the sale of the company's principal assets or business the Association suggests that the shareholders should be consulted before the change is put into force. Incidentally contemplated restriction or non-restriction of the objects clause in the Memorandum has a bearing on the matter.

This should apply only where the main assets or business of a company have been disposed of and should not apply where a company sells one of two or more separate businesses which it has been conducting in the ordinary course of business.

(c) Issue of Shares

No comment.

(d) Borrowing of Money and Charging Property

It should be possible in Scotland to create a floating charge on a company's assets as is the common practice south of the border, thus bringing the law of England and Scotland into line.

(e) Lending Money Otherwise than in the Ordinary Course of Business

Whilst fully aware of the criticisms (really few in number) which have recently and quite fairly been made, the Association puts forward no recommendation because of the difficulty of defining the kind of lending to which any restriction ought to apply.

6. Directors' Duties*(a) and (b)*

The Association has considered anxiously whether it would be possible to define the duties of a Director more clearly. It was generally felt that if it could be done without unduly interfering with normal and honest business some definite expression of the general responsibilities and obligations of directors should be made in any new Statute. The difficulty in which the Association finds itself is that any definition must necessarily be in such general terms that it is doubtful whether it is of any assistance. One definition which was rejected for this reason runs as follows:

"A director shall at all times act honestly and faithfully and use his best endeavours to promote the interest of the company. He shall use reasonable diligence in the discharge of the duties of his office."

The present unsatisfactory state of the *ultra vires* laws referred to in heading 1 (b) on page 1 was also considered.

Some support was given to a suggestion that when the appointment of a new director is filed, the Registrar should send to him or her a brief summary of "The Duties of a Director", and it might be desirable that such a summary should be included in any new Statute, thus giving it the force of law.

(c) and (d)

With regard to dealings of directors in the shares of their own companies it is suggested that the Register of Directors Shareholding should be available throughout the year during normal business hours for inspection by any member of the company or by anyone who has ceased to be a member within twelve months. This should apply to directors and should be extended to the Secretary.

(e) Bodies Corporate as Directors

No examples have come to the attention of the Association where this provision has led to any abuse. It is convenient because the body corporate which is a director is then able to nominate whichever of its own directors may be available to attend any particular meeting or to attend to day-to-day business requiring a director's signature. This facility, therefore, serves a useful purpose and should be preserved.

(f) Appointment of Directors

The following points do not seem to fall aptly under any of the sub-headings (a) to (e) but nevertheless they are mentioned here as they relate to directors.

It is suggested that if a director is elected to fill a casual vacancy there should be a statutory duty on the company to put him up for re-election at the next Annual General Meeting, whether that director has been appointed to some other office such as managing director or not.

It is appreciated that this suggestion might cause difficulty in a perfectly *bona fide* transaction, such as might be the case if the directors of a Private Company wanted to bring in an outsider as a Managing Director to replace a Managing Director who has (say) died, and there is no capable successor within the organisation.

The new appointee might be hesitant to give up a position and join the Company, with a risk of not being re-elected at a later meeting.

Probably it would be advisable to restrict this suggestion to Private Companies, where it would be easy to call the shareholders together at once to ratify the proposed appointment.

Cases have occurred where companies have purported to appoint an individual as director without his being aware of the intention. It is suggested that it should be the duty of every company to obtain a written consent to act before appointing a director, such written consent to be filed with the statutory return of appointment.

In order to make a repetition of frauds more difficult it should be provided that no person shall act as a director if he has previously been convicted of an offence involving fraud or dishonesty unless by leave of the Court.

7. Shares with Restricted or No Voting Rights

Since non-voting shares have their legitimate uses it is suggested that they should continue to be permitted provided always that they are so described in all documents issued by the company. It is hoped that the Stock Exchange would follow suit in always insisting on the use of the description "non-voting shares".

A suggestion was made that the total amount of the Ordinary Capital carrying votes must always be greater than the total amount of the non-voting Capital.

These suggestions only apply to Ordinary Shares, as special and restricted rights are common in the case of Preference Shares, and no comment is called for.

8. Protection of Minorities

Members of the Association are aware of many cases that require attention particularly in the field of private companies and there is a general feeling of dissatisfaction with the present remedies.

There are as yet few English reported decisions on section 210 and no case reported or otherwise seems yet to have been fought to a successful conclusion in England. The wording of section 210 suggests that it is only available as an alternative to winding-up* and this may explain to some extent why comparatively few cases have reached the Court. (The Law Society is believed to be making representations on this point.) The Chancery judges have stated that a petitioner must indicate the nature of the relief he seeks and this ruling has imposed an unfair burden on the petitioner who has no precedents to guide him and has often felt that he may fail because of an unsuitable choice of remedy even though he succeeds in proving the abuse.

Even if section 210 is amended so as to make it clear that it is available otherwise than as an alternative to winding-up applications to the Court are likely to remain rare unless (a) the complaining party is given some lead as to the sort of relief he might seek and (b) the section is operated more effectively. It is thought that on the first mentioned point the Jenkins Committee is in a position to provide valuable assistance. The Committee may not appreciate that the very mention by the Cohen Committee in paragraph 59 of its Report of the case entitled "Excessive remuneration of directors" has been of very considerable value to minority interests suffering from this particular type of abuse. Professional advisers have been able to quote paragraph 59 to offending directors and point out to them that their action is the very sort of mischief which the Legislature had in mind; thereafter directors have often listened much more seriously to complaints by minority interests. If the Jenkins Committee were disposed in their report to quote other types of abuse and indicate the type of relief which might be appropriate, considerable benefit might flow, because the examples could be quoted by complaining parties and their advisers. We know of a case very

* Footnote page 54 Modern Company Law by L. C. B. Gower, 2nd edition.

similar to that cited by the Cohen Committee in paragraph 59 entitled "Excessive remuneration of directors" except that in the case known to us the directors have gone further and have protected themselves by long term service agreements at large fixed salaries. In such a case some measure of relief would be secured by a Court Order directing the Board to reconsider the terms of the service agreements in the light of the criticism offered by the minority, coupled with an indication that if nothing was done an Order might be made revising the terms of the agreement so as to reduce the period and salary to more reasonable proportions or making some part of the remuneration dependent on profits. In other cases a Court Order appointing directors on behalf of the minority shareholders for a term might be appropriate; and in a case of serious neglect or deliberate running down of a business an order removing directors might be suitable. In a case where directors have insisted on ploughing back profits regardless of the claims of minority shareholders an Order directing the Board to consider other ways of raising capital and to reconsider its dividend policy might be a solution. We feel certain that if a lead of this sort could be given as to the types of relief which a Court would consider, in time a useful group of Orders would be developed by the Courts. To some of us it seems that more useful results are likely to be obtained if in appropriate cases the Court exercised a power of adjournment so as to give the parties the opportunity of agreeing the type of relief which might be appropriate. The party complaining of oppression would state the facts of which he complained and if a *prima facie* case has been made out the other party would then reply. If the case then appeared to be one calling for relief and the nature of the relief was not apparent, it is suggested that it would be appropriate if the Court granted an adjournment in order to allow the parties an opportunity to arrive at a settlement (which might involve the giving of undertakings on certain points by the parties complained of). If the adjournment produced no solution the Court would make the order which seemed most appropriate. It seems to many of us that the judges have not appreciated the difficulty which the average shareholder experiences in finding out what is really happening to the Company's business and that the perfectly proper motive of protecting directors against frivolous enquiries and actions has too often operated to the shareholder's detriment.

We think that the position of the minority would be materially strengthened if the Court were given power to order the personal attendance in Court of the directors for the purpose of assisting the Court with information and explaining their conduct. The very existence of such a power might well result in the directors showing a more accommodating attitude towards minority interests (even before an application to the Court were mooted). In our view the Court should be given power to make an award against the company in respect of the costs to which a minority shareholder is put in making his application.

It was generally agreed that an important minority shareholder(s) even in a private company should be entitled to representation on the Board of Directors, and to that end, the Association had before it a memorandum on Cumulative Voting, as operated with considerable success in the United States of America. (See Annex A.)

Such a system is of undoubted benefit to minorities.

Except that the system is almost, if not entirely unknown in the United Kingdom, there appears to be no reason why any company should not import the system in its Articles, and therefore the Association did not feel it was called upon to make any recommendation.

9. Protection of Special Classes of Shares

With regard to preference shares it is felt that the shareholders originally subscribed in the knowledge that their shares might be repaid by a return of capital and this cannot be regarded as an abuse.

On the general question it is suggested that where there is no Modification of Rights Clause in the Articles of Association of a company it should be provided in the Act that Clauses 4 and 5 of Table A shall apply.

10. Board of Trade Power to Appoint Inspectors

The procedure of appointment of inspectors by the Board of Trade should generally be simplified with a view to greater expedition. This applies particularly to regulations for the appointment and for the publication of the Inspector's Report. For this purpose it may be necessary to increase the powers of such inspectors. Speed of operation of this procedure is considered essential, as cases where it is invoked are usually those where quick action is a paramount consideration.

11. Disclosure of Ownership and Control

The Cohen Committee reported in favour of requiring nominee shareholders to disclose the beneficial ownership. In principle the Association agrees but recognises the practical difficulties of applying such a requirement. Nevertheless it is felt that the directors of a company should be made aware of the position in cases where an "interest" is gradually acquiring a large number of shares. It is, therefore, suggested that where any person or group of persons of which that person was a participant is the beneficial owner directly or indirectly of more than 10 per cent. of any class of shares there must be immediate disclosure to the directors of the company concerned. This should apply the moment the person in question has acquired the right to the shares whether the transfers are lodged or not. Failure to declare in accordance with this provision should incur heavy penalties and also result in the holder's voting rights being limited to 10 per cent. of the total voting power of the company. Admittedly such a provision could be avoided to some extent by a group of persons secretly acting in concert. There is also the possibility of an individual who wishes to hide the position using a wholly owned company for this purpose or avoiding disclosures in some other way. Nevertheless it is felt that some provision of this kind would be better than no provision at all.

12. Share Transfer and Registration Procedure

The procedure of share transfer and registration is too slow and cumbersome. If possible some simplification should be effected.

Some clarification of section 436 should be made to bring it into line with technical advances. This section permits a company to keep its register "either by making entries in bound books or by recording the matter in question in any other manner". This would appear to allow the use of punched cards or other mechanical methods but section 113(1) and (2) gives members the right to receive a copy of the register or any part thereof. This seems not to meet the physical facts of modern methods of record keeping.

Section 110(2) allows the register of members to be kept at an office other than the registered office of the company. It must be kept in the country of registration whether England or Scotland and the Registrar must be notified and he must be notified of any change in the place where the register is kept. It is, therefore, in order and sometimes happens that the registered office and registration office are in different towns. If the Annual General Meeting is held at the registered office the register must be immediately available because a poll may be demanded. Strictly the Act does not permit the temporary removal of the register for this purpose. To meet this point it is suggested that the word "normally" should be inserted before "kept" in Section 110(2) where it occurs first and in provisos (a) and (b).

There seems no reason for requiring a description of allottees in the return to be made under section 52(1). The words "and descriptions" might well be dropped from paragraph (a) of sub-section (1).

13. Multiplicity of Directorships held by One Individual

The Association recommends that no change should be made. Lengthy lists of directorships often arise because many companies are subsidiaries of one parent.

(See next subject number.) Apart from this there would be a considerable reduction in the value of the services and advice offered by professional and non-executive directors if the number of directorships were limited. It is suggested that a company is itself the best judge of whether a particular individual will be useful as an addition to its Board and its freedom of choice should not be limited.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

The Association sees no reason to recommend that any change be made in the general principle of carrying on business through subsidiary companies.

In the United Kingdom Company Law permits the use of subsidiary companies and the taxation system does not impose the same kind of penalty that is often found in other countries. This advantage should not lightly be discarded. The United Kingdom system of Overseas Trade Corporations and the ability to make subvention payments where both companies are subject to United Kingdom tax are examples of the kind of advantages at present enjoyed for tax purposes.

15. Loan Capital

(a) *Debentures and Debenture Stock*

As from the date of the passing of any Act resulting from the recommendations of the Company Law Committee it should only be permissible to use the word "Debenture" in circumstances where something in the nature of a charge has been created. Where there is no charge it is most desirable that the description should omit the word "Debenture".

(b) *Trust Deeds*

No comment.

(c) *Registration of Charges*

Legislation should require a company to make an entry in its own register of charges immediately after the charge is created.

16. Take-Over Bids

At the time when take-over bids first came prominently into the news the Association appointed a working party to consider the subject. This working party produced a memorandum (see Annex B) which was endorsed by the Association's governing body but was not forwarded to official quarters because by then the Government Committee on Company Law had just been appointed, *inter alia*, to consider this question of take-over bids. The Association has reviewed this memorandum and it fully endorses everything in it from the point of view of industry and commerce. It does, however, wish to add the following points.

If 50 per cent. or more of any class of shares is acquired as the result of an offer, then the remaining shareholders should be given the right to demand the same terms, the power to be exercised within a limited period.

Where the directors of a company recommend acceptance of a take-over bid:

- (i) they should be required to indicate by circular the assets, earnings and potential profits of the company;
- (ii) they should satisfy themselves that the bidder has funds available to implement the offer;
- (iii) a duty should be imposed on them at the same time as signifying their recommendation to make full disclosure of any inducements they may have received such as the offer to continue in office or to retire with compensation for loss of office; *per contra*, any inducement for recommending rejection must equally be disclosed.

Section 209, which gives a company which has acquired 90 per cent. or more of the shares of one class in another company the right to acquire the remaining shares of that class, is drafted so as to lead to needless delay in some circumstances. It is not necessary to wait for the expiry of the four month period in those cases where the requisite 90 per cent. has been acquired sooner. It would suffice to permit of one month after acquiring 90 per cent., within which the minority could be required to sell.

17. Prospectuses

The Association supports the principle underlying the Private Members Bill, the Companies Act, 1948 (Amendment) Bill. It will be recollected that this proposes that if any invitation has been issued to the public to deposit money with the company then that company must deliver the equivalent of a prospectus to the Registrar. This requirement is to apply to Private Companies and any company inviting deposits should cease to be classed as an Exempt Private Company.

18. Control over Business of Dealing in Securities

The Association feels that this subject is a technical one and would prefer to leave others more directly concerned to deal with it.

As a general observation the Association suggests that Licensing Regulations should be more strictly formulated, and may be a more strict code as to enquiries by the Board of Trade before a Licence is issued.

It was also suggested that section 14(1) of the Prevention of Fraud (Investments) Act, 1958 requires clarification as to whether an advertisement pursuant to the requirements of the Stock Exchange is or is not a circular.

19. Unit Trusts and Open End Mutual Funds

For the reason given in paragraph 18 the Association feels unwilling to make any comment.

20. Reduction of Capital and Purchase by a Company of its Own Shares

The Association would oppose the idea of permitting a company to purchase its own shares. If a company were permitted to purchase its own shares it would open the door to objectionable practices. It would be possible for some members of the company with special knowledge to cause the company to purchase the shares of other members at less than their real worth so securing to themselves at an unfairly low price assets that might be of great value.

It is suggested:

- (i) that a parent company of a group should be permitted to provide funds for the purchase of shares to be held not only for the benefit of its own employees but also for the benefit of employees of wholly owned subsidiaries;
- (ii) that the sanction given in section 54(b) as to employees should be extended to past employees.

21. Accounts

The Association has considered the suggestion that figures of turnover or sales ought to be provided but it feels that this is neither desirable nor necessary.

It was said in a recent case in *re Sussex Brick Co. Ltd.* (Chancery Division 20th/22nd July, 1959, Weekly Law Reports 1960, Part 15, at page 666)

"... it is manifest that from modern Balance Sheets very little real information can be obtained as to the Capital Value of Assets, even treating the Companies as going concerns, and of course, on the footing of a liquidation the Balance Sheet figures are almost useless...".

In this connection some support was received for a suggestion that shareholders by a bare majority should have the power to require that the Directors have a valuation made of the Fixed Assets and report to the members say every five or ten years. Notice of such a demand must be circulated to all shareholders in order that a vote can be taken.

Further valuation and details of Trade Assets on the Balance Sheet were discussed, but it was borne in mind that a company may have holdings in Trade Investments or Associated Companies which it would not be in the company's interest to disclose, and so no recommendation is put forward.

The subject of accounts is largely one for the accountancy profession and apart from the above the Association wishes to make no comment.

22. Audit

Under Section 161(2) an Exempt Private Company is excluded from the requirement that an audit shall be carried out by a qualified auditor. It is suggested that as part of the price of the benefit of enjoying limited liability all Exempt Private Companies which are trading should be required to have a proper annual audit. This could be secured by adding the words "and is not trading" at the end of the proviso of sub-section 2 after the words "exempt private company".

23. Provisions as to Returns

It is suggested that the time limits for rendering returns and filing documents are sometimes not sufficiently strictly enforced by the Registrar of Joint Stock Companies. Reasonable latitude should continue to be allowed but some cases have been permitted to continue unchecked too long.

If the accounting date of a company is changed resulting in the date of the Annual General Meeting also being changed, two returns equivalent to "annual" returns should be accepted for filing in the same year. They are not at present accepted on the ground that there would be two returns in one calendar year.

A suggestion was also put forward for consideration that in view of the length of the list of members the requirement to file every third year puts a great burden on the company. Accordingly a company with more than 5,000 members at the date of the return should be relieved of the obligation entirely.

24. Company and Business Names

Section 201 requires that directors' names should be stated on "all trade catalogues, trade circulars, showcards and business letters". This is largely ignored at the present moment as regards trade catalogues, trade circulars and showcards and this part of the requirement might well be dropped. At the same time it might be made clear that an invoice is a business letter to which the requirement applies.

A company registered before 23rd November, 1916 is exempt from this requirement referred to above. This is so even when it becomes the wholly owned subsidiary of a recently registered company. The exemption for the older type of company has been misused in at least one case and could well now be allowed to lapse.

The Registration of Business Names Act should be amended to restrict any present partnership or company from styling itself bankers or merchant bankers unless it complies with the 1948 Act. Similarly any overseas company desiring to use the name of banker or holding itself out as banker should comply with the 1948 Act in the same manner as companies registered here.

The Registrar of Companies should be required to consult with the Trade Marks Registry before accepting the name of a company for registration. One glaring case has occurred in which a new company in innocence registered a name which was the registered trade mark of another concern.

The application for registration of a business name is at any rate technically due to be made after the business has commenced. The procedure should be the same as for the registration of the company, i.e., the prior clearance of the name.

It was also reported that cases have happened where a foreign company has subsequently learned that an English company has been registered under its name without any authority. To remedy such an abuse the foreign company might be given the power (possibly to be exercised within six months of learning the facts) to require the English company to change its name. It is appreciated that if the English company had traded complications might arise.

25. Foreign Companies

No comment.

26. Internal Management and Administration

It is suggested that the distinction between an Extraordinary and a Special Resolution might be abolished.

The Association favours the suggestion that proxies should be allowed to speak at meetings of Public Companies. The prevailing practice of inserting a name such as that of the Chairman of the Company in the form of proxy seems to the Association to be objectionable. It would be preferable if a blank were left so that the proxy form read:

"I being a member of the above named Company hereby
appoint or failing him (here the name of the Chairman could
be inserted at will)"

Typewritten copies of all documents should be acceptable by the Registrar provided they are submitted in a manner satisfactory to him. He would, for example, wish to be satisfied that there was no risk of fading. This suggestion would save much expense.

27. Winding-up

Proof of Debts, i.e., Claims by Creditors, in a Winding-up by the Court

This should not be mandatory as at present, but should be at the discretion of the Liquidator, as in a Voluntary Winding-up.

Liquidator, in Compulsory Liquidation, to send Accounts and Reports to Creditors and Shareholders

There is no provision in the Act for Annual Accounts to be prepared once a Company has gone into liquidation, nor is the Liquidator in Compulsory Liquidation obliged to make any report from time to time to Creditors or Members. In practice he spends much time and postage answering letters which he is not legally obliged to answer, and strictly that is not an allowable expense. It is recommended that an Annual Account and Report of his stewardship be sent to all Creditors for amounts above, say, £5, and in cases where the Assets are expected to realise more than the Liabilities to Shareholders or relevant classes of Shareholders.

Directors should submit reasons for insolvency as well as a Statement of Affairs, and the Liquidator should report to the Board of Trade whether he considers these reasons adequate, and if not give his own opinion. In appropriate cases he should recommend that Directors should be forbidden to take part in affairs of other companies, Directors in such cases to be allowed to answer the Liquidator's allegations.

The Directors should be allowed to answer any allegation by the Liquidator to ensure that the wrongdoer is caught but the honest man has a chance to make a good defence. The Personal Investigation Department of the Board of Trade should be in touch with specially qualified accountants in insolvency work to investigate borderline cases of fraud if the Liquidator has insufficient company's funds. The Board of Trade should have a fund to enable the Liquidator to take proceedings where the Board itself has no wish to prosecute.

It is suggested that where a Company is wound up by the Court, the Creditors should have the choice of deciding whether the liquidation should be conducted:

- (a) by a compulsory winding-up by the Official Receiver or an outside Liquidator, or
- (b) as a voluntary winding-up with an outside Liquidator.

Committee of Inspection

In a Compulsory Winding-up the Court appoints a Committee of Inspection representing Creditors and Shareholders. It does happen that in the course of time the Creditors are paid off in full, so that the only parties interested in the liquidation are the shareholders. There is, however, no power to ask the Creditors' representative(s) on the Committee to retire. It is suggested that he (they) should automatically retire from the Committee once the Creditors have been paid in full.

The converse may happen, e.g., a company is thought to be solvent and goes into voluntary liquidation and the Committee of Inspection is confined to representatives of shareholders. Later it is found to be insolvent. The Committee of Inspection should be reconstituted by representation of creditors only.

Public Utilities

It is often found that public utility concerns threaten to cut off supplies to a company in course of being wound up or in Receivership unless the outstanding account is paid in full. Threats of this kind should be made illegal. They are a form of blackmail bringing pressure to bear on the Liquidator or Receiver to accord the public utility preferential treatment entirely outside the Companies Act, 1948, or any earlier Act.

28. Problems of Administration and Enforcement of the Law

Penalties

The whole question of penalties requires examination.

The penalty under section 54 which prohibits the giving of financial assistance by a company for the purchase of its own shares is quite inadequate being only £100. The Court should be empowered to impose a penalty of a much more substantial amount. Furthermore, directors committing glaring acts of misfeasance of this kind should be personally liable to repay to the company any amounts improperly applied.

29. Any other matters within the Terms of Reference

Deposits

Many powerful and highly respectable Finance and Hire Purchase Companies advertise for deposits. But, on the other hand, many new and mushroom Companies have been formed in the last few years. All should have to have an Industrial Bankers Licence to be issued annually by the Bank of England, acting in conjunction with the Board of Trade, which should have power to call for information at any time. Before issue circulars inviting deposits should be filed with the Board of Trade under the Prevention of Fraud regulations.

It is suggested that the Companies Department, Board of Trade, through the Bank of England shall call for a return, the terms of which should be published, on the following lines:

- (1) Weekly returns of deposits and assets.
- (2) Quarterly returns showing paid-up capital and reserves and short-term borrowings.
- (3) Quarterly returns showing the total value of balances under instalment contracts on which payments were three or more months in arrears.
- (4) Any information judged necessary by the Bank to enable it to form a true estimate of a Company's condition.

- (5) Audited accounts showing liabilities in respect of Bank Advances, Acceptances and Deposits separately, to be submitted to the Bank of England yearly, the Bank to have power to call for an interim audited account if deemed necessary.

The object of these steps should be to enable the Bank to judge whether the company's own capital was likely to be seriously eroded by trading losses and if so to prevent the company from soliciting or accepting further deposits or other loan capital.

Use of Title "Chamber of Commerce"

The Association is much concerned at the possible misuse of the title "Chamber of Commerce". A separate memorandum on the question is attached (Annex C) making suggestions how the matter should be regulated. Added importance is attached to the subject because Chambers of Commerce may in certain circumstances be required to give Certificates of Origin in connection with the European Free Trade area.

Reconstruction Schemes

It is suggested that in the case of a reconstruction scheme following financial difficulties, something on the lines of procedure in Scotland might be useful. There the Court refers the scheme to an independent Accountant or Arbitrator who is required to make a report giving regard *inter alia* to what expert investment opinion would regard as reasonable and fair.

ANNEX A

Cumulative Voting

Notes on American Practice

Complaints have frequently arisen that majority stockholders oppress the minority. Under the old-fashioned rule of voting, which still prevails in many corporations, the stockholder is entitled to cast a number of votes equal to the number of shares he holds, for one candidate for each position on the board of directors. Where, for example five directors are to be elected, a person holding 51 shares out of 100 shares of stock can elect his five candidates. To prevent this situation, a system of cumulative voting has been devised which in some states is prescribed by the statutes or the constitution of the state, and in other states is often included as a part of the machinery of management provided in the certificate of incorporation. Under this system of voting each stockholder has as many votes as is equal to the number of voting shares he owns multiplied by the number of directors to be elected. These votes he may accumulate for one candidate or may distribute among the candidates for election in any way he sees fit.

In the example cited above, the majority stockholder would have 255 votes (51×5) and the minority interests would control 245 votes (49×5). If the majority contents itself with casting this cumulative vote for three out of five directors, it can secure their election by giving each director 85 votes. The minority may elect two directors by giving one of the directors 122 votes and another 123 votes. In this case, if the majority frittered away its strength among five directors, while the minority concentrated its strength upon four, the minority would gain control of the board.

Staggered Terms and Cumulative Voting

Cumulative voting operates to give representation to minority groups if all directors are elected at the same time. If the terms of the directors are staggered so that only one or a few are elected each year, a minority might be prevented from electing any directors even though cumulative voting is permitted. In any event, staggering of the terms of directors (also called "classification") dilutes the stockholders' maximum voting strength under cumulative voting.

For example, in the case of a nine-member board, if all members are elected at the same time and cumulative voting is permitted, the owners of 10 per cent. of the stock plus one share can elect one director. However, if the terms of the directors are staggered so that only three members are elected each year it takes 25 per cent. of the stock voted plus one share to elect one director. Moreover, a minority holding 49 per cent. of the stock can elect four of the nine directors through cumulative voting where all are elected at once, but can elect only one out of three each year if the terms are staggered, so that it would never have more than three directors on the board.

ANNEX B

Take-over Bids

1. There is no satisfactory legal definition of a Take-Over Bid which is as old as the joint stock company itself, but it may be taken as meaning here "any acquisition of control of a company through the purchase of its shares by an outsider". It is in essence a market device, there being a market for control of a company just as there is for investment in its shares, and it is one of the ways in which the capitalist system corrects the inadequate use of assets.

2. Three factors have favoured the take-over bidder in post-war years:

- (a) There has been a big structural change in Britain's national economy. Some industries have diminished in importance and new industries have grown up. Distribution of the national income is more equal than in the 30's. The consumer durable goods industries using new materials and processes have developed, aided by hire purchase or short term credit. The multiple store and self-service store have expanded at the expense of the independent shopkeeper.
- (b) Economic planning has changed. Local and central governments have become increasingly involved in economic affairs resulting in increased taxation, much of which falls on companies. (See (i) below.) Dividend payments have not kept pace with the increase in profits and with the growth of companies' profit-earning assets. Stock market prices are determined largely by current and prospective dividends and consequently share prices rose less than profits and assets. (See (ii) below.) Thus the take-over bidder could buy his way into a conservatively run company by purchasing relatively low priced shares. Many such companies had large liquid assets capable of being turned to profitable use. Moreover, when there was a big cash holding the bidder was compensated for the cash spent in buying the company's shares.

Note (i).—Taxation as a percentage of gross trading profits less depreciation at Inland Revenue rates:

1938	..	..	34.9
1952	..	..	52.8
1958	..	..	41.4

Note (ii).—Percentage of profits distributed as ordinary dividends:

1938	..	..	58.2
1952	..	..	19.7
1958	..	..	23.9

Source: National Income and Expenditure 1956 and 1959 "Companies Appropriation" and other tables.

- (c) Because of the burden of taxation many shareholders were tempted by tax-free capital gain. They would thus often prefer to sell at once rather than wait for higher, but taxable dividends in the future. Since 1952 dividend payments

have increased through the freeing of controls, the easing of taxation and the threat of the Take-over Bid.

3. There is some concern about the increase in the number of take-over bids made in answer to the Restrictive Trade Practices Act, and its effect on price agreements. Were this trend to lead to more vigorous action by the Monopolies Commission the consequences might be legislation in the nature of the United States Anti-Trust Laws.

4. There are some exceptions, but on the whole take-overs are not harmful to employees in the long run because if a business is going downhill they will eventually lose their jobs in any event, whereas with new management and drive their prospects are often improved. In actual practice the taking-over company usually finds it in its own interests to look after the employees of the taken over company. Clerical staff are the least protected where the take-over results in administrative streamlining.

5. The Association is concerned primarily with the protection of shareholders who suffer from lack of information, this applies particularly in the case of bids affecting the medium sized public companies whose shares have a relatively inactive market.

At present the rapidity with which some take-overs are effected does not always permit a full statement to the shareholders about the companies involved. Such statement should be issued only after adequate preparation and the shareholders should be given at least three weeks to consider it. If the Directors of the company which it is sought to take over support the bid then any statement should include a certificate signed by the auditors of the respective companies to the effect that the facts relating to the company or companies for which they act are correct. If the Directors of the company to be acquired oppose the bid then any statements, whether offering to acquire shares or opposing the bid should likewise be accompanied by an auditor's certificate as to facts. Though this procedure would not certify about the future it would give some indication of the prospects from past performance.

6. The Prevention of Frauds (Investments) Act consolidated in 1958 became law in 1939 in circumstances no longer prevailing today. Was it expected that the Board of Trade's powers would be used as fully as they now are? Sections 13 to 15, dealing with circulars, could well be considered as subjects for amendment, particularly as regards bringing circulars recommending the rejection of offers within the ambit of the Act.

7. The register of directors' shareholding should be available for inspection by shareholders and debenture holders in the same way as is the register of members. Owing to the time required for registering transfers, this right of inspection would, however, not always reveal the number of shares acquired by a director at the last minute in anticipation of a quick take-over.

8. United Kingdom legislation has not been fully used to enforce the widest possible disclosure of the part played by nominees in take-overs, though sub-sections (1) and (3) of section 172 of the Companies Act, 1948, goes part of the way.

(a) Where a take-over bidder has acquired some shares other members of the company may apply to the Board of Trade under section 172(3) of the Companies Act, 1948, for the appointment of an inspector unless the application is vexatious, i.e., "without good reason". Mere suspicion that nominees are acquiring shares for a take-over bidder might not be sufficient reason.

(b) Where a take-over bidder has acquired no shares the Board of Trade may appoint an inspector under section 172(1) for the purpose of determining the true persons "financially interested"—the interpretation of "financial interest" is perhaps too narrow to be effective.

(c) The Board of Trade may, under section 173, investigate membership without appointing inspectors.

9. There is some belief that by the speeding up of registration of transfers the existence of share purchases prior to and directed at a take-over attempt would be revealed. The existing machinery is as follows:

- (a) If the potential bidder, without using the Stock Exchange and without using circulars, buys some only of a member's shares, the lodging of the transfer with the share certificate for entry in the register of the company may show that an unusual number of dealings are taking place, though these may be hidden to some extent by nominees.
- (b) If, however, the purchase is of all the member's shares the transferee may delay registration unless the transferor applies to the company under section 77 of the Companies Act, 1948, for the registration of the transfer.
- (c) If the potential bidder uses the Stock Exchange the efficient broker will lodge the transfer quickly and the register will show the activity of the shares which will also be reflected in the Stock Exchange "Dealings".
- (d) If the register is at the headquarters of the company the latter will, in an efficient organisation, be able to spot rapidly the trend in purchases. But in the case of a company with a head office in the city which, to keep down the cost of accommodation, keeps its register in the suburbs or where an agency is employed to keep the register, there may be a delay before the head office is aware of changes in membership of the company.

From the foregoing it would appear that there is nothing basically wrong with the existing machinery provided it is speeded up.

10. It is of interest to note the way in which the United States has dealt with the problem. There, owing to the existence of a Capital Gains Tax, mergers not involving the immediate payment of the tax by shareholders, are more common than take-overs of the United Kingdom type. The disclosure requirements under Federal Law are governed by the Securities Exchange Act, 1934.

- (a) Section 10(b) of the Act provides that in the *purchase or sale* of a security (whether listed or not) it is unlawful for anyone to engage in misleading practices or to employ anyone to engage in misleading practices or to employ any scheme or device to defraud in contravention of rules and regulations made by the Securities Exchange Commission (S.E.C.). Rule X10B5 of the S.E.C. in effect makes it unlawful for any person to purchase or sell any security by means of misleading statements or omissions of material facts necessary to be stated in order to avoid creating a misleading impression as a result of the facts stated or to employ any scheme or device to defraud. This rule *does not require* the submission of written Take-Over Bids to the Commission.
- (i) The existence of S.E.C. Rule X10B5 and the almost invariable practice of the management of companies, subject to take-over bids, of bringing the matter to the notice of the Securities Exchange Commission leads to the *informal* submission of the papers to the Commission for comment. Such comment is without prejudice to any action on the part of the Commission to seek any appropriate relief against a misleading document should any violation of the rule be found to exist.
- (ii) Since the management is not engaged in buying or selling a security its literature in opposition to a take-over is not subject to any restraints under the Securities Acts. This is not the case in a proxy fight. Here the literature of both sides, if the company's shares are listed, is subject to the Commission's proxy rules which do not permit any restriction on the contents.
- (b) Any person who acquires directly or indirectly 10 per cent. or more of the equities of a listed company must within ten days after the close of the month in which such percentage is reached, make a report to the Commission and

to the Stock Exchange on which the shares are listed, disclosing his name and the number of shares that he has acquired. Thereafter, so long as he is the holder of 10 per cent. or more of such equity securities he must make reports monthly of his acquisitions and dispositions of shares and the amounts thereof. Furthermore, the courts have laid down that when a person acquires sufficient shares to constitute control of the company, his failure to disclose to stockholders selling their shares to him plans which he may have to dispose of assets of the company at a profit, or other plans which may enhance the value of the stock, constitutes a violation of Rule 1 10B5.

ANNEX C

Use of the name " Chamber of Commerce "

Sections 17 and 19. Companies Act, 1948
Registration of Business Names Act, 1916

1. The Association submits that it is necessary to control by law the use of the name " Chamber of Commerce ". To achieve this it will be necessary to amend the Companies Act, 1948, and possibly the Registration of Business Names Act, 1916. There are some Chambers of Commerce in Scotland which are incorporated by Royal Charter. They are adequately governed by their Charters and no suggestion is advanced here for any change in their position.

2. The reasons for the submission are as follows:—

- (a) The title " Chamber of Commerce " carries great prestige both nationally and internationally. Yet there is no legal impediment to an unincorporated group of individuals adopting the title although they are not representative of business and may not conform to the standards associated with Chambers of Commerce, of which the principle is that a Chamber of Commerce is non-political and does not aim to make profits.

It is perhaps stating the obvious to recall that the term " Chamber of Commerce " has by usage acquired a meaning in business circles which merits protection by law. In other countries Chambers of Commerce are public bodies in the sense that they are responsible for performing certain functions which in this country are done by Government. It therefore comes as a surprise to a foreigner—even if it occurred to him—that a body in the United Kingdom which called itself a Chamber of Commerce might in fact be a small group of persons which is not representative of anything material and which may be of no substance.

- (b) Difficulties do arise owing to unrepresentative bodies purporting to act as Chambers of Commerce. For instance, a crop of such bodies which claimed to be able to offer special facilities in the European Economic Community, caused the Chambers of Commerce in Europe to consider how to distinguish genuine Chambers of Commerce by adopting code letters which might be registered and protected by law.

- (c) It is also desirable to enable the public to distinguish between a Chamber of Commerce and a Chamber of Trade, because they differ in character and sometimes in their objects. This point is expanded later on.

Present Statutory Regulations

3. Some Chambers of Commerce are incorporated under the Companies Act as limited companies and are governed by those Acts.

Chambers of Commerce which are not incorporated are not subject to any specific statute. They are voluntary associations of persons who are severally subject to the general civil and criminal law.

Incorporated Chambers

4. There are two particular restraints exercised by the Board of Trade on incorporated Chambers of Commerce. They are:

5. First, by virtue of section 17, Companies Act, 1948 no company shall be registered by a name which in the opinion of the Board of Trade is undesirable.

It is not known what criteria the Board of Trade adopt in practice under this section. They could limit their interpretation of the word "undesirable" to "offensive" or "gravely misleading". On the other hand they could insist on perfect accuracy of description, which is unlikely so far as the term Chamber of Commerce is concerned, because strictly "Commerce" denotes "merchanting", whereas Chambers of Commerce embrace all kinds of businesses in some areas, and in other areas, more commonly, all kinds of businesses except retailers. It would be possible under this section for the Board of Trade to insist on a name containing the words "Chamber of Commerce and Trade" in those cases where retailers constitute a substantial part of the membership.

6. Second, by virtue of section 19 the Board of Trade may licence direct that an association may be registered as a company with limited liability without the addition of the word "limited" to its name. The Board must be satisfied that an association "is to be formed for promoting commerce . . . and intends to apply its profits or other income in promoting its objects".

The Board may attach conditions to the grant of such a licence.

A body to which a licence is granted is excepted from the obligation to publish its name and to send lists of its members to the Registrar.

Subsection 7 directs that if the name of the body from which a licence is withdrawn contains the words "Chamber of Commerce", the body must change its name so as to exclude those words. (This is curious because if the body had those words in its name and never applied for a licence it need not change its name.)

Comment on the Present Statutory Regulation

7. The comment is that section 19 is a very indirect way of protecting the public interest. Its two sanctions are:—

- (i) to withhold the privilege of omitting the word "Limited" from the name, which is no great penalty nowadays, whatever it may have been in the nineteenth century, because the public accepts and even expects the word "Limited" as a mark of correctness of legal form.
- (ii) to oblige the association to send a list of its members to the Registrar, which can be a nuisance, but not in these days of addressing machines.

It is submitted that the kind of supervision which is required should be more direct.

The Purpose of Supervision

8. The broad purpose of the supervision which it is suggested should be enacted, is to forbid the use of a name which includes the words "Chamber of Commerce" to any body of persons unless it conforms to the criteria normally expected of Chambers of Commerce. This applies whether the body is incorporated or not.

Criteria of Chambers of Commerce

9. The criteria include the following, namely:—

- (a) The object of the Chamber is the promotion of industry and commerce.
- (b) The Chamber is not connected directly or indirectly with any political party.
- (c) The Chamber is a voluntary, self-governing association.
- (d) The Chamber represents industry and commerce of the area which it claims to cover without prejudice to including some retailers in its members, so long as they do not control the Chamber.

- (e) The Chamber is not formed for the purpose of earning profits. Its income should not be used for any other purpose than furthering the interests of industry, commerce and the related professions, including the promotion of training for those pursuits, and no part of its surplus should be available to be distributed to its members except on a winding-up.
- (f) The constitution of the Chamber may be such as the members in their discretion decide as regards membership subscriptions and voting rights, provided that the Council or other Executive Committee, by which the affairs of the Chamber are managed, is freely elected by the members.

Method of Supervision of Incorporated Companies

10. The supervision should be exercised by the Board of Trade in accordance with regulations which would include the following, namely:—

- (i) The Chamber should file its memorandum and articles and all changes in them with the Registrar, but not amendments to its byelaws which merely regulate procedural details for meetings and conferences.
- (ii) The Chamber should file a copy of its statement of assets and liabilities and of its income and expenditure after they have been adopted by the Annual Meeting.
- (iii) The Chamber should be excepted from the need to file lists of members (a) because of frequent changes and (b) because the members have no financial interest to be protected, seeing that the company has no share capital and is guaranteed by the members in a fixed sum and no surplus can be distributed to members.
- (iv) The Chamber should be permitted to omit the word "Limited" from its name, not because its liability to creditors is not limited, since it is, but because it has no share capital like normal limited companies have.
- (v) If the Chamber failed to conform to the criteria set out above in paragraph 9, the Board of Trade, after hearing the company and considering its proposals for bringing itself into conformity, should have power to direct the Registrar to delete the company from the register and to appoint a liquidator.

Unincorporated Chambers

11. As is mentioned above, there is no statutory regulation of unincorporated Chambers of Commerce. In order to preserve the respect with which the term Chamber of Commerce should always be regarded, it is suggested that some similar supervision should be instituted corresponding to that suggested for incorporated Chambers of Commerce.

12. It is not necessary to require incorporation as a condition of having the title Chamber of Commerce. There should be freedom of association in whatever form the individuals desire. The need is that their conduct should be in the public interest. Admitting the added convenience of adopting corporate form, both to the association itself and to others who have dealings with it, there is no reason why the association should be compelled to incorporate itself if it does not wish to do so. There are unincorporated bodies acting as Chambers of Commerce efficiently and to the satisfaction of their members and of the business community in which they work. But it is necessary to create an obligation in law to conform with the criteria set out in paragraph 9 above.

13. To institute a system of supervision of unincorporated associations would require some other legislation than amending the Companies Acts. It seems that one convenient course would be to provide for it by amendment of the Registration of Business Names Act, 1916. Admittedly the main purpose of that Act was to disclose an enemy interest in any business and therefore it would be a material change in the object of the statute to use it in order to supervise the conduct of some unincorporated

associations. However, this statute is particularly mentioned in the terms of reference of the Committee and this mention offers a suggestion to use this statute to resolve this problem which has previously been submitted to the Board of Trade.

14. The following suggestion is submitted as a possible means of extending the Registration of Business Names Act, the drafting being intended to convey the meaning rather than the appropriate words, which latter would be supplied by the Parliamentary draftsman on instructions.

Section 22 of the Registration of Business Names Act, which contains the definition of "business", which now reads "business shall include profession", should be completed by adding some such words as the following, namely: "and in the case of an association of persons carrying on business shall include the furthering of the interests of the business of their members".

The supervision of the unincorporated Chamber of Commerce could be assured by the insertion of a new clause to follow section 14 (which gives the Board of Trade power to forbid the use of names which may be misleading by reason of nationality) to the following effect:—

"Where an association of persons which is not a corporation carries on the business of furthering the businesses of its members under a name which includes the words 'Chamber of Commerce', the Registrar may be directed by the Board of Trade not to register the said name, or if the name is registered to remove it from the register, if the Board of Trade is not satisfied that the association conforms to the prescribed criteria."

15. The prescribed criteria would be those detailed above in paragraph 9 with the substitution of the word "Association" for the word "Chamber".

16. The Board of Trade would need to make regulations to secure the information periodically to satisfy itself that the conditions were met, but it would not need to receive a list of members nor to concern itself with rules other than those relevant to these conditions. The above words would avoid involving unincorporated associations which are friendly societies or trade unions.

Chamber of Commerce and Chamber of Trade

17. The terms Chamber of Commerce and Chamber of Trade have acquired distinctive meanings which seem to be confined to the United Kingdom. In continental countries where with few exceptions Chambers of Commerce are public bodies governed by law and entrusted with some of the duties of public administration, the term Chamber of Commerce is the only description used and the bodies cover all businesses except in some countries, agriculture, and generally, state monopolies. In Canada the associations are entitled Chambers of Commerce or Boards of Trade indifferently and they include retailers.

18. In the United Kingdom the term Chamber of Trade connotes an association which consists predominantly of retailers although it may contain also some manufacturers, merchants and professional men. This is fairly common in small market towns where there is only one organisation representing business. They sometimes adopt the title of Chamber of Commerce.

In towns where industry is strong, it is the general pattern that there is a separate Chamber of Trade representing other businesses and professions.

In between the predominantly market town and the industrialised town there are towns where the Chambers of Commerce have a retail section, the balance of power being with the non-retailers. There are also towns which have Chambers of Commerce where retailers are more than a section but are still a minority in numbers.

19. Chambers in which retailers are in the majority in numbers are not normally affiliated to the Association of British Chambers of Commerce. Such Chambers, by

whatever name called, are more naturally affiliated to the National Chamber of Trade. The National Chamber of Trade encourages its members to adopt a name which includes the words Chamber of Trade, but many still have the name Chamber of Commerce, which is confusing.

20. Under the proposals submitted above it would be for the Board of Trade to control the descriptive name of an incorporated Chamber of Commerce under the Companies Act and for the Board of Trade to control the descriptive name of an unincorporated Chamber of Commerce under the proposed amendment of the Registration of Business Names Act.

21. It is desirable when legislating for control of the name "Chamber of Commerce" to deal also with Chambers of Trade which now have a name which includes the words Chamber of Commerce or which hereafter may wish to adopt it. So far as the Association is concerned, it is only competent to say that a body should not be permitted to register a name which includes the words "Chamber of Commerce" unless it conforms with the criteria mentioned in paragraph 9. It is not entitled to go further and say what criteria should be laid down for Chambers of Trade, nor what name they should adopt. The Committee however may be willing to receive a suggestion on the method of distinguishing between a Chamber of Commerce and a Chamber of Trade, for the guidance of the Board of Trade.

22. First, it is suggested that the Board of Trade should designate a company or an association as a Chamber of Commerce or as a Chamber of Trade respectively and avoid ambiguous descriptions such as "Chamber of Commerce and Trade" or "Chamber of Trade and Commerce". Second, the criterion to determine in which class the company or association falls should be whether the control of the company or association is vested by its articles or its rules in the non-retailers or the retailers.

If control is vested in the non-retailers, and the other criteria mentioned in paragraph 9 above are satisfied, the body could be registered with a name which includes the words "Chamber of Commerce".

If control is vested in the retailers, and such other criteria are satisfied as may be agreed with the National Chamber of Trade, the body could be registered with a name which includes the words "Chamber of Trade".

Normally control would be determined by reference to the voting powers in general meeting, but there are cases where control is determined by reference to voting power in the Council or Board because the articles or rules entrust to it the decisions on policy.

The company or association can then determine for itself in designing its structure which of the two sections of business was its main purpose, knowing that the vesting of voting control in the retailers or the non-retailers would determine the title it could adopt.

APPENDIX XXI

Memorandum by The Committee of Scottish Bank General Managers

Note: Unless otherwise stated, the Act of Parliament referred to throughout the Memorandum is the Companies Act, 1948.

1. Incorporation of Companies—Memoranda of Association

(a) Requirements as to minimum number of members, and other conditions of incorporation

Having regard to the practical difficulties which frequently arise when one of two members dies or is unable to act, it is submitted that the minimum number of members of a private company should be increased from two.

(b) Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects

It is felt that, in their dealings with a Limited Company, third parties are sometimes treated unfairly as a result of the limitations imposed by the Objects Clause in the Memorandum of Association, coupled with the application of the doctrine of *ultra vires*.

Members of a company already enjoy a great privilege in being allowed to draw profits without limitation and yet to limit their liability for loss. There is added to that privilege under the *ultra vires* rule a further privilege, namely the right to disclaim responsibility for any act of the directors which is outwith the company's powers. Members of a company may have an interest to see that the company adheres to its objects and this is the proper province of the rule. The public have no such interest and, in fact, their interest lies in abandonment of the rule since it is unfortunately true that its application may result in loss to the third party dealing with the company and gain, or at least avoidance of possible loss, by the members.

It is difficult to find a rational justification for applying a rule which was designed to protect the public in circumstances in which its effect is the reverse. The universality of the modern objects clause may have rendered the question academic, and the ease with which the objects can be changed under Section 5 of the Act has had a like effect. The principle has not as yet, however, been abandoned, nor can be without legislation, and the time is opportune for it to be discarded in a question with third parties.

It is recommended, therefore, that the structure of the Objects Clause and the method of altering Objects, should remain as at present, and that the rights and limitations thereby imposed should continue as far as the internal government of a company is concerned, but that such rights and limitations should have no application as between a company and third parties; and that in respect of contracts involving a company and third parties, the company should be deemed to have the same powers as an individual.

(c) The company as a legal entity distinct from its members—"one-man" companies

The concept of the company as a legal entity should not be disturbed.

There is no inherent fault in the idea of a "one-man" company. If such companies more frequently abuse the privilege of limited liability, the remedy should be to prevent the abuses without attacking the separate entity which is sound in principle. For instance, there might be a more rigorous application of Section 332 (Fraudulent Trading) on the grounds that the director of a "one-man" company could have little or no excuse for being unaware of the true state of his company's affairs.

(d) Shares of no par value

No comment.

2. Prohibition of Partnerships with More than Twenty Members

No comment.

3. Classification of Companies

a. Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter

No comment.

(b) Nature and merits of distinction between exempt and non-exempt private companies

While, on the one hand, there is much to be said for the idea that in return for the privileges not only of limited liability but also of being allowed to grant loans to directors, an exempt private company should be required to file accounts like other companies, yet, on the other hand, it cannot be denied that there may be sound reasons why the confidential nature of an exempt private company's affairs should be respected.

On balance, therefore, as a practical solution, it is suggested that an exempt private company should be required to file, with its annual return, either its accounts or a statement that its audited balance sheet shows no loans to directors. In the latter event, a declaration should also be filed with the annual return that the accounts have been audited as at a date within the past two years.

(c) Unlimited companies and companies limited by guarantee

Companies limited by guarantee and having a share capital are now little used and could possibly be eliminated.

In view of the definition of a private company in Section 28 of the Companies Act, 1948, clarification is required as to whether or not a company with no share capital can be a private company.

4. Donations by Companies for Charitable and Political Purposes

No Comment.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) Fundamental changes in company's activities

No comment.

(b) Disposal of undertaking and assets

No comment.

(c) Issue of shares

No comment.

(d) Borrowing money and charging property

The abolition of the limitation of the directors' power to borrow and charge the company's property is favoured, in so far as such limitation affects third parties.

Article 79 of Table A should be retained to assist members to control the operations of the company but the Act should be amended to show unequivocally that no responsibility rests on third parties to ensure that the limit imposed by the Article is observed.

If the above suggestion is not acceptable, it is felt that two phrases in Article 79 should be clarified:

(i) Temporary loans obtained from the company's bankers in the ordinary course of business. (*Lines 3/4 of the second paragraph.*)

(ii) Express notice. (*In the fourth last line of the last paragraph.*)

(e) Lending money otherwise than in the ordinary course of business

No comment.

6. Directors' Duties

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

No comment.

(b) *Are directors generally aware of the legal duties arising from their fiduciary position?*

No comment.

(c) *Directors' and officers' dealings in their own companies' shares*

No comment.

(d) *Disclosure of directors' interests*

Article 84 (2) (b) declares that the granting of security by a company over its own assets is not a transaction in which a director shall be held to have an interest merely because he is a guarantor for the company. This provision is no doubt designed to meet the point raised by the decision in *Victors v. Lingards*, 1927, 1 Ch. 323, but Table A has not the force of law and is not in any case universally adopted. A provision of such importance, assuming that there is even the slightest risk of a security resolved to be given by a Board, all of whom are interested as guarantors, being open to challenge deserves to have the full force of law and should be incorporated in the Act as an extension, perhaps, to Section 199.

(e) *Should bodies corporate be allowed to be directors?*

No comment.

7. Shares with Restricted or No Voting Rights

It is submitted that this question can be resolved by requiring it to be publicised, where such is the case, that the shares have no voting rights.

Such shares should be clearly identified by name as, for example, NON-VOTING shares.

8. The Protection of Minorities

Adequacy of existing remedies. Winding-up under the "just and equitable" rule (Section 225 (2) of Companies Act, 1948); the remedy afforded by section 210.

No comment.

9. Protection of Special Classes of Shares

Modification of class rights (Section 72 of Companies Act, 1948)—getting rid of preference shares by winding-up or return of capital

No comment.

10. Board of Trade Powers to Appoint Inspectors

No comment.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies)*

This matter was considered at length and the conclusion was reached that the present state of affairs should not be disturbed. It was felt that any legislation compelling the disclosure of beneficial ownership could easily be circumvented. In this connection reference was made to the law in the U.S.A. where the requirement that the beneficial ownership of 10 per cent. or more of the capital of a company must be disclosed can, it is understood, be easily by-passed by the use of a syndicate.

In the event, however, of any legislation being passed, which would compel the disclosure of beneficial ownership of holdings, regard should be given to the increased work likely to be imposed on banks, stockbrokers and others.

It was considered that the existing powers of the Board of Trade might be extended so that, on application from a company, holders of 5 per cent. or more of the capital could be compelled to disclose whether or not they held their shares in a nominee capacity, and if so, for whom.

(b) *Control through nominee directors*

No comment.

12. Share Transfer and Registration Procedure

1. It is considered that section 117 regarding recognition of a trust, should not apply to mere specific designations of accounts.

2. It is felt that there is no longer any good reason for retaining the use of special forms of transfer, and that all companies should be compelled to accept the standard form.

13. Multiplicity of Directorships held by One Individual

No comment.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

While it might be said to conflict with the concept of the Limited Company as a separate entity, it is felt that consideration should be given to the case for making a Holding Company liable for the debts of a wholly-owned subsidiary.

Related to this subject is the practice of limited companies acquiring a business formerly carried on by an individual or partnership. For reasons probably connected with preservation of goodwill, it sometimes happens that the "parent" company cloaks its identity and trades under the business name without disclosing the true position. Such a practice is directly contrary to Section 108, but this alone does not seem a sufficient deterrent and the company's banker may be placed in the undesirable position of having either to refuse to conduct a banking account in the trade name, at the risk of being thought obstructive, or else to co-operate, passively it may be, in a contravention of the Act. The practice should be *expressly* forbidden and the penalties increased.

15. Loan Capital

(a) *Debentures and Debenture Stock*

No comment.

(b) *Trust Deeds—Duties of Trustees and Receivers*

No comment.

(c) *Registration of Charges*

No comment.

16. Take-over Bids

(a) *Procedure*

No comment.

(b) *Securing disclosure of information on which shareholders can form an opinion*

No comment.

(c) *Functions of Directors*

No comment.

(d) *Disclosure of identity of bidder*

No comment.

(e) *The financing of such transactions*

No comment.

(f) *Disclosure of Directors' Interests—compensation for loss of office (Sections 191–194 of Companies Act, 1948)*

No comment.

- (g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority (Section 209 of Companies Act, 1948)*

No comment.

17. **Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders**

- (a) *Adequacy of protection afforded to investors by existing law*

No comment.

- (b) *Usefulness and necessity of the existing provisions*

No comment.

- (c) *Certificates of exemption (Section 39 of Companies Act, 1948)*

No comment.

18. **Control over Business of Dealing in Securities**

No comment.

19. **Unit Trusts and "Open End Mutual Funds"**

No comment.

20. **Reduction of Capital and Purchase by a Company of its Own Shares**

No comment.

21. **Accounts**

Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies? Are all the existing provisions necessary and useful in present-day conditions?

1. It should be obligatory for the parent company to publish its Profit and Loss Account as well as a Consolidated Profit and Loss Account. (Section 151 (3) refers.)

2. Where a company is owned wholly within a group (but no one company in the group owns more than 50 per cent. of the equity) and is not by definition a subsidiary of any one company within the group, nevertheless it should be treated as a subsidiary for the purpose of the group accounts.

- (a) *Revaluation of fixed assets and use of any resulting surplus*

No comment.

- (b) *Share premium account*

No comment.

- (c) *Use of pre-acquisition profits of subsidiaries*

No comment.

- (d) *Description of reserves*

No comment.

- (e) *Definition of profits*

No comment.

- (f) *Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948*

The arguments advanced by the banks to the Cohen Committee in 1943 in general still hold good.

The exemption of the banks from certain of the provisions of the Companies Act, 1948, should be continued as at present, particularly in the matter of disclosure of reserves. While the fullest disclosure may be desirable in the case of commercial concerns, this is not so in the case of banking institutions, whose stock-in-trade is money.

Public confidence is essential to banking; our stable banking system has been built up over centuries and it is in the interest of the public that we ensure that their confidence in the banking system is not affected by abnormal fluctuations in profits and in the value of assets. Such fluctuations should, therefore, continue to be taken care of by transfers from or to Inner Reserves, before the Banks' Accounts are published, so that normal earnings are not distorted by, for example:

- (1) Temporary changes in the value of Government stocks which always form a considerable percentage of their assets.
- (2) An unusual profit or loss, not solely attributable to the year of the accounts under review.
- (3) External influences, such as the economic or fiscal policy of the Government of the day.

Account must also be taken of the ill-advised comment which might be made by certain sections of the popular Press, which are very ready to make the banks their target.

For these reasons it is felt that banks should continue to be allowed to maintain undisclosed Inner Reserves, through which any adjustments which are thought desirable may be made in the Profit and Loss Account of any particular year. This privilege is of great value to the banks themselves, and it is of even greater importance in maintaining public confidence in the banking system.

22. Audit

(a) *Qualifications and appointment of auditors*

No comment.

(b) *Duties and responsibilities of auditors*

No comment.

(c) *Exemption of "exempt" private companies from the provisions of section 161 of the Companies Act, 1948*

No comment.

23. Provisions as to Returns

1. The Sixth Schedule lays down the form of annual return to be made by companies. A company registered in Scotland requires to give: "Particulars of the total amount of the indebtedness of the company in respect of all mortgages and charges which are required (or, in the case of a company registered in Scotland, which, if the company were registered in England, would be required) to be registered with the registrar of companies under this Act . . .".

As was pointed out by the Scottish banks in 1943, this requirement necessitates anyone making a return for a Scottish company familiarising himself with English law. In this connection attention is directed to the question whether an undertaking by a Scottish company to grant a security is a "mortgage or charge" which needs to be disclosed.

2. The Board of Trade have prescribed the form in which a bank making an annual return shall give a list of its branches. The form requires the county to be specified. It is suggested that the name of the county might well be omitted unless there be two towns of the same name, since this requirement prevents banks from using their standard printed lists of branches and is the cause of unproductive effort.

3. With regard to section 200 of the Act which requires a company to intimate any changes in its register of directors, it is felt that Form 9a should be filed only by the company concerned in the appointment or resignation, and that changes in "other Directorships" need only be disclosed annually at the time of filing annual returns.

4. In an age when many companies have converted their shares into stock and in which uncalled liability on shares has become unusual, it is quite extraordinary that no modification in the form of annual return has been made to reflect these changes. Many irrelevant headings are included. Many others require to be amended. It is suggested that a more suitable form of return be provided.

24. Company and Business Names

Effectiveness of present provisions (see sections 17-19 of Companies Act, 1948, and the Registration of Business Names Act, 1916); similarity of names; misleading names

Registration of Business Names Act, 1916

1. This act should be more strictly applied particularly where a limited company has entered into a partnership.

A company should not be allowed to register or trade under a name which may mislead the public as to the true nature of the business.

2. The use of the words "Bank" or "Bankers" or "Banking" in the descriptive name of a company should be restricted to a company carrying on a recognised banking business.

25. Foreign Companies

No comment.

26. Internal Management and Administration

(a) Annual and other General Meetings

No comment.

(b) Mode of passing extraordinary and special resolutions

No comment.

(c) Securing proper disclosure of information in circulars seeking proxy votes

No comment.

(d) Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g. by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company

No comment.

27. Winding-up

No comment.

28. Problems of Administration and Enforcement of the Law

In particular, are any difficulties caused by provisions which appear obsolete or inappropriate in modern conditions?

No comment.

29. Any other Matters Within the Terms of Reference

(a) Floating charges

The Scottish banks are strongly of the opinion that the law should be altered to permit the introduction in Scotland of a security in the form of a floating charge. Apart from the increased capacity of Scottish companies to raise credit which might reasonably be expected to accrue from a change in the law, there would be won at long last the power to appoint a receiver and manager at short notice and with the minimum of formality. That power could prove of inestimable value in salvaging the fortunes

of a badly run company or in preventing it from obtaining credit and increasing its deficiency right up to the bitter end.

The setting up of a register of such charges is every bit as effective a means of publishing the existence of such charges as the overt act of taking the subjects of a security into actual or constructive possession and the present rigid rule of Scots Law, which requires such possession or the constitution of a real right in the subject of a security, rests not upon the belief that there is any inherent virtue in possession itself but upon the necessity of an earlier age which made possession the only guaranteed means of ensuring publicity. There is no sacred principle of law involved which prevents Scotland from adopting now the solution which other countries, notably England, adopted many centuries ago.

(b) *Companies Act, 1948, Section 54:—*

Prohibition of provision of financial assistance by company for purchase of or subscription for its own or its holding company's shares

This section should declare that it does not have any effect on the rights of third parties acting in good faith and without notice or knowledge of the facts.

Edinburgh, 24th May, 1960.

The National Association of Trade Protection Societies
did not submit a written memorandum.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
EIGHTH DAY

Friday, 25th November, 1960

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. K. W. MACKINNON, Q.C., T.D.,
M.B.E.

MRS. M. NAYLOR

MR. C. H. SCOTT

MR. R. SMITH (*Questions 2402 to 2707
only*)

MR. W. WATSON, C.A. (*Questions 2402 to
2544 only*)

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. C. T. OCKLESTON and MR. A. OWEN called and examined

2402. *Chairman*: We are very much obliged to you, gentlemen, for the memorandum you have submitted, and for coming to help us today. To make sure we have got our record right, are you Mr. Ockleston, President of the Council, and Mr. Arthur Owen, Secretary of the Council, that is the Council of Associated Stock Exchanges?—*Mr. Ockleston*: Yes, Sir.

2403. If I might ask some questions about your Council and its character and activities: first of all your Council, I understand, represents 22 stock exchanges,* of which 19 operate in Great Britain, one in Northern Ireland and two in the Republic of Ireland—would that be right?—*Mr. Owen*: That is correct.

2404. Your constituent members in the shape of these 22 stock exchanges govern their members by their own rules I take it?—*They do, Sir*.

2405. Can you give us any idea of the strictness of the control exercised by your constituent bodies over their members?—*Mr. Ockleston*: The rules, my Lord,

governing each exchange are extremely strong, and they are even stronger really than in a court of law in that there is no appeal against the findings of the committee. Our disciplinary powers are very strong indeed, and, of course, we watch the behaviour of all our firms. In Liverpool in particular, in which I am interested, the balance sheets of clearing house differences of each firm are produced each account so that we know exactly how they are trading, and if they are in any doubt the committee have power to call in the books of any firm and study them.

2406. That is the committee of the constituent body?—*Of each exchange, and the discipline is really in the hands of each exchange*.

2407. What function do you perform as between yourselves and your constituent bodies?—*Co-ordinating the wishes of our exchanges and transmitting them to the London Stock Exchange. We were there yesterday at a meeting to discuss the new rates of commission*.

2408. Representations are made to you I suppose by your constituents that in certain respects the rules ought to be altered, or relaxed, and that certain types

* On 1st January, 1961, the Newport, Mon., Stock Exchange merged with the Cardiff Stock Exchange thus reducing the membership to 21.

of transaction might be prohibited to the members of these bodies, that kind of thing?—Yes, Sir.

2409. Then you represent your constituent bodies, perhaps, in discussion and in negotiation at the London Stock Exchange, is that it?—That is quite right.

2410. As to your constituent bodies again, how big are they, how many members do they have? Do they vary very largely in size? I suppose they can.—*Mr. Owen*: I can answer that, Sir. The membership is 140 in Glasgow, 130 in Liverpool, roughly 110 I think in Birmingham, and just under 100 in Manchester. Edinburgh have between 50 and 60 I think, and the others are between 4 and 36. There are about 880 members altogether in the 22 exchanges which form this Council.

2411. And do they deal primarily in securities quoted on the London Stock Exchange?—*Mr. Ockleston*: Yes, Sir. Of course we have our own daily lists in the many exchanges where local securities are listed.

2412. I was going on to ask that. In addition to securities quoted on the London Stock Exchange you may have securities which have a local quotation of their own?—Yes, and, of course, a good many of the local ones are again quoted in London but the principal market might well be in our area.

2413. And in deciding whether to grant a local quotation I suppose you have regard to the soundness of the investment, and so on, and to compliance with your rules as to the rights of the holders of these securities, and that kind of thing?—Yes. We adopt the rules of the London Stock Exchange absolutely, and interpret them in exactly the same manner.

2414. If, for example, the London Stock Exchange says an official quotation will not be granted unless the directors' power of borrowing is limited in some way, you would follow that yourselves?—*Mr. Owen*: Yes, Sir, we have the same regulations.

2415. The report of the Cohen Committee suggested that it would be in the public interest for the rules and practices

of the provincial stock exchanges to be brought into line with those prevailing in London, and it was suggested that an approach might be made by the London Stock Exchange to the local exchanges for the purpose of securing uniformity. From what you have been telling me I gather that that has in effect been done?

—Almost I think, except for a few disciplinary rules, but permission to deal in, official quotation and the ordinary dealing rules, commission rules, these are all adopted from the London rule book.

2416. On what you have been saying about the uniformity of the rules of your constituent bodies, and those of the London Stock Exchange, you mean that to refer to all your constituent bodies, do you?—Yes. That refers to all of them, except for the exchanges in the Irish Republic, in Dublin and Cork.

2417. Passing from that to some of the matters of general interest raised in your memorandum, one might perhaps refer first to the *ultra vires* rule. As to that, as you remember, the Cohen Committee recommended that the *ultra vires* rule should be abolished, as in their view having regard to the extreme width of modern object clauses it was an illusory protection for shareholders and a pitfall for third parties. So the Cohen Committee was in favour of abolishing the *ultra vires* rule altogether and allowing companies to do anything they chose, any restriction on their activities being an internal matter only—do you follow me?—Yes.

2418. I gather from your memorandum that you think it would be preferable to keep the *ultra vires* rule, and make the objects of a company more circumscribed?—*Mr. Ockleston*: I think, Sir, we feel that there is now a new race of investors appearing, the little man who probably is not very skilled on the Stock Exchange, and we think that everything should be done so that he knows exactly what is happening; if he buys shares in a company he ought to know exactly what he is buying, and the activities of the company, or principal activities of the company in which he has placed his money.

2419. He should know whether he is in gold mines or tea or hotels, or whatever

it may be?—Yes. Some of these shell companies at some time are very misleading—the rubber company which turns itself into a property company for example. If it changes its activities a company should fully advertise the facts.

2420. Anyone receiving the report and accounts of a company, any member of the company, would over a period I suppose, if not on the first occasion, grasp what the company was doing, would he not?—Yes, Sir, I hope so.

2421. But I think I am right in saying, am I not, that you would prefer to narrow down the objects of the company?—With this very changing world we do not want to make it difficult for the company, but when it does change we think that everybody should be notified of what the changes are, the principal changes; I think that is really the point.

2422. They should be notified; that is to say you would not make it necessary that there should be the sanction of a resolution of the shareholders before the change was made?—I do not think we want to embarrass the board. If it was a very drastic change perhaps it would be a good thing to mention it at a special meeting. The directors are charged by the shareholders to make as much money as possible for them, and they have a very difficult job sometimes, and we do not think anything should be done to hamper their activities as long as they notify their shareholders exactly what the position is.

2423. I see. Then returning to the *ultra vires* point, I think you favour the view, unless I have misunderstood your memorandum, that if the objects of a company were stated more realistically and more decisively, then when the question arose of making a change it would probably be necessary for the directors to take action by way of alteration of the object clause in their memorandum of association, and that would automatically give the shareholders a voice in the question whether the new venture should be embarked upon or not.—Yes, my Lord.

2424. I do not think I need enlarge upon that. I think the Cohen Committee principle and your suggestion both give rise to difficulty. I think you would agree

it would be hard now to alter all the memoranda of association of all existing companies so as to limit them—you would agree to that?—Yes.

2425. That would be a Herculean task.—It would.

2426. On the other hand it would be difficult to prevent directors taking as much power as they could by what one might call a blanket resolution so as to avoid the necessity for going to the shareholders. Do you agree that might be difficult to prevent?—I think, my Lord, that if the company really does fundamentally change its activities it should be with the shareholders' consent.

2427. What I have got noted here as perhaps the upshot of this part of your memorandum is that if the object clause were properly drawn, that is to say in your view precisely and concisely drawn, the necessity for shareholders' consent would automatically follow, because the directors would have to get a special resolution from them to alter the objects?—Yes.

2428. That is how that stands. Now passing to an entirely different matter, as you know the Gedge Committee recommended the adoption of shares of no par value. There is one point on which there is still discussion where the Gedge Committee went the other way, and that is the question of permitting the issue of preference shares of no par value. Have you ever considered the possibility or practicality of that?—Not really, Sir. This no par value idea seems to have lost some of its point we think. When another Government was in power it sometimes made capital out of the tremendous dividend distributions made, and we felt at one time that if the shares were of no par value, and you declared a dividend of 5*d.* a share it looked all right taking into account the amount of capital employed in the company; but if you declared it as perhaps a 45 per cent. dividend then capital was made out of it. But now that there is a tendency for the small man to take an interest in the Stock Exchange we think that that point is better understood.

2429. Forgive me, that was, as it were, the main point, was it not, whether shares of no par value should be allowed at all or not?—Yes.

2430. That point has been decided in the affirmative by the Gedge Committee who, however, did not extend their recommendation to preference shares of no par value.—No.

2431. I was only asking you—there may be nothing in it—whether you have any ideas on that subject?—We would say no par value shares should be permitted for ordinary shares only.

2432. And a no par value preference share would to the uninitiated seem rather a peculiar animal?—Yes.

2433. It would have to have preference as regards half a crown per year, or something of that sort, and in winding up preference I suppose to the extent of the price which was set upon it when it was originally issued, something of that kind?—Much better keep the preference capital as it is.

2434. Then passing again to an entirely different matter, you express the view that the consent of the company in general meeting should be required to an increase not only of the authorised capital of the company, but of the issued capital of the company, and the latter branch of that suggestion means that no shares should be issued by the directors without the prior consent of the shareholders.—I do not think we quite meant that, my Lord. The sort of position we envisaged was a company wishing to raise finance on the best terms to itself might issue a convertible debenture to an insurance company, or something like that, which was not a shareholder at the time, and that by doing that, and the insurance company having the power to convert later on, the real control might be taken away from the existing shareholders and be given to somebody else. In such a case we think it would be only fair that the existing shareholders should have some say. It is perfectly all right in the ordinary way if it is a rights issue, and the existing shareholders are being offered the opportunity of acquiring the shares; in that case we think that the directors, as they are allowed to now, should be able at a directors' meeting to pass the resolution and issue them.

2435. You would say that the directors should be able, without any sanction of the company in general meeting, to dispose

of any shares which they were minded to issue by way of an offer of rights amongst the existing shareholders?—Yes.

2436. In that case you say the shareholders obviously are not being damaged at all, and there is no reason why they should be called upon to approve it.—Yes, it is to their advantage, they can take up the rights, and there we are. In a case where the shares are going outside and the option to purchase is given to somebody who is not a shareholder, it might be to the detriment of the existing shareholders at a future date, and they should certainly be asked.

2437. Would you put any minimum limit on that? You are saying now that if the shares are issued to an outsider, unless I misunderstood you, the shareholders ought to be consulted.—Yes.

2438. Would that apply to all issues of shares, or only to substantial or important ones? If I can give an example, supposing the capital of the company were £10,000, and then it were increased to £50,000, and £40,000 of new shares were issued to outsiders, that would completely alter the position of the existing shareholders.—Yes, that is what we want to prevent. We want the shareholders to sanction such an issue.

2439. And, of course, if the shares were issued for a consideration other than cash, there could be no question of a rights issue amongst shareholders?—No.

2440. In that case then the only protection for the shareholders would be their consent?—Yes.

2441. And again would it be your view if the transaction were a substantial one the shareholders' consent ought to be obtained then?—Yes, certainly.

2442. The difficulty is to say what is sufficiently important, and that might be difficult.—Yes, my Lord. I think they ought to be asked, if the existing shareholders are not given the right to subscribe themselves.

2443. Then they ought to be asked. I was thinking where there was a large acquisition of property, and the bargain was that the price should be satisfied by the issue of shares in the company credited

as fully paid-up, the only person who could get those shares would be the vendors of the property, so the shareholders could not get any participation in that issue, could they, very well?—No, I appreciate that, my Lord. If it were going substantially to alter the voting power, it might be as well if the shareholders were asked.

2444. According to what you have been saying, I think it would be consistent with your view that they should be asked in that case. We touched on the question of *pro rata* shares offered by way of rights to existing shareholders. What would be your view of a statutory provision to the effect that any shares proposed to be issued for cash should be offered in the first instance to the shareholders *pro rata*?—Yes, we think they should always be so offered.

2445. You may have such a provision in your articles—and there used to be one in the old Table A, although it has disappeared from the existing Table A—and shareholders can alter it by special resolution. But if you have it in the Act it overrides the articles, and, of course, is unalterable except by a further Act of Parliament. It is a paramount statutory provision. Do you think that this provision as to offering shares *pro rata* to the existing shareholders is of such importance that it should go into the Act itself rather than into an article?—I think probably, my Lord, it is better to provide for it in Table A.

2446. Of course the difficulty is that at the stage when the articles are adopted there is no one really interested one way or another in the question.—No.

2447. The form of the articles depends on the advice the promoters get from their solicitors and accountants, and counsel perhaps, and the most up-to-date and fashionable type of article is selected and registered with the memorandum, so that provisions of this kind may or may not be in the original articles, and there has really been nobody interested or concerned to see that they should be, if you see what I mean?—I think, my Lord, in most cases they slavishly follow the printed articles which are handed round, and everything is based on them.

2448. There are some obliging people who will supply articles of association for

a large company, a small company, a medium company, a non-exempt private company, and an exempt private company, and you get them and you fill in the names and adapt them so far as appears to be necessary for your particular case, and that is how it is done.—Yes.

2449. They are never submitted to the scrutiny of a meeting of the people who within a matter of weeks become the members of the company.—*Mr. Owen*: They are submitted to the Stock Exchange, and we feel quite strongly that the Stock Exchange should look at them from that point of view.

2450. I agree so far as a company for which shares are to be quoted is concerned, there I can see there would be the Stock Exchange scrutiny, and they would presumably apply their minds to what would give proper protection to the shareholders.—Our view is that the shareholders should be offered new issues *pro rata*, and it is just a matter of the best way of putting this principle into practice. Whether it would be the right thing to put it in the articles or not is a matter of opinion.

2451. There you do get a difference between the company whose shares are to be quoted, and the company whose shares are not quoted. Now would one of your exchanges, in a case where local quotation was going to be sought, insist on the insertion in the articles of the company of a provision of this sort, that is to say that shares, issued for cash, must be offered *pro rata* to the members?—We have not done so yet, not to my knowledge, but I think if an application came before the Liverpool Stock Exchange we would try to insist on it. I think we should ask the company for that.

2452. Then there is the question of borrowing powers, and you, I think, expressed the view in effect that unsecured borrowing should be left to the discretion of the directors. I understand that the London Stock Exchange require the borrowing powers of the directors to be limited to a reasonable amount, an example of such control subject to the consent of the company in general meeting is in article 79 of Table A. No distinction for that purpose is made between secured and unsecured borrowing. How do your

constituent exchanges stand, for example, as regards a provision of that kind, because what is in your memorandum does not exactly follow by any means the London Stock Exchange requirements?

Mr. Ockleston: My Lord, we in Liverpool, and we believe the other exchanges, have adopted the London procedure exactly, and insist that all companies now lay down a maximum figure which they are allowed to borrow, and that this figure should be easily appreciated by all, except, of course, borrowing between the subsidiaries and the main company, inter-company borrowing.

Mr. Owen: My Lord, we have endeavoured to get a letter from each local company saying that it will adopt this practice, and we have asked them to amend their articles to conform with the requirements of the London Stock Exchange at the first opportunity.

2453. I follow. Then there is the matter of directors' dealings in the shares of their own company. You express the view in your memorandum that you think it is impossible, and in any event undesirable, to prevent directors from buying and selling shares in their own companies on their own account. Why do you think it is impossible? Misuse of nominees, and that kind of evasive action?—*Mr. Ockleston:* Yes, my Lord. It would be very very difficult to keep track of it. We do feel, of course, that no director should make use of any knowledge which he has obtained by being in a privileged position, and from contacts we have we have seen most directors obey this absolutely scrupulously. We do not really see that any law could be passed to tighten it up.

2454. You have section 195 about the register of directors' shareholdings.—Yes.

2455. And I think most people who have expressed views to us regard that as fairly adequate.—Yes.

2456. One criticism is made, and that is this register is apparently only open 14 days before and three days after the annual general meeting, and it has been suggested that this register should be open at all times during ordinary business hours on the same lines as the register of members of a company. What would be your view

as to that extension of the possible scrutiny of the register?—I think we would agree to it, my Lord. There should be nothing to hide.

2457. Then this has been suggested, that a summary of each director's dealings in shares of his own company and the resulting profit or loss should be included in, or in some way attached to, the directors' annual report which is laid before the shareholders in general meeting.—I think that is going a bit too far.

2458. You think that is going a little too far? Why?—I do not know. I may be wrong, my Lord, but if they have been elected directors, and so on, they are supposed to be very honourable men, and I think it would be a bit too much to expect.

2459. If they are honourable men they would not mind. If they were embarrassed that would perhaps show that they felt that they had really rather overstepped the mark.—My Lord, surely if they wanted to be deceitful they could do it through nominees' names, or their first cousins, or somebody, and the whole object would really be defeated.

2460. Yes. Of course there is always that. So you would be against this suggestion of a summary?—I think so, my Lord.

2461. Then does it follow that you would not agree at all with the law in the United States, or some parts of the United States, under which any profit arising from short-term dealings by a director—I think that means buying and selling within six months—is to be accounted for to the company?—Yes, I do not think we would be in favour of that.

2462. Next this question of disclosure of beneficial interest, concerning which everybody feels some difficulty. In your memorandum you said this:—

"We consider that the crux of the problem posed by this question lies in the responsibility of the principal for whom the nominee is acting."

I do not quite follow that. I do not know whether you could perhaps explain it?—Can we say, my Lord, that the answers to these questions were sent in by

our predecessors in office, and we just cannot answer them, and I must admit when I read it the other day I was not quite certain what it meant.

2463. If the language is not yours, and you find it rather difficult to understand, perhaps we had better pass from that.—I think so, my Lord.

2464. What is your view as regards disclosure of beneficial interest?—I think we are rather against it really. We think that nominee companies and holding shares in nominees' names definitely has its uses. There is this tendency for take-overs these days, and it is rather difficult to see how the company which is intending to take over another could acquire the shares over a period of time unless it could register them in the names of nominees; otherwise it would be putting the price up against itself very quickly if it was known who was buying them.

2465. Putting the price up against itself and in favour of the owners of the shares?—Yes.

2466. It might then be protection to the members of the company if the bidder were compelled to disclose his beneficial interest?—I am personally not against take-over bids at all, and it would be very difficult to see how they could work unless the bidder could use nominees to buy the shares, or a certain proportion of the shares to start with. I would say that in nearly all cases when there has been a take-over bid it has been to the benefit of the shareholders that have been taken over.

2467. I think few people would say that the take-over bid in itself was a bad thing. But the question I am putting to you at the moment is whether it is fair to the members that the intending take-over bidder should go about the business in that way, concealing his identity.—If, Sir, a company was going to make a take-over bid there is no reason why it should not do so in anybody's name, a director's first cousin's name, or any individual's name. It would be perfectly all right, they could not connect the actual bidder with the deal in any way, but using a nominee company or bank's nominees helps considerably administratively in the collection of dividends, and that sort of thing.

2468. I think everybody agrees that that is legitimate.—There would be no need to make disclosure if the shares were acquired in an individual's name, the bidder would be able to acquire the shares quite quietly, and he would not have to make any declaration at all; so it would seem that if an Act was brought in the object of it could be avoided.

2469. Yes. Then your view is against statutory provision for disclosure of beneficial ownership?—Yes.

2470. Of course the nominee system may be used in other transactions than take-over bids.—Yes, of course.

2471. Some person controlling a particular company may have interests in another company, and supposing he takes the assets of company (1) and puts them into company (2) the view taken might be very different, if it turned out that company (2), ostensibly an independent body, was really controlled by nominees of this same man. The nominee system can be a cloak for fraud in other words. What would you say about that?—That is rather out of our province, my Lord.

2472. I see. You have no ideas on the subject then. Then here is another point. The status of your constituent bodies for the purposes of the Prevention of Fraud Act depends on their being prescribed or recognised stock exchanges.—*Mr. Owen:* Yes.

2473. And the body who decides whether they are prescribed or recognised is the Board of Trade.—Yes.

2474. How does the system work in your experience? Are you satisfied with the way in which the Board of Trade exercises that power, or do you think the procedure should be altered in any way?—No, we are quite satisfied. There are five large exchanges, I think, prescribed under section 39, which is concerned with certificates of exemption. Only on one occasion in the last three years have we issued a certificate of exemption in connection with a prospectus. Before we issue a certificate of exemption we always communicate with the London Stock Exchange.

2475. I follow that, but the point I was seeking to raise really was that your

constituent members, in order to be able to operate under the Prevention of Frauds Act, have to be recognised by the Board of Trade.—They have.

2476. I am not dealing in detail with the statutory provision, but broadly that is it?—Yes.

2477. Have you had any case where an exchange was refused recognition?—No, Sir. If I remember rightly there was a lower limit on the number of members before we could get this authority from the Board of Trade. I think exchanges with a membership of over 50 were recognised when the 1948 Act came into force.

2478. You have no complaints on that score?—We have no complaints.

2479. Then there is this point. It has been suggested that as a condition of recognition a Stock Exchange should be required to set up a compensation fund to compensate investors who may suffer loss as a result of default by one of their members.—Yes.

2480. I believe such funds have been set up by the London Stock Exchange and some of the larger provincial exchanges, or do all your constituent bodies now provide such a fund?—Not all. There are about 17 I think that have compensation funds.

Mr. Ockleston: In the case of the Liverpool Exchange we have earmarked part of our general fund for such a purpose. We have not in fact set up a special fund for it, and that is a pattern that the other 17 exchanges which have agreed to set up funds so far have adopted. It is very difficult. Some of our very small exchanges have found it very difficult to set up such a fund. But we are still pressing on with it, and we hope that eventually all exchanges will have such a fund.

Mr. Owen: Our fund, Sir, in Liverpool, is approximately £50,000 at the moment, and I think it varies in accordance with the size of the other exchanges. Some of the small exchanges with five or ten members find it a bit difficult, and I presume if they ran into difficulties they would have to have some sort of a levy on their members. I think they would

find it rather difficult to create a compensation fund, and the Council of Associated Stock Exchanges is not anxious to take over complete responsibility for this at the moment. They have been considering it, but they are not anxious to take over complete responsibility because they have not got absolute control. An exchange like Liverpool, of course, has absolute control over all its members, but the Council of Associated Stock Exchanges, if it set up a fund, has not got disciplinary powers over the members of other exchanges, so in other words Liverpool at the moment does not see why it should guarantee the smaller exchanges. That may come in time, but not at present.

2481. Would you think it was reasonable as matters stand at present if such funds were made a statutory requirement?—I do not think it would create a lot of hardship, because it would then tend to make some of the smaller exchanges amalgamate. There are a number of exchanges where they have five, ten or fifteen members, and I think you might find perhaps two or three of these exchanges might amalgamate and create one rather larger exchange.

2482. I suppose this can be done within limits by insurance?—No, it cannot.

Mr. Ockleston: We tried that, my Lord. The Liverpool Exchange said they were willing to pay the first £25,000 and would like to take out an insurance for a further £50,000 or so, but they failed. Lloyds were not interested, and the Council of Associated Stock Exchanges also tried and failed. The Provincial Brokers' Stock Exchange has such a policy, but it was disastrous in its first year, and that I think upset the underwriters.

2483. In these days one hears about professional ethics and the desirability of setting up bodies to maintain proper professional standards amongst their members. That leads, perhaps, to legislation for registration and compulsory membership of the institution, or whatever it may be called, by people pursuing the particular profession or activity. Have either of you given any thought to the possibility of an institute being established to which all persons carrying on business dealing in securities, and so on, would be expected to belong?—Yes, we would welcome it,

I am certain. I think Sir John Braithwaite first produced the idea that one day there would be a charter for all stock brokers, and there would probably be an examination, and so on. We think it would be an extremely good thing.

2484. Has this come within the range of practical politics, so to speak? Are any concrete steps being taken about it?—The lead definitely would have to come from the London Stock Exchange, and so far we have not heard anything definite of their future plans.

Mr. Owen: The Provincial Brokers' Stock Exchange did institute an examination; I think they still set one for all new members.

2485. Did they set it to any of the old members?—No, Sir.

2486. Then there is this question of licensed dealers. I gather that, given the necessary degree of care in granting licences to deal in securities, you are satisfied with the control imposed over licensed dealers by the new Board of Trade regulations—would that be right?

—*Mr. Ockleston:* Not altogether, my Lord. We think it might be tightened up a bit. The Board of Trade, we think, takes rather too long to act in certain cases, and we would rather that the licensed dealers in stocks and shares were under some really good discipline, either the London Stock Exchange or in the provinces under some very stiff rules of conduct, and that it seems perhaps the present arrangements are not quite strict enough. I am very much against these people who are allowed to advertise—they have been a thorn in our flesh for many years—they are allowed to do it under the Board of Trade licence. We would be glad to see those bodies, who are allowed to approach anybody whether they are their clients or not, disappear.

2487. You think the regulations as to licensed dealers should be tightened up in this respect?—Definitely.

2488. But beyond that what view would you take of the criticism which has been advanced that the whole system of licensing individuals is wrong and should be abolished? That would mean the

individual would have to become a member of a recognised stock exchange, in effect, I suppose before he could carry on his business.—We are all in favour of that, my Lord.

2489. You think that would be a good move?—I am certain it would, yes.

2490. The licensed dealers do not seem to be very numerous. I am told there are 38, of which 33 are limited companies. I do not know how accurate that figure is, but it does not suggest that a very large proportion of the total stock exchange kind of work is carried on by licensed dealers at the moment.—One of the most important of these licensed dealers seems to have disappeared in recent years; it was an institution which caused everybody a considerable amount of trouble. We were always getting complaints of what it had done, and we were very pleased to see it disappear altogether.

2491. There is no controlling body so far as they are concerned, except the Board of Trade?—No.

Mr. Owen: We think they should be members of a Stock Exchange where the committee of that Stock Exchange would have some control over them.

2492. Yes, I thoroughly appreciate that point. Where dealers have formed themselves into an association which is recognised, a recognised association of stock and share dealers, what view would you take?—We would like to know in a case like that who the controlling body were, and what powers of discipline they had got. In Liverpool, for example, the committee have the power at any moment to send for the books of any member. We have got absolute control over all our members in Liverpool, and we think all other Stock Exchanges should be in the same position. The Prevention of Fraud Act should be altered in some way so that only members of regular bodies were permitted to deal in stocks and shares, and not individuals.

2493. Then it is not fair to ask you the general question, what would your view be about recognised associations of stocks and shares dealers, because your answer to that is that it depends upon the membership and the constitution of the

association?—It depends on the powers that the governing body would have to control their members.

2494. And you do attach a great deal of importance to this element of control?—We do, Sir.

2495. Passing from that, what do you think of the suggestion that an official body on the lines of the United States Securities and Exchange Commission might be formed in this country to control issues of and dealings in shares and securities? Do you know of the existence of the S.E.C.?—No, we do not know a great deal about it actually. I do not know personally.

2496. What would be your view of an Act of Parliament setting up a permanent body which would be charged with the duty of controlling and supervising the activities of dealers in stocks, shares, securities, and so forth?—*Mr. Ockleston*: We think, my Lord, that it is much better as it is now, controlled strictly by the Stock Exchanges; if it was a government body they never seem to function very easily.

Mr. Owen: We would rather not have control of that description, Sir.

Chairman: That is all the questions I have. Other members of the Committee may wish to ask you some.

2497. *Sir George Erskine*: May I just ask you one question relating to the disclosure of beneficial interests, or the use of the nominee system. Your evidence mainly dealt not with the what you might call the administrative convenience of the nominee system, but you discussed the advantages of being able to cloak dealings or acquisitions of shares in a particular company by having the shares put into the name of nominees, and you expressed yourselves as being in favour of that. If you take that to its logical conclusion do you not get a situation arising where the board of a company might one day be faced with the fact that the control of the company had passed into the hands of one person or group of individuals, so far as they were concerned overnight? Do you not think the board of a company ought to have some protection, if it can be devised, against

finding themselves in that situation?—*Mr. Ockleston*: I think it would be extremely difficult to frame such a law. As I said before with these take-overs it might possibly harm the directors, but directors usually get the golden handshake to a modest extent even now. Most of the take-over bids that have taken place recently have been to the advantage of the company that has been taken over, and I do not think that there has been any real hardship. It would be very hard I think to bring in legislation to cover it.

2498. So in effect you do not see anything odd or wrong or difficult from the point of view of the running of businesses that the board might suddenly find themselves in a situation from one day to the next that they would be liable to be replaced by a different board of directors; there may after all be a substantial minority of shareholders, who still are shareholders in the company, apart from the people who have bought themselves control of the company.—It is an extremely difficult problem really, and I quite see that in the case of a family business which has been floated on the market for death duty purposes, or something of that sort, it would be upsetting to the family suddenly to be deprived of everything that had been built up over the years by the family. But sometimes before coming to the market, there might be a class of shares set up, with perhaps rather heavier voting powers, which the family would still retain. I have seen that happen once or twice. It is very unsettling for the board of directors to look over their shoulders all the time with things creeping up on them, but it would be very difficult for legislation to be worked out to cover it.

2499. *Mr. Bingen*: I understand from your evidence that the Council of Associated Stock Exchanges co-ordinates the activities of these 22 exchanges, and all these exchanges virtually have the same rules as to conduct of business, quotations, commission rates, and so on, as the London Stock Exchange?—Yes.

2500. How do people become members of these various exchanges? Do each of them have roughly the same system of election—by nomination, being proposed, or being an authorised clerk? Could I

set up shop in Halifax and become a broker overnight?—*Mr. Owen*: I speak particularly for Liverpool, but I think this applies generally, perhaps with a slight difference in figures, to all the other exchanges. Anyone wishing to become a member of the Liverpool Stock Exchange can do so in two ways. He can start as a clerk or come in as an attaché. We have an attaché list, but we will only allow a person to remain on that list for one year, and be then has to make up his mind to be a member or not. Anyone else with less than five years' stock exchange experience becoming a member in Liverpool has to pay an entrance fee of £700, and a share in the General Fund, which is a varying figure, at present £465. The £700 is not returnable; the share in the General Fund is repayable on resignation or death. Members also have to put up security of £2,500 for four years. If they become a partner immediately the security is for four years and if they become a partner at the end of the third year they would be under this £2,500 security for seven years, four years from the date of membership, or the date of partnership, whichever is the latest. They also have to purchase 100 shares in the company which owns the Stock Exchange building. When the committee deal with these applications for membership they go into the matter very carefully. The amount of capital a member requires depends first of all on whether he is the son of a member, whether he wishes to set up in business on his own account or whether he is going to go into partnership with an old established firm. Those are the actual conditions of membership. It is possible for someone to come in straight away, but we do not encourage it, and know that if they do join up with an established firm, the firm will be responsible for the discipline side. In the case of an applicant of over five years' experience the entrance fee is reduced to £350 and the security to £1,500. I think the above general conditions apply to practically all provincial exchanges.

2501. Now the Chairman asked you a question about the S.E.C., the Securities and Exchange Commission of the United States, and I think you said you did not know very much about it, but you would not very much like a sort of statutory body here which regulated the dealings of

stockbrokers. There is the other side of the S.E.C.'s job, that is the vetting of new prospectuses and issues, and the filing of company accounts with them, and general supervision over the activities of all quoted companies; in other words some of the work which the Board of Trade does here, and some of the work which the London Stock Exchange does. Do you see any merit in that sort of approach to the problem: in other words if you had a body not taking the place of the Stock Exchange as the forum in which deals are made, but exercising a general control over the forecast of prospects, production of information, and things of that kind?—No, Sir. The London Stock Exchange regulations for quotation, and I am quite sure I am right in this, in most cases are more stringent than the Companies Act.

2502. Yes.—And I think that the London Stock Exchange rules are equally keenly followed by the smaller exchanges.

2503. Let us take a concrete example: I gather, arising out of the offer for Fords in the U.K., because that offer is coming from the U.S., Fords in the U.S. will have to comply with S.E.C. regulations, and therefore in due course people will receive a 50-page booklet which will give a much greater analysis of the accounts of Fords in the U.K. than we have ever seen so far. Do you think that is a good thing?—I do not think there is time to read most of the information given. I think the present system here works very well.

2504. In your memorandum you start off by saying that you would like to see companies having much more restricted objects, so that if the company went beyond the objects laid down it would be *ultra vires*, and investors at any rate would know the sort of company in which they were investing largely by the name and the objects clause. You do appreciate now that companies get so diversified that it would be difficult to describe what their objects were, that it might be difficult just by reading the memorandum really to get anything more in the way of protection to investors. I was wondering really whether this evidence was not prompted by the fact that a number of rubber companies became property companies. If so, do you think that just because occasional instances of malpractice arise—and

I suspect some of the rubber companies which became property companies might have fallen within that category—we ought to alter the law in the sense of trying to prescribe objects more closely and to confine companies to objects so described in their memoranda of association?—Would it not be possible, Sir, to have a main objects clause and then a number of subsidiary objects in the clause?

2505. That is what you generally have now.—Yes, but in some cases I think some companies have to have a meeting; in some cases the power is in the hands of the shareholders and in other cases it is in the hands of the directors.

2506. The trouble really is that you get these widely drawn memoranda of association, so that with all the multiplicity of the objects clause a company can pretty well do what it likes, and I gathered that you do not like that, and you would like to have a much more prescribed objects clause.—Yes.

Mr. Ockleston: I think it would help if when the company's balance sheet was issued there was attached to it a list of the subsidiary companies, and what they did. I think some companies already do this. We are keen that everybody who buys shares should know exactly what he is taking a stake in.

2507. Do you suggest that should be a statutory obligation, or merely a matter of practice?—Merely a matter of practice.

2508. It would not tell you very much unless you saw what the size and importance of the relative subsidiary and associated companies were.—The list would perhaps give the percentage of interest in each associated company.

2509. Earlier on, you said that you thought in any case in which there was anything other than a rights issue the directors should obtain the consent of the shareholders before offering, we will say, to an institution shares or a convertible debenture (except when the shares were issued to the vendor of assets to the company). You added, I think, that if that was not the law then you might find control passed from the existing holders, and I can

see that might happen where there was a substantial transaction, but surely you would not wish to apply that to minor transactions?—No, I think that is perfectly right. I am interested in a brewery company which bought a hotel and issued 10,000 shares to pay for it; it would be a waste of everybody's time calling a meeting to sanction such a thing.

2510. There would then have to be something laid down in the Act which determined what was a substantial issue.—*Mr. Owen:* Only where the control might change hands.

2511. Have you any ideas on what sort of figure would be the relevant figure?—*Mr. Ockleston:* It would be rather difficult to fix a figure. You could say that issues of 10 per cent. or more should require shareholders' consent. But the directors could evade such a requirement by making a series of issues of less than 10 per cent. to the same people.

2512. However, if we are going to recommend legislation we have to be precise. And I should have thought you would not want to prevent the board dealing with a small block of shares where it was convenient, and you would not want to convene a meeting of shareholders in those circumstances.—No.

2513. In your evidence under heading 6 (c), directors' dealings, you wind up by saying: "We think, however, that it is desirable that directors should not invest pension fund money in the company's shares and so increase their voting strength." In the old days before you had pension funds and merely provided unfunded pensions, then, of course, the prospective pensioners had to rely on the strength of the company for their future pensions. Because of that the pension funds were started by companies, but you would not suggest in appropriately managed pension funds they should not be allowed to invest a proportion of the pension fund monies in the shares of the company which created the fund, if that were a good investment?—No. There could be a case where a company was faced with a take-over bid, and to protect itself had sold an investment in its pension fund, perhaps wrongly, and bought its own shares.

2514. But it is a choice of evils, is it not? In other words, a well managed pension fund should surely be allowed, if thought appropriate, to invest a proportion of its funds in the shares of its own company?—Oh, a proportion is all right, but it could be that it might be abused.

2515. I see difficulty in legislation. Of course, these pension funds are very often not managed by directors but by trustees.—That is all right.

2516. And you say directors should not be allowed to invest pension fund money in the company's shares and so increase their voting strength?—A good many are run by the directors of the company, are they not?

2517. I expect it varies from company to company.—I am sure it does.

2518. *Chairman:* Arising out of some of your answers to Mr. Bingen, when I was asking a question on the desirability of obtaining the shareholders' consent before any substantial issue of shares, I understood your answer to be to the effect that you thought some provision to this effect would be desirable, and you thought on the whole that any such provision should go in the articles of association rather than be made the subject of statutory legislation. Then in answer to Mr. Bingen I think you were contemplating a legislative provision—that is to say, provision in the Act itself as opposed to the articles.—We think it would probably be better provided in the Act, my Lord.

Chairman: I am much obliged to you. I just wanted to clear that up.

2519. *Professor Gower:* Could I follow on with much the same point? In connection with issues of new shares I think you said in reply to Mr. Bingen that, in cases other than *pro rata* offers to existing shareholders, consent of the shareholders should be required where the issue might affect control. Surely there is more in it than that. Every issue of more equity shares to outsiders dilutes the share of the equity of the existing shareholders.—The practice is to make a rights issue nearly every time, so the existing shareholders get a chance of subscribing. I think it is very rarely that an issue is made to the public.

2520. That is true, but taking the case of an issue for a non-cash consideration—your example of the brewery company. In effect, the issue of these shares as ordinary shares to the hotel you bought reduced the share of the equity of the existing shareholders. Therefore it is arguable they should be given an opportunity of consenting even although the issue of the shares would not affect the control of the company.—I think we thought of it as a tiny bargain.

2521. But it is not just a question whether it is so substantial that it will affect control. You have to have a narrower definition.—Yes, we thought 10 per cent. probably the right sort of figure.

2522. In my ignorance I am afraid I was a little surprised when you said that all the provincial exchanges had identical regulations to the London Stock Exchange in respect of quotations and permission to deal. I thought I saw in the Press that Birmingham had announced that they were not going to give quotations for non-voting ordinary shares. That is not the same as the London Stock Exchange, is it?—In actual fact I think there was such an outcry that I do not think they have brought it into being. I think the tendency is to frown on non-voting shares, but we all feel that it is a gradual process. The Institutions have rather banded together against them and they will one day, we hope, disappear.

Mr. Owen: We felt that the proposed rule at Birmingham should have come before the Council of Associated Stock Exchanges. It was a matter of policy which should not have been decided by one of the constituent exchanges.

2523. This is an isolated example, is it?—I should think so. I do not know of any other.

2524. It is not just a question of having regulations but of scrutinising statements to make sure they comply with the regulations not only to the letter but in the spirit. Have your smaller provincial exchanges really got the staff to do this adequately?—I do not think they have. We get quite a lot of encouragement from the share and loan department in London. I cannot be sure of this, but I think a number of the secretaries do communicate

with London, and also some of the smaller ones got in touch with the secretaries of the larger exchanges.

2525. I can quite see if the shares were also going to be quoted in London they would come under the umbrella of that Stock Exchange, but is there really adequate scrutiny in the other cases always?—I should have thought so. I do not think they have very many issues on these smaller exchanges. One or two smaller exchanges, for example, practically always come to Liverpool.

2526. This leads to my final question. The arrangements in the Companies Act for authorising and prescribing certain Stock Exchanges presupposes of course that the Board of Trade is in a position to know what goes on in the Stock Exchanges. I rather gathered from your evidence that in fact the Board of Trade just granted a rubber stamp authorisation provided that the Stock Exchange in question had the right number of members. Is it a fact that the Board of Trade really is in a position to know what is happening in the provincial Stock Exchanges?—In that particular case I think yes, because the President of the Council of Associated Stock Exchanges and the Secretary visited Mr. Marker who was then in charge of the Insurance and Companies Division of the Board of Trade, and I think the whole question was discussed with him at the time.

2527. They may have known in 1949, but surely the Act presupposes that the Board of Trade keep their eye on the exchanges to decide whether they should continue to have their authorisation. Does the Board of Trade send somebody round to talk to you?—No, I think they just ask for a list of members at the end of February each year.

2528. In other words, if, as you suggested, one should have a rule that people should not be allowed to deal in stocks and shares unless they were a member of a Stock Exchange authorised by the Board of Trade, the authorisation would not mean a great deal, would it?—No, but we would have no objection to a member of the Board of Trade coming along.

Mr. Ockleston: Could we put it this way round? We are much more vigilant

and have much more at stake in watching the position ourselves than any Board of Trade person could ever have.

2529. Yes, but I think there is more in it than that. The real control presumably is exercised by the exchanges rather than the Board of Trade. I suspect it just is not true that control is exercised by the Board of Trade.—No, it is not true.

2530. Mrs. Naylor: To return to the question of scrutiny of an application for quotation by one of your member exchanges, if an application was simultaneously made to London and to one of your exchanges and London turned it down, would one of your exchanges also turn it down automatically? In other words, could the rules be interpreted differently?—Oh, no. We work in very, very close touch. We would not dream of passing anything that London turned down. I would say that in reverse, I hope, it would be exactly the same.

2531. I would like to go back to the question of directors dealing short term in their own company's shares. The Chairman referred to the fact that in the United States profits made by directors on shares bought and sold within six months have to be paid over to the company. Do you think it is proper for directors to buy shares in their own company and sell them within six months?—No, I think it is very wrong. But it would be very difficult to bring in a law here which prevented it. He could do it in his cousin's name, for example, and nobody would ever know.

2532. They might not know, but if there were sufficient sanctions as deterrents, if there were a penalty attached if it were discovered, it might deter them?—I do not know, but I would say if the chairman of a board of directors found out that that had been happening he would be very angry indeed.

2533. Yes, I see.—I think it works pretty well now on the whole as it is.

Mr. Bingen: Could I make a comment on that? Mr. Ockleston said, quite naturally, that he thought it was very wrong for a director to buy and sell shares within six months. I would agree that in principle it is entirely wrong for directors to deal with knowledge—because they

have knowledge—but to suggest they should necessarily be culpable raises rather a difficult question. Suppose a director of a company perfectly properly bought shares with funds which he had available—say, £5,000—and then suddenly some member of his family got into trouble and he had to help a relative, and that was the only asset he had, it seems to me a bit hard under the circumstances, when he did not start out with the intention of making a short term profit, that he should be penalised.

Mrs. Naylor: He would not be losing the original investment, of course, but only any profit on the investment.

Professor Gower: It is an arbitrary law, is it not, but it seems to be fairly effective in discouraging what these gentlemen felt to be improper.

2534. *Mr. Scott:* Could I ask a question about the objects of the company? Are you referring to quoted companies only when you say the small investor really ought to know what the company he is investing in actually does? Do you have quoted companies in mind or are you extending it to the whole range of companies?—We were thinking only of quoted companies.

2535. Is it the fact that investors to your knowledge have shares in companies about which they know nothing—or rather want to know something, but cannot find out? Do they not usually buy their shares initially on the advice of a stockbroker who can tell them what the company does? Is there a case for saying there are a lot of unhappy investors who have not the faintest idea what the companies they invest in do—and care very much, if that is so?—No, I think most investors, the small ones, they buy on the advice of a stockbroker, or a Sunday newspaper.

2536. Even if they buy on the advice of a Sunday paper they presumably make the purchase through a stockbroker who might encourage or dissuade them, and he would be in a position to tell them what the company did if they wanted to know.—I may be wrong but personally I would like as much knowledge as possible to be available to everybody. If full information is readily available the investor has bought the shares with his eyes open.

2537. Is there a danger of confusion between giving information to shareholders and imposing restrictions on a company either through its memorandum of association or by the Act. I think everybody is in sympathy with the idea that full information should be given. Would your point be met if the annual reports of the company gave adequate information about the company's activities, rather than having to rely on some restrictive provisions in the memorandum of association?—Yes, I am all for as much information as possible being given in the annual report about the activities of the company and so on. Most of that information then appears on the Exchange Telegraph card, which is readily available to everybody.

2538. We are told by some companies that giving full information about what they do is sometimes detrimental to their interests. For example, if a company is in a manufacturing business and does also a certain amount of wholesaling some of the customers might be angry if they knew about it. Would you think there should be an exemption from having to disclose that kind of information in such circumstances?—I think so.

2539. You think some such exemption would be reasonable?—I think so, yes.

2540. *Mr. Mackinnon:* I wonder whether you could let us have some practical information about the quotations granted on each of the 22 provincial exchanges, say, back over the last five years—where there was no application for a quotation on another exchange. It might be rather interesting, because then we could see the nature of the problem, for example, at Cardiff or Newport in isolation.—*Mr. Owen:* Yes, we could do that. We could give you the number of such quotations, and the names and capital of the companies involved, for each provincial stock exchange.*

2541. *Chairman:* There is just one other thing I would like to ask you. It has been pointed out that one of your affiliated exchanges has only three members, and there is another one with only four. A certain amount of amalgamation might be

* A summary of the information supplied is printed on page 547.

desirable, might it not?—I think the one with three members is considering amalgamating with another exchange.

Mr. Ockleston: We personally would like the smaller exchanges to amalgamate or to join the Provincial Brokers' Stock Exchange. It would strengthen our organisation, we think, and would help quite a lot. Some of our exchanges do not even publish a weekly list, and we think they perhaps really should not be in our organisation.

Chairman: I see. Thank you.

2542. *Professor Gower:* I believe there is a Stock Exchange at Oldham which does quite a good business. This does not appear in your Association at all. Could you explain that?—Oldham allow branch offices in Burnley, Rochdale and Southport, etc.—we do not. They asked to join the Council of Associated

Stock Exchanges on two occasions but the Council turned them down. I think eventually they will become individual members of the Provincial Brokers' Stock Exchange.

2543. There would be a certain number of companies whose shares were quoted there, and the statistics you are going to give us would not bring those in.—No, they would not.

2544. Could you get that information from them, do you think?—We could try, we could ask. It is cotton mill shares only, I think.

Chairman: Are there any more questions anyone wants to ask? Well, gentlemen, I think everybody has asked you the questions which have occurred to them. We are very much obliged to you for your memorandum and for coming to help us this morning. Thank you very much.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

MR. CHARLES CLORE and MR. L. SAINER called and examined

2545. *Chairman:* Good afternoon, gentlemen. We are very much obliged to you for coming here to talk to us and for sending us the memorandum, which we have all read. For the sake of the record, we have before us Mr. Charles Clore and Mr. L. Sainer, who is Mr. Charles Clore's solicitor. Now, Mr. Clore, you, as I think everybody knows, have had very great practical experience in the operation of the Company Law now governed by the Companies Act, 1948. Would it be right to say that your experience has especially included the amalgamation of companies and the financing of purchases of property?—*Mr. Clore:* Yes. I think, however, that they are two different things. When we look at a company we do not look at it only from a property angle; I think that is a misconception. One may have a great industrial element, which is entirely different from a property company. Naturally, when you look at a company's balance sheet you look at the assets, whether they are fixed, and so on, and so forth. But we have two or three

different caps. We might look at a company entirely from an industrial point of view, and buy an industrial company to hold and develop, and not for resale. When we wear our other cap, as a property development company, we look at an intended purchase from a property angle. But these two things, in my humble opinion, are entirely different. The public's idea of a take-over bid—primarily the property element and a quick profit—is entirely wrong as far as I am concerned.

2546. Yes. A number of points arise out of your memorandum. To start with there is this. I gather that you are impressed, as I think most of us are, with the extraordinary number of companies registered under the Companies Act which is now in existence, and the extraordinary rate at which new companies are being formed year by year. You would agree that that is a rather remarkable feature of Company Law, would you not, the popularity of the limited liability system,

if you like to call it that?—Oh, yes, I agree entirely.

2547. And you make an interesting suggestion, which might tend to limit what one might call the irresponsible formation of companies?—Yes.

2548. Your suggestion is that a minimum capital contribution might be made compulsory on the formation of every company, and that this minimum capital amount, if not fully paid up in the meantime, should be the liability of the promoters of the company in the event of winding-up?—Yes.

2549. The Board of Trade have noted this particular expedient, but they feel that it would not be very much use because it could easily be evaded. Do you think it could easily be evaded?—I think that it could be controlled.

2550. The actual proposition is, if I understand it aright, that the signatories to the memorandum of association of a company should be compelled to agree to take some relatively substantial number of shares instead of the pound share or the shilling share as at present?—Correct.

2551. How do you deal with the cases, which are not uncommon, where the signatories of the memorandum are two, or it may be seven, typists in the office of the solicitor who is forming the company?—They would not be able to do so in the future.

2552. You think the solicitor would not go so far as to make his girls each undertake to pay £25?—I agree—I cannot see very much difficulty in altering it from as it stands now to, say, a £25 or £50 minimum, or even more.

2553. Would you put it that this at all events would be some deterrent against people rushing into limited liability overnight?—I am sure it would.

2554. Another suggestion has been made to us, and that is that the minimum number of members required for the formation of a company might be increased—that is to say, instead of the two which are now sufficient for a private company there should be seven or eight members in all cases. Do you think there

would be any use in that as a restrictive measure?—Yes, I do.

2555. Then, on the other hand, as regards numbers we have had suggestions that a company should be capable of being incorporated with only one member. That tends in the other direction. What do you think of that suggestion?—I do not agree with that at all.

2556. Would you agree where it was a case of a holding company and a wholly owned subsidiary?—Yes—if it was a wholly owned subsidiary of the parent.

2557. But you would not agree to any member of the public who wanted to form a company doing it all by himself, converting himself into a company?—No.

2558. Another suggestion is that every company, public or private, might be required to have two directors. Nominee shareholders, it is put, are not under any obligation to anyone, but if they assume office as directors, then they have statutory responsibilities. Do you think that suggestion might be worth exploring or considering?—Yes, I think it might.

2559. Then there is another possible method of restriction—or it is put as a possible method of restriction—which actually comes in our questionnaire under a different head. That head is the classification of companies, and the particular company in view is what is known as the exempt private company. Those companies, as you know, have certain privileges. They are not obliged to file accounts with the Registrar, they are not obliged to have an auditor with the qualifications expected in the ordinary case, and there is no prohibition in their case of making loans to directors. Those, I think, are the main advantages they enjoy. Now, it is put that these privileges ought to be withdrawn. That is put in the first place I think on the ground that anyone who obtains the advantages of limited liability ought also to bear the disadvantages. What would be your view? I appreciate that you said in your memorandum that you are in favour of the retention of the exempt private company as the only kind of private company. Do you maintain that view now?—*Mr. Sainier*: Our view is that there should be two classes, private

and public. The private companies should be exempt and the public companies should be public with full balance sheets and disclosure. Whether they are quoted public companies or not quoted is immaterial. So that one would have a position of a family private company being exempt, but a company which has more than a certain number of members and with a wider appeal being non-exempt whether it is quoted or not.

2560. Yes, but do you know that of all private companies I think something like 80 per cent. are exempt private companies now?—Yes, I do. We feel they should either be private and exempt or public and non-exempt and there should not be the present distinction, in private companies, between exempt and non-exempt.

2561. All private companies should be absolved from the obligation of sending in accounts, and they should all be allowed to make loans to their directors?—Yes.

2562. And they should all be allowed to have their accounts audited by an auditor who has not the full qualifications required by the Act?—No. All companies should have a proper audit of accounts by a qualified accountant, though it may not be necessary to have them filed.

2563. Why should they not have to file them as well?—The affairs of a private company should not be open to inspection by the world at large.

2564. Well, you do appreciate, do you not, that these exempt private companies include very large companies indeed, really big concerns?—Yes, I do. It may be expedient to make provision where there are more than a certain number of shareholders that the company is a public company and therefore not an exempt private company. At the moment they are rather mixed. Certain private companies are not exempt because they do not fall within the technical exemption clause, and large companies are exempt because they are technically exempt, but in the public interest it may not be proper for them to be exempt.

2565. We have had evidence from such bodies as trade protection societies, that they do attach importance to the filed

balance sheet as a ready means of finding out the credit worthiness of someone with whom their client proposes to deal.—With respect, I would not say that a balance sheet was always a good guide of credit worthiness.

2566. Well, balance sheet and profit and loss account.—The accounts may show a certain position, but the best reference would be a bank.

2567. Yes, there are other means of finding out.—Oh, yes, banks and trade sources.

2568. So you are in favour of the continuance of the exempt private company, and you would let the non-exempt private company die a natural death in effect?—Yes, there should not be two classes of private company.

2569. It is suggested that one of the advantages of the abolition of exempt private companies is that it would discourage these very numerous formations of companies.—I think that would be covered by the point which was discussed earlier—that is, to make the promoters of the company personally responsible up to a certain extent. This would eliminate the small one-man company with £2 capital paid up which is able to get credit or enter into commitments or hold itself out as being a substantial body; it is small companies of that kind which we feel should be discouraged.

2570. Yes. I think we might pass from that point now. The question of *ultra vires* is constantly raised before us by various witnesses. As I understand it the line you take there is that you should either abolish the rule altogether and let the directors do what they like, or you should adopt some means of limiting the scope of the objects stated in the memorandum of association. And you suggest that the Registrar might be given wider powers, or exercise more widely any powers he has got, to see that the objects are stated within reasonable limits?—Yes.

2571. Has this occurred to you as possibly having some merit as a practical solution—I am not saying it has. The suggestion is that there should be legislation which simply validated any transactions as between the company and a third

party where the third party was contracting *bona fide* transactions and the only ground for holding such contract invalid was that it was not within the stated objects of the company?—I entirely agree that should be done, because a third party should not be concerned to enquire whether a transaction is *ultra vires* or not. That is really an expedient mid-way between the two extremes.

2572. It is a possible way of dealing with it.—There is another possibility. If companies are clearly divided between private companies—i.e. really private, exempt companies—and public companies, whether quoted or not, the *ultra vires* rule could apply to the latter and not to the former, but it should be regulated in some way or another. Our feeling is that it is much too difficult at the moment for third parties concerned to find whether or not a transaction is *ultra vires*, and that objects can be changed much too easily today.

2573. Do you agree to that, Mr. Clore?
—Mr. Clore: Yes, I do.

2574. Now, Mr. Clore, the next point is our heading 5, and concerns the powers given to directors and the degree of control retained by shareholders. You express the view in your memorandum that all the matters listed under heading 5 should require the sanction of the company in a general meeting with the exception of the borrowing of money in the ordinary course of business. The items were as follows: a fundamental change in the business of the company; disposal of the undertaking and the assets of the company; the issue of shares; the borrowing of money and charging property; and the lending of money otherwise than in the ordinary course of business. And I think I am right in saying that you expressed the view that all these matters with the exception of the borrowing of money in the ordinary course of business should be the subject of the sanction of the shareholders in general meeting; is that right?
—That is so.

2575. It has been suggested by a number of witnesses that requirements of that sort would be liable to handicap the directors in carrying out the business of the company to the best advantage. It has been pointed out that the convening

of a general meeting in itself means publicity, and of course in itself it also means delay. Speaking with all your experience, Mr. Clore, would you say that provisions of this sort would unduly handicap the director?—No, I do not think they would, except in the case of borrowing money and charging property in the ordinary course of business. But I think that fundamental changes definitely should be done with the concurrence of the shareholders.

2576. The shareholders should say whether or not they are to be made?—Yes, that is so.

2577. How would one judge the fundamental character of a particular transaction?—I do not think that would be too difficult. If a company changes its activities—let us assume they were engineers and the next day they decide to be clothing manufacturers, I think that is a complete change in the company's activities.

2578. But if it ran electric trams and switched overnight to motor buses that would be very different, would it not?—I do not think it would be necessary to convene a meeting on that because that would not be such a complete change of activity.

2579. You would not need the approval of the shareholders in that case because that would be merely a development in the company's business?—That is so.

2580. But when one speaks of these requirements, if imposed, as a handicap, one does have in mind that it may well be that, on a sale of assets from one company to another, the company proposing to buy them might be given only a limited time to make up its mind; and might there not be a risk in some cases that the time might be overrun and the bargain lost?—No, if the agreement was made in the first instance subject to the agreement of the shareholders it should not take too long. Some of these conditions are really imposed today by the Stock Exchange.

2581. Oh, yes, the Stock Exchange of course plays a very important part in all these questions. I think I appreciate your answer on that. Heading 6 is about the duties of directors and whether anything

more should be done in effect to make them appreciate their duties and carry them out. We have in the course of our investigation had a case brought to our attention where a director—I think he was a managing director—concerned in quite a group of companies was found to be unable either to read or write. If you get directors of that quality it would be very difficult, would it not, to make them understand their duties?—I do not know. He might have been a wonderful chairman, or he might have been a wonderful tailor—I do not know. It depends on his other capacities.

2582. So we cannot condemn a director necessarily because he cannot read or write?—I do not think so. He might have certain technical qualifications. I once knew a very, very wonderful farmer who could not read or write, but people came to consult him from all over the country.

2583. And if he could have passed one of the recognised examinations he probably would have gone into an office somewhere and never been heard of again.—That is so.

2584. You say the directors' duties should be more clearly defined. That would hardly be possible, would it, as a matter of legislation?—It would be difficult.

2585. Do you think it would be useful if the Board of Trade were to issue a sort of Directors' Code, like the Highway Code, or that sort of thing?—*Mr. Sainer*: I would think that would be the only way of dealing with it.

2586. And it would be very difficult to make such a Code binding?—Yes, I agree.

2587. Yes, the Code would be in the form of friendly advice, and there would be an endorsement somewhere no doubt that the Board of Trade were not responsible for the accuracy of its contents! I do not think there is anything really I can usefully take up on that. The next point which has been made the subject of discussion is the purchase and sale by directors of shares in their own company, and you say that you see no objection to that practice.—*Mr. Clore*: Definitely not.

2588. What is put on the other side is that if a director buys and sells shares in his own company and makes a profit thereby, there is a risk that he is enabled to do that by inside information which he gets in his capacity as a director.—Yes; I say it is one of his prerogatives to buy and sell shares so long as he does not abuse inside information which he may have. I see no reason why you should prevent a director buying or selling shares when Mr. Jones and Mrs. Brown who have no responsibilities can do so. Why should they be able to buy and sell and not the man who works in the business? I cannot see that myself. But of course everything in moderation. I suppose it may happen that some parties abuse this. But otherwise I would see no objection. I would want the director concerned to disclose what he is doing. You can look up the "Wall Street Journal" any day and see a whole list of directors' dealings. I cannot see there should be any restriction on a director dealing in his own shares if he wants to. I do not want him to have information which Mr. Jones and Mrs. Brown have not got, of course, but provided Mr. Jones and Mrs. Brown have that information I have no objection.

2589. As long as it is all fair and above board, so to speak, you think it is all right?—That is it, if the whole world knows the exact position.

2590. That answer suggests that you would probably be in favour of the continuance of the register of directors' dealings in the company's shares which is imposed by section 195 of the Act.—Yes.

2591. Would you agree to that register being open at all times?—That is the suggestion we have made in our memorandum.

2592. Keep it open like the register of members, so anyone can see it by and large during the usual business hours?—That is so.

Mr. Sainer: If I may say so, Mr. Chairman, we feel that the present legislation is ineffective because the register is not open at times when people may wish to inspect it. It is only open for a very limited period of time. We have found on occasions it is not available when we have

asked for it during the stipulated period of time, and our feeling is it should be open at all times, and that transactions in the company's shares should be recorded within a specified period of time after they have taken place. In my experience the legislation at the moment is more honoured in the breach than in its observance. There is a widespread view amongst directors that if they hold shares through nominees they need not be recorded; that if they own shares as trustees they need not be recorded; and there are many companies today who have either no register or no effective register of dealings in directors' shares.

2593. That is a matter of enforcement of the law. One could re-enact it I suppose in more stringent language.—I feel it would become more effective if the register was dealt with in exactly the same way as the register of shareholders, so that it was up to date within a matter of 14 or 28 days of any transaction and it was always available for inspection. I am sorry—I think Mr. Clore missed part of what you said when he answered your earlier question. He did not wish to suggest that directors should make use of confidential information to make money in shares, but we feel there is no objection to directors buying and selling shares in the company; otherwise of course it would mean they would be precluded virtually from holding an interest in the company of which they are directors.

2594. Of course one has to consider their special position. They are in a fiduciary position to their members.—Yes. If there is this complete disclosure of transactions I think that would prevent people abusing special information which may reach them as directors.

2595. I gather that you would be in favour of a provision requiring a summary of the dealings of all directors in the year under review to be attached to the annual report by the directors to the shareholders?—Either that or perhaps better still a statement of the directors' interests at the end of each year which people could compare with the previous year.

2596. You would want to include details of all transactions in the shares?

—I think that might be rather cumbersome and too complex to administer, but I feel that if there were a statement attached to the accounts showing the shareholding of each director at the beginning and at the end of the year that, coupled with a comprehensive and effective register of such transactions, would serve to prevent any abuse of information.

2597. If one wanted to find out what the directors had really been doing one would want particulars of the date of the transaction and the price and whether he made a profit—That would appear in the register.

2598. You would get that out of the register. But the suggestion has been made to us that such dealings might be brought to the notice of the shareholders if there was a note of them in the annual report.—I do not think one can go so far as to put in the annual report a note of every transaction or the profit or loss which the individual directors may have suffered in the shares, because it might well be misleading and unfair. The director may have sold in good faith at one period of time and many months afterwards the shares might have gone up or down considerably and it would seem he had made some special profit. If his holding in the company were disclosed anyone could then examine the register and see precisely when the profit was made.

2599. Yes, I follow your point. Passing to another topic, the question of the protection of minorities, it has been put to us that minorities are handicapped in making out a *prima facie* case for appointing an inspector, and also for relief under section 210, because they have not got access to the books and documents of the company which may contain the information they want for the purpose of substantiating their claim. What would be your view of a provision that some specified minority of shareholders could claim the right to inspect such books?—I think that might encourage troublemakers to get together and harass directors for various reasons which they might feel appropriate. Our feeling is that the powers of the Board of Trade ought to be extended. Upon some *prima facie* case being made the Board of Trade should have liberty to call for the books

or appoint an inspector without any publicity of the appointment, which always causes difficulty to a company. I also feel that the Court should have much wider powers, but again one would have to protect companies from wildcat attacks and that might be done by legislation to the effect that no petition under section 210 could be presented without the consent of a Judge in Chambers, who would then be able to deal with the matter *in camera* and decide on the evidence available whether there was a *prima facie* case.

2600. Then it would be right to say as regards the actual question I was raising, that you think it would be dangerous to give minority shareholders the right to go and look at the company's books and documents, being books and documents not normally open to shareholders, and that any such measure as that ought to be done under the aegis of the Board of Trade through one of its inspectors or by the Court sitting *in camera*, at all events until it can be decided whether there is a *prima facie* case or not?—I agree.

2601. Do you agree, Mr. Clore?—*Mr. Clore*: Yes, I agree.

2602. I am not sure what your view is about disclosure of beneficial interests. How far do you think, Mr. Clore, a shareholder ought to be required to disclose to the directors of his company his beneficial interest?—We think they all should be so required.

2603. You do not see any practical difficulties in the way?—No, I do not think so.

2604. Because it is said that in any sizeable company the work of recording these beneficial interests would be very large indeed.—*Mr. Sainer*: I do not think we have in mind that a register should be kept showing all beneficial interests, but that the company could, if for good reason it decided so to do, require any shareholder to disclose whether he held the shares for his own beneficial account, and if not for whom.

2605. The company would be able to require the registered holder to disclose any beneficial interests of other people?—Yes, if it found a large holding building up in one name it could, if it felt

proper, ask for disclosure. One might find a company having a competitor building up an interest, and of course that brings up the point of the right of some specified minority to investigate your books. It would be most dangerous if a competitor could build up a holding of 10 per cent. in a company and then have a roving commission through its books.

2606. But what you would actually do on this question is to empower the directors, not compel them but empower them, if it appeared to them that somebody was operating on behalf of a beneficial owner other than himself, to ask him what the true position was?—Yes.

2607. And do you think it would be possible to make the operation easier if the disclosure were confined in the first instance to the question of *aye* or *no*, does he hold beneficially or not for somebody else, without specifying the particulars of the trust?—I think it would be a very good thing if they could ask the question first and then if necessary ask for the names and addresses of the beneficial owners.

2608. Having got that far the time might be ripe for inviting the inspector to come in.—Really it would work the other way, it is the owner of the holding in the shares who is asked to disclose his identity.

2609. The Board of Trade can empower an inspector to investigate the ownership of shares.—That is quite so. At the moment the powers to ask for disclosure of beneficial interest are vested in the Board of Trade and the Inland Revenue, not in the company itself, although I think that where there are restrictions on the holding of shares by foreigners the companies concerned do in fact ask for disclosure of beneficial interests. They have no power to compel it but they do ask, and they are entitled to refuse to register the holding unless the information is given.

2610. Perhaps we can pass from that. It is obviously a very difficult question. Then there is this suggestion as regards carrying on business through subsidiaries, Mr. Clore. The suggestion is that where a holding company carries on business through subsidiaries its accounts should

include a statement of the names of the subsidiary companies.—*Mr. Clore*: That is quite all right.

2611. You see no objection to that? —No.

2612. It is suggested by some people that a provision to that effect might be prejudicial to particular companies, because it would be better for them, for one reason or another, not to let it be known that the AB Company was the same company as the XYZ Company.—Yes, I appreciate that.

Mr. Sainer: Our feeling is that it may be better from the point of view of that particular company's business activities, but not in the general public interest.

2613. So again there is an argument. Some people say it is not contrary to the public interest to conceal such connections.—That must depend on the circumstances of each case, but one would not want two companies which are in fact owned by the same company, to be thought to be in competition with one another. Provision could be made for the Board of Trade to exempt any company in special circumstances.

2614. The next point I would like to ask about is this. You say, I think, that where somebody makes an offer for all the shares in a company, or for all a particular class of shares, and he gets 50 per cent., then the outstanding 50 per cent. should be able to compel him to buy their shares. Would you make it work both ways? Supposing the offeror gets 50 per cent., it might be a little unfair, might it not, if the holders of the outstanding 50 per cent. could compel him to buy them out but he could not compel them to sell out?—*Mr. Clore*: It would not work both ways and I do not think that would be unfair.

2615. Would not that rather put a stop to people making bids for all the shares in companies if they might only get 50 per cent.?—I object to people making bids for a limited interest in companies. If they make a bid for any company they should make a bid for 100 per cent.

2616. No one should be allowed to bid for 50 per cent. It ought to be 100 per cent. or nothing?—That is so.

2617. If the man did acquire 50 per cent., then the holders of the outstanding 50 per cent. should be able to say "You must buy our shares as well"?—Yes.

2618. *Mrs. Naylor*: What would happen if he succeeded in buying 50 per cent. in the market? He would then have got 50 per cent. of control.—I think that would be different, he has not offered to buy the whole capital.

2619. *Chairman*: Have you any views, Mr. Clore, about the setting up in this country of a body like the Securities and Exchange Commission in the United States?—I do not think a Securities and Exchange Commission is necessary in this country. I think we have got adequate control by the Stock Exchange. From time to time, of course, they can amend their requirements for quotation. I have found in America that they have a tremendous amount of restrictions and conditions, and the prospectus is very thick, but I see things happening in America which do not and could not happen in this country.

2620. So you think that our system on the whole is preferable?—I think so.

2621. Those are all the questions I have. I think some other members of the Committee may like to ask questions.—*Mr. Sainer* has just suggested that he thinks the Board of Trade might have more power from time to time in various company matters.

2622. I think everybody has agreed to that to some extent, but it is one thing to give powers and another to enforce them. There is no doubt, of course, that the Board of Trade's jurisdiction, extending as it does to these thousands and thousands of companies, makes it a very difficult matter to enforce the law as quickly as might be desirable.—*Mr. Sainer*: I think, if the Board of Trade's powers and personnel were strengthened, then the Board of Trade plus the Stock Exchange would be preferable to a system such as the S.E.C. in the United States.

2623. *Mr. Smith*: In paragraph 11 of your memorandum, on disclosure of ownership and control, you make the point that the company should in certain circumstances be entitled to seek disclosure. Could you tell me why you would

restrict this power to the company, and why you would not carry this to the point of the entitlement of the public and the employees in an industry to have knowledge of ownership?—*Mr. Clore*: There are certain cases, I suppose, where privacy is reasonable. I do not think it is necessary to go as far as you have suggested, though it does not matter, really, if everybody knows that Mr. Brown has *x* percentage of the shares of a company. I have no very strong views. Either we have the right to own things or we do not have it, and if we have the right to own things why not tell the world.

2624. That is rather what I am saying, but I did not think you were saying it. I was particularly interested to know whether you agreed with me that a company and the directors have responsibilities not only to shareholders but to workpeople, and that workpeople have an entitlement also to know for whom they are working and what are the general policies to which they are working.—I do not know whether the workpeople are particularly interested in that.

2625. I am seeking your views, of course, and not intending to put mine. That rather leads me to my other question. On take-over bids, it has been suggested that the offeror ought to make known his intentions about the company that he is bidding for, and this again has a special interest so far as workpeople in an industry are concerned.—I entirely agree with that. A bidder should disclose his identity and intentions.

Mr. Smith: This does not come out in your memorandum which, like most of the memoranda we have had, is much more concerned with the shareholder and limited to the shareholder.

2626. *Mr. Scott*: On the question of *ultra vires*—and the objects specified in the memorandum—in whose interest do you suggest there should be some tightening up of the businesses that a company can carry on—the shareholders, the creditors, or anybody who is dealing with the company?—The shareholders, I think.

2627. That is a measure you suggest for protecting the shareholders, so that the directors cannot carry on a business which

the shareholders do not know about?—That is so.

2628. In paragraph 5 of your memorandum you say that *inter alia* the issue of shares and, I suppose, the creation and issue of debenture stock should not be carried out by the directors without the sanction of a resolution of the shareholders.—That is the position.

2629. So you say the directors should have no power to issue unissued shares in any circumstances, without the consent of the shareholders?—*Mr. Sainer*: We feel that the creation of new share capital should only be made for specific purposes. In other words, the practice of having a large number of unissued shares at the free disposal of directors should be restricted.

2630. You would not allow them to issue any shares which were authorised by the company, without a specific additional authorisation by the shareholders when they wanted to do so?—Or a confirmation of the proposal.

2631. You think that would be a good idea. Do you think there is any particular mischief which is at present there and which ought to be stopped?—This may be linked up with the *ultra vires* point, but the mischief is, of course, that the directors may buy businesses with large numbers of unissued shares, which they have no mandate from the shareholders to do, and which has nothing to do with the company's activities.

2632. Supposing it had something to do with the company's activities?—If it had, I think that would be part of the directors' powers of operation, but I feel these things must be linked up one with the other. If you give to directors wide powers, then I think they should be restricted in the issue of capital. If their powers are narrow, then the question of the issue of capital, of course, is not as important because they are controlled from another source. The mischief that we mean to prevent is that a shareholder finds himself in an entirely new business, other than that into which he put his money in the first place, and with no power to say aye or no.

2633. *Sir George Erskine*: What about the ordinary rights issues?—If it is a

rights issue for cash, the shareholder has a right to subscribe or not, and of course the increase of capital usually has to be authorised. The difficulty here stems from the power of the directors. There is no harm in directors issuing shares for the expansion of the business of the company, but it is wrong for the directors to ask a company in general meeting to authorise an enormous block of unissued shares and then to use them for something which the shareholders may or may not approve. The point is partly covered at the moment by the Stock Exchange, which will not give permission to deal in the issue of shares for another business, unless full details are given.

2634. *Mr. Scott*: There is rather a difference between giving full details after you have done it, as compared with getting the previous consent of your shareholders.—I agree. I think that that presents the difficulty. At least, the Stock Exchange enforces the giving of information on that score, but I do feel that the company should not have authorised capital unissued, which is available to be issued at the discretion of the directors.

2635. *Mr. Althaus*: Referring to Mr. Scott's point, there is still a further sanction that the Stock Exchange might refuse a quotation for these shares if they were not satisfied, and you might regard that as an additional safeguard. As Mr. Scott says, it is one thing for the directors of a company to say what they have done afterwards, and it is another thing to get permission to do it. But in any event it must clearly be important, where shares are being issued in respect of an acquisition that there should be a quotation for them?—Yes.

2636. *Mr. Scott*: You would also go further, would you not, and say that the consent of the shareholders should also be required for the creation and issue of debenture stock?—Unless it was within the normal borrowing powers of the company; that is for borrowing in the ordinary course of the business. We clearly made an exception for the latter.

2637. On take-over bids, you say that any acceptances, notwithstanding any agreement to the contrary, should be capable of being withdrawn by the acceptor. I cannot just see why that is

regarded as a good and sensible suggestion. There may be some reason which I have not followed.—There is a tendency at the moment to make acceptances irrevocable, so that the shareholder, to whom the offer is addressed, is bound by his acceptance, but the offeror is not bound because he still has the option to go on if the other conditions are fulfilled, or withdraw. If another offer comes along, very often difficulties arise from the fact that shareholders want to accept the better offer. I think there should be a time limit in which they can withdraw or proceed.

2638. Do you think it right for an acceptor to be able to say "I accept your offer", and then afterwards to be able to say "Never mind that I said I would accept—I do not now accept"? Does it not put the offeror in a difficulty, if he does not know if people are going to change their minds?—If our recommendation were adopted he would know within seven days of his closing date.

2639. The closing date might depend on the number of acceptances.—There are difficulties, but I do feel a person accepting a conditional offer is entitled to have the opportunity of withdrawing his offer if he so desires.

2640. *Mr. Mackinnon*: This point would be met, surely, if the closing date for the purpose of any such provision was the first closing date given, and not the extended date.—Yes, I think it would have to be provided that an acceptance would become unconditional within seven days of the first closing date.

2641. *Mr. Scott*: It would prevent people entering into a contract. It would be declared by law that although they had entered into a contract it was not binding.—It is not really a contract. It is really in law an offer to sell his shares subject to certain conditions, which the offeror may not accept.

2642. I do not think so, with respect. If it is conditional on 90 per cent., then after that the offeror has got to go ahead.—He is bound, but he is only bound by a 90 per cent. acceptance on his closing date. But he always reserves the right to extend the date, to accept a lesser percentage, and on many occasions other conditions are also put in. I do agree that if

he has 90 per cent. he is bound by it, and that is the end of it.

2643. *Mrs. Naylor*: Could we know more about your thoughts in connection with strengthening the Board of Trade's powers? In what particular field do you think these powers need strengthening? Is it with regard to the issue of shares, dealing in shares, or the conduct of companies' business?—In the conduct of companies' business. They should have much wider powers to either appoint one of their own officials, or an outside accountant or lawyer, to investigate a company's affairs or a particular aspect of them, and this without an official announcement and without publicity, because that is the thing which damages a company. But I see no reason why, upon proper information or evidence, the Board of Trade should not appoint an individual to investigate certain aspects of a company's activities and report, and then the Board of Trade would have the power either to publish the report or to do nothing more; or to announce either a wider investigation or take whatever other steps may be necessary in the circumstances of the case.

2644. *Mr. Mackinnon*: Going back to the question we were discussing a moment or two ago, about revocation of acceptances up to seven days of the closing date, what you have in mind I suppose is the case of a further offer coming along, the first offer having been accepted by rather precipitate people, and the offeror being able to pick up those shares at what in fact is going to prove a very cheap price compared with the subsequent offer that comes along?—That is one point which arises.

2645. You are seeking to do justice to the unfortunate victim of his own precipitate conduct on the offer?—Exactly.

2646. As regards disclosure of beneficial interests, would I be right in thinking that what you had in mind was this, that the company should have the right to call for disclosure of the information in the first instance and pursue it, and then it would get the alleged nominee's story on the matter; and if necessary it could go on and proceed to the next stage of getting the Board of Trade to investigate the thing

more fully, which they could do on oath?—If it was necessary.

2647. So that the two are not mutually exclusive; one amplifies the other?—The beneficial ownership of shares is a matter very much to the heart of the company—to know who are the real owners of the shares—and it does seem strange that the Board of Trade and Inland Revenue have the power to inquire, but the company itself has not.

2648. I did not quite follow your answer. Are you saying that such information should or should not be made public?—I do not think that it should be made public.

2649. You would merely say that it is right for a company to know its own shareholders, and it is a matter in which the public interest is concerned, but there should be no record of the result and no power for the local union or anybody else to make the same sort of enquiry?—I do not think it is a matter of public interest in the first instance. It is certainly a matter of interest to the company itself to know who are the beneficial owners of its shares. But I also think the ownership of shares, as Mr. Clore said, is a private matter concerning the owner. There may be circumstances in which the information is of public interest, warranting either publication or advice to the Board of Trade or other public statement, which could be in the report or in the Chairman's statement in the accounts. I would not like to say precisely in what circumstances publication would be appropriate, but in the first instance I think the company itself ought to have the power to know who are the beneficial owners of those shares.

2650. Supposing a company wishes to issue shares for cash. Is it your view that all offers should go to the existing shareholders? Should they be given by statute the right to have the first take of those shares?—I think so. It could be dealt with in this way—that all new shares to be issued for cash should in the first instance be offered to the shareholders unless the shareholders in general meeting should otherwise decide. So that if there were a comparatively small number which had to be issued for a particular business reason, or which could not be conveniently

allotted to shareholders, all that is needed is a meeting with an explanation as to why it is necessary for this to be done.

2651. But you would contemplate going to the shareholders, even over a small cash issue of a few thousand shares?—It might not be expedient to offer them to the shareholders, but the way in which it would be done then would be to ask the shareholders to pass a resolution authorising an issue in a particular way.

2652. That would be something that you would require by statute, that the consent should be *ad hoc* to the issue and that the shareholders should not be asked to give blanket permission for 500,000 shares to be issued at the discretion of the directors? It should be in the form of 500,000 shares to be issued for the purchase of business X or business Y?—This point, of course, would really only apply to a public company, and I feel that this could be dealt with by the Stock Exchange requiring the articles of association to be drawn in a form to deal with this matter, rather than by legislation.

2653. *Professor Gower*: Are you saying this would only be a matter of concern to a public company? It might apply to a private one where there was no control by the Stock Exchange at all.—If it is a private company, it is dealt with by its own articles and its own internal arrangements. I do not think that this point would arise in any force, so far as a private company was concerned. I think Mr. Mackinnon's point concerns the case where the directors of a public company issue a block of shares to a third party, rather than to their own shareholders.

2654. *Mr. Mackinnon*: You say it should be provided in the articles—and then, if they seek to alter the articles, they will immediately have to satisfy the Stock Exchange—rather than made a statutory sanction?—I think so.

2655. And just limited to publicly quoted companies?—That would be my view of dealing with it.

2656. *Professor Gower*: Could I ask you a few questions about take-over bids? It is obviously hardly necessary to ask you whether you regard them as a good thing—obviously you do, I take it—and I

assume your reason briefly would be that these enable the resources of the company taken over to be employed more efficiently and profitably. Would that be a fair way of putting it?—*Mr. Clore*: Yes, I agree.

2657. That being so, I am not quite clear why you do not want non-voting shares banned, because surely the whole object of non-voting shares is to prevent a change of control. I can see that one can like take-over bids, or like non-voting shares, but I do not see how you can like both.—I think non-voting shares are a different topic altogether. There are many methods of controlling a company. You can control your company very nicely and very tightly by management itself, having no financial interest in the company whatsoever. There are companies which are controlled by voting shares. There are cases where a company is controlled by management shares representing a very small percentage of the capital. There are various cases, but I do not approve of them all.

2658. But it is a fact, is it not, that if the existing management has perhaps 2 per cent. of the equity, as long as that 2 per cent. is voting and the other 98 per cent. is non-voting a take-over bid can never be effected? The only way of having a change is by a sale by the directors of a majority of their 2 per cent.?—I say that no company can remain in existence, whether it has non-voting shares or voting shares, if it is an unsuccessful company.

2659. No, but the fact remains that, even if it is an unsuccessful company, the existing management holding the voting shares may, despite the fact that they have not been very successful, sell their voting shares to someone else who will give them a very large price for those voting shares, simply because they possess control of the assets of the company. You can probably think of the example I am thinking of.—That is an abuse. It has happened, but very seldom.

2660. In America some of the courts have come close to saying that, in those circumstances, the controllers who have sold should be forced to share out the excess price, representing the control, among the remaining shareholders.—I quite agree with that.

2661. You would agree with that?—Yes, if it were an abuse.

2662. Could you, from your unrivalled experience in these matters, draw our attention to any abuses or possible abuses in take-over bids which are not caught by the new Board of Trade regulations? Do you know of anything that is really still not tied up in any way?—I do not quite follow. You mean in a case where one is making a take-over bid for a company?

2663. Yes. There have been several nasty scandals in connection with take-over bids.—I do not know of any.

2664. Lintang?—That is a different thing entirely. The shareholders did very well. It may be proved that the shareholders have done very well out of take-over bids. The take-over bid is not the beginning and end. Sometimes it is the beginning of something, the beginning of trouble for the people who have bought the business. Sometimes shareholders have done very well, and in that particular case extremely well.

2665. You do not think there are any possible abuses?—I think there may be abuses, but on the whole there have not been many abuses.

2666. Could I suggest to you something that has always seemed to me a possible abuse? You will agree, I think, that when a bidder makes a bid he may not always care very much whether he gets his 90 per cent. acceptance or not. If he gets his 90 per cent. acceptance he gets control, but if he does not get his 90 per cent. acceptance the fact that the bid has been made will have caused the value of the shares to rise. . . .—And it is suggested that he then sells them and puts a profit in his pocket?

2667. Yes.—I do not think it works out that way.

2668. It could work out that way?—It could but, first of all, there are abuses in everything. I think on the whole we can honestly say that we try to make it our practice as a rule not to buy any shares at all in advance in a company which we think we are going to take over as it would only operate to run the price up and we would then not be successful in our take-over bid.

2669. I am sure you do, Mr. Clore, but not everybody does the same as you do.—I do not think it is as easy as all that. As I say, I think anything can be abused but I do not think it is as easy as that. In any case, I expect the Committee is considering the fact that you can tighten some of the methods of take-over bids.

2670. I was not suggesting that there was any abuse in that, but I was going on to ask if you might not have cases where the bidder has deliberately made a bid, not with the intention under any circumstances of acquiring control, but simply in order to influence the price of the shares in order to speculate successfully in the shares. May I give an example? I buy some shares on the market at their present price. I then make a bid at a considerably higher price. The price by this time will have risen because of my bid and I then start selling. I go on selling until I have sold far more than I have got. I then announce that I am withdrawing the bid and the price then falls. I buy in the market and the fall in the price is sufficient to meet my commitments.—That would make a very good film story.

2671. But as the law stands at the moment is this not perfectly possible in practice?—Everything is possible.

Mr. Sainer: It is a possibility. I do not think it has really happened to any degree.

2672. Do you think it has happened at all?—I think it may have happened in one or two isolated cases. But I think it is now covered by the Board of Trade rules, which require a person making a bid to put up the money to implement it, and he is always at risk, of course, that the bid will be accepted.

2673. Is he? He alone knows whether a bid has been accepted. If he decides to withdraw the bid, notwithstanding that 90 per cent. has accepted, nobody knows this except himself.—Once 90 per cent. has accepted the bid is unconditional.

2674. How does anybody know except the bidder?—Then you are on the point of complete illegality and fraud.

2675. That is what I am trying to get at.—May I put it this way? The offer is usually made by the company who is

making the bid, or by a finance house which must be either licensed or exempted by the Board of Trade, and therefore it is not just one individual who is involved and who can see how many acceptances he has got, and then say "I have not got 90 per cent. and the offer is withdrawn". It goes far deeper than that and many people will know the true position. It would almost amount to a vast conspiracy to get to the situation you have indicated, but one cannot prevent bids being made.

2676. Surely, one could prevent this sort of abuse, could one not, if one banned the conditional offer? Why should a man be allowed to make an offer which is conditional upon his subsequently deciding whether he wants to accept it?—It is really only conditional upon getting a specified number of acceptances. One would not seek to ban, say, an offer for a farm, if a man said "I will only buy it if I can get the farm and 100 acres of adjoining farm". It is a simple matter of contract.

2677. One obviously cannot stop people buying as few shares as they want on the stock market, but if they make a general offer to the shareholders the offer should be unconditional. If you did that you would prevent people using this for abusive purposes such as I have indicated, because they would never dare do it. They would have to take up the shares from those people who had accepted the offer. As you, yourself, pointed out, at the moment it works all in one way. At the moment it would appear that the man who accepts the offer is bound, but the man who makes the offer is not bound unless he chooses to make the offer unconditional.—That is why we have suggested that the seller should be given the opportunity of withdrawing if he so desires, but your solution would prevent anyone making a take-over bid at all, because no one would want to take the risk, particularly when you have got large companies, of finding himself with 20, 30 or 40 per cent. of the shares and no measure of control over them.

2678. Do you really think that is true? I want to ask Mr. Clore this, because presumably when he makes a bid he thinks he is making a good bid. Would he really

mind making this in an unconditional way?—*Mr. Clore*: I would not be interested in making a bid on the lines that you suggest, because I am not interested in buying a minority interest in a company. If I make a bid for a company I know I have got to go to work in the company and introduce my ideas.

2679. Before you make a bid at all you normally buy some shares on the market, do you not?—No.

2680. No?—Sometimes, but not always. Many a time I am without a single share in a company.

2681. *Mr. Mackinnon*: The price per share of a 30 per cent. interest in a company to any normal purchaser is not the same price per share as the price per share for all the shares in a company. That is what it seems to me.—That is so.

2682. Would it be fair to follow this up by saying that, if you had to accept whatever was offered, which might reduce you to 30 per cent., you would never make an offer at what was the proper price for 100 per cent.? You would be getting into the other dilemma that you would be getting the lot rather cheap.—At the same time, there would be no point in anybody like myself making an offer for 30 per cent., because I could not do with the company what I wanted to do, and therefore there would be no point in it.

2683. *Professor Gower*: Could I turn to another point? It is generally regarded as improper, though apparently not illegal, for directors who have knowledge of an intended bid to start buying shares, in order to sell them again to the bidder at a higher price.—You mean the directors of the company which is being bid for?

2684. Yes.—They often do. That is my experience.

2685. Is this not something which the law should prevent?—Of course.

2686. So you would agree that something ought to be done about that?—*Mr. Sainer*: The register of directors' shareholdings would do that.

2687. As I say, I would have thought most directors would have regarded it as improper to start buying shares on the

market, if a bid had been made which they thought was not a good one and were not proposing to recommend.—*Mr. Clore*: Sometimes they do it innocently, because I had the experience of a director saying "Do you mean to say that you think that these shares are good?" Then he just buys them in an innocent way.

2688. You would say directors of the offeree company ought not to buy shares on the market after a bid has been made?—Definitely.

2689. Then it ought to work both ways. The bidder ought not to buy shares on the market after he has made a bid.—No, you cannot say that because, by the time he has made his bid, the shares have gone up and his price may be higher than the market price.

2690. Once the bidder has announced it, I agree there can be no objection. What I am saying is that you may make a bid for the XY Company. You approach the directors and the directors say "No, we are not going to recommend this." Now at that stage they frequently start buying shares to foil you and you may start buying shares in order to keep pace with them. The shareholders in the prospective offeree company are selling shares with a lack of inside information which their directors have and which the bidder has.—I agree with what you have said so far as the directors are concerned, but I am not saying that about the bidder, because many a time the bidder is buying in the dark, but the directors definitely have full knowledge and it is their duty to see that their shareholders sell only at a fair price.

2691. I see your point, but the directors of a company are going to regard this as a little hard, are they not, if having decided that they do not want to submit to your bid, you can go on prior to announcing the bid buying to your heart's content, whereas they are forbidden to do so. If they are to be banned I would have thought that at that stage you ought to be banned, too.—*Mr. Sainer*: That may be one of the penalties of being a director of a company.

Mr. Clore: We had an experience only the other day, where we approached a certain large shareholder in a company,

and the answer we got was that "we must go and discuss it with the Chairman" which they promptly did, and the shares went up by 10 per cent. each day for two days.

2692. That is really the next question. In connection with a recent number of mergers the Press has given considerable publicity to the way in which prices of shares have risen astronomically during the course of unannounced merger discussions. The implication is that someone with inside information has been buying shares. In your view, who are the people who are doing it. Is it directors, lawyers or financial advisers?—I think, when negotiations go on about an amalgamation, there are so many people who have to be called in. Information, somehow or other, does leak out. It is amazing how it does. It could be a telephone operator or a printer, it is not necessarily the people concerned in the operation. It does not matter how careful one is.

2693. If section 195, concerning the directors' shareholding register were observed more and widened a little, this might at least restrain the directors from doing this?—It would do.

2694. Finally, and perhaps *Mr. Sainer* could help on this, you draw attention to the fact that section 54 of the Act seems to be completely ineffective at the moment. It is not preventing the abuse that it is designed to prevent—the provision of finance by a company to purchase its own shares. Have you any views on how it should be amended to make it more effective, and what in your view really are the abuses that take place at the moment under section 54?—*Mr. Sainer*: The section seems to be so vague that no one can tell where you draw the line. The worst case, of course, is if a man agrees to buy shares in a company which has cash and uses the cash on completion of the purchase in order to pay for the shares.

2695. You think that is the worst case?—Yes.

2696. Some people think there is no particular abuse there.—This view has been expressed to me by quite eminent solicitors, but I would not agree that this is a normal course of business. But then

you get the other extreme where a company buys another company, pays for it, and after a period of time needs for the combined business some of the cash in the subsidiary and withdraws it. The difficulty is where does one draw the line. It is sometimes argued that that still comes within the section, and I think if one reads the section literally it does. I really cannot offer a solution, except to put a time limit.

2697. There are two troubles at the moment; one is that the section is rather vague and, secondly, the sanctions seem to be completely inadequate. There is a fine of £100.—I am not at all sure whether that is right, it is not just the fine that is the problem. You may get a situation where there is an arrangement to do this, and it may well be a conspiracy. I feel that the section should be clarified, and I am afraid it is extremely difficult to suggest how to do it, except perhaps to put a time limit before the subsidiary's funds could be used by the parent company. It could be three months or so.

2698. It is not just that, is it? There is no doubt that there is this vagueness but it is equally clear, is it not, that the sanction is ineffective because, quite clearly, a lot of people are breaking this section in cases where it clearly applies?—I agree.

2699. We had our attention drawn to one case where a company's balance sheet said that it had set money aside to pay the £100 fine.—It has been constantly put to me in my practice as a matter of normal business.

2700. Would a possible sanction be to say that the directors of the company that has lent the money for this purpose should be liable to a fine equivalent to twice the amount of the loan?—I do not think you can impose a sanction without making the section clear, because if someone has bought a business and paid for it, there is no reason why he should not use its assets in the ordinary course of business. The section is aimed against using the assets for the purpose of paying for the shares of the company being bought.

2701. *Mr. Bingen*: I want to touch on the question of directors' duties and directors' dealings in shares, and I am

not talking about anything to do with take-overs or in anticipation of take-overs, or anything of that kind. I think it is rather an emotional sort of question, in the sense that the public thinks that the directors of some companies feather their nest very pleasantly at the expense of the general body of stockholders, despite the fact that they are in a sense trustees. I know that is not done in better organised companies, and I know, too, that they are not accountable since the decision in *Percival v. Wright*. They are not trustees and they have not got to account to their shareholders for any profit that they make in dealing in their own shares. You both take the view that there is nothing improper in a director dealing in shares in his own company, always provided he has not got information which the general body of shareholders has not got. I quite see that and, with those qualifications, I think it is right. I also see the other angle, that it would be wrong to disenfranchise directors and to put them in a worse position than anybody else who wants to deal in the shares of a particular company. But is there in your view ever a time in which the director of a company has not inevitably got more knowledge than the general body of shareholders?—*Mr. Clore*: He may have.

2702. We presume that in an ordinary company there are weekly, fortnightly or monthly meetings, and all the current figures and projected developments are laid before the directors, so they must know what is cooking.—*Mr. Sainer*: The directors must of necessity have general information as to the trend of the company's business. I think there is a distinction between that information and special information such as an increased dividend which they are going to pay, or a take-over bid which is imminent or something of that kind.

2703. Must they not at all times have a fairly shrewd appreciation of the trend, more than you get from reading the *Financial Times*? Must they not have a fairly shrewd idea of what the interim or the next final is going to be?—I think that situation cannot possibly be avoided, unless you go to the other extreme and prohibit directors from holding shares in the company in which they are interested.

2704. You cannot do that because, I believe, the Stock Exchange still require a qualification which seems to cut entirely across this argument. Would you think there should be a limitation of dealings within x months of an interim or a final dividend being declared?—It has practical difficulties. My feeling is that a comprehensive register of directors' shareholdings would act as sufficient protection for the shareholders and the public against abuse.

2705. Of course, you can always get round that register quite obviously. You can deal through nominees.—With respect, as I have pointed out, I think that shares held by nominees are required to be shown in the register. If you are going to bring other people in, then of course third parties are becoming involved.

2706. I cannot see the solution to this problem, because it may well be that a director bought as an investment in a perfectly legitimate transaction and, for some reason or other, he had to sell it later, and quite accidentally made a profit or loss. It is just that this is a matter of public interest and, in so far as business has an ugly connotation to certain sections of the community, I think it does derive from the feeling that directors are not simply running the company but are doing a private trade on the side.—I feel that if directors' dealings in shares are really open to inspection by anyone who is

interested, you will get rid of most of the abuses that may exist at the present time. I do not think it is possible, for any practical purpose, to legislate or provide against every possible abuse. If a director chooses to get a third party to buy shares, and hides that fact, I do not think it is possible to legislate against that. Even if he had no shares at all, he could still arrange for someone to buy and sell them.

2707. *Mr. Mackinnon:* From your experience have you any suggestions to offer as to how section 195, concerning the register of directors' shareholdings, might be tightened up. Perhaps you have not thought about it, but if you did know of any loopholes in it, it would be very valuable to know that.—I think the section is sufficiently wide, if people could understand it. There is a wide belief, even amongst the legal profession, that shares held by nominees are exempt, and it is only shares registered in the names of directors, themselves, which are required to be noted in the register. I think, if the provisions as to the registration of shares and transactions were extended, and the clause made clearer by requiring disclosure of the interests of the director, his wife or his nominee, it would help.

Chairman: Those are all our questions, gentlemen, and we are very much obliged to you for coming to help us. Thank you very much.

(The witnesses withdrew)

MR. P. G. SMITH and MR. W. A. TUCKWELL called and examined

2708. *Chairman:* You are Mr. P. G. Smith, Chairman of the Association of Stock and Share Dealers?—*Mr. Smith:* That is correct, Sir.

2709. And you, Mr. Tuckwell, are the Secretary of the Association?—*Mr. Tuckwell:* That is so, Sir. May I elaborate on that? I am, in fact, a chartered accountant employed by Messrs. Peat, Marwick, Mitchell and Co. I am managing clerk in charge of a department which provides secretarial services to companies and associations such as this,

but I am primarily concerned with the administration of the affairs of such organisations rather than with their products or actual services.

2710. I understand that your association is a recognised association of dealers in securities for the purposes of the Prevention of Fraud (Investments) Act, 1958?—*Mr. Smith:* That is correct, Sir.

2711. The result of that is that your members are exempt from the restrictions imposed by section 1 of that Act on

carrying on the business of dealing in securities, and by section 14 on the distribution of certain circulars relating to securities.—That is correct, Sir, yes.

2712. You owe that status to an order made by the Board of Trade under the Act?—Yes.

2713. Am I right in thinking that the basis on which your association is recognised is that it insists on a satisfactory standard of conduct from its members, and can discipline members whose conduct is unsatisfactory, and you can even go to the extreme length, I take it, of expulsion?—Yes, we can.

2714. That, of course, would be a very serious penalty, because the individual concerned could then only do these things as a licensed dealer if he could obtain an appointment as such from the Board of Trade?—Yes.

2715. What system do you have for controlling the activities of your members?—We have a general council, of which I am the Chairman, and any complaints which are made, or which emanate from the public or other bodies such as the Board of Trade, are sent to the council and discussed at a council meeting. If action is obviously required, then the first thing that the council will do is to have an investigation made. Under our byelaws we are empowered to appoint a member of one of the professions, such as the accountancy or legal professions, to investigate the books of that firm or person against whom the complaint has been made, and he will render us a report. It is on that report that the council will make a decision as to whether the member shall be punished or not. It has happened once or twice but fortunately it is fairly infrequent. That is the system we employ and we have found it satisfactory. Otherwise, for the occasional offence of a minor nature, there will be a severe reprimand and the member will be brought up before the council. That is about all we need to do to control our members, so long as they abide by our rules and regulations. Fortunately, discipline is rarely called upon to be exercised.

2716. That is very fortunate but, when it is required, that is the way you do it?—It is indeed, Sir, yes.

2717. I take it that the individual who is accused of improper conduct does appear before the council and has an opportunity of being heard?—Yes, he does indeed, and generally he brings his solicitor or other adviser with him.

2718. You have just told us that disciplinary proceedings are a rarity. How do you select your members? What are the conditions of membership?—Members of the public apply for membership to the association. They write to Mr. Tuckwell, who is our Secretary, and he will send them copies of our byelaws and an application form, which is a very comprehensive one. It is a searching form, indeed, and if they feel that they could operate whatever business it is they wish to operate under our byelaws they will probably apply for membership. Various references are requested and strictly scrutinised. We attach a great deal of importance to references. Then the application is put before the general council, and if it is approved the person is elected. But, as to the type of people we elect, we are very wary of electing a person who has no business experience in dealing in stocks and shares. In fact, since I have been Chairman of the association I doubt whether anyone has been elected without proper experience in some office, such as a Stock Exchange office or a finance house of some sort. He would not become a member of the association, and we would recommend that he apply to the Board of Trade for a licence. We would rather pass it over to them.

2719. You do not finally accept a man until he has done something which serves the same purpose as articles?—Yes, and gives us reasonable grounds for believing that he understands what he is going to do, and what the profession is all about. The members of the Association of Stock and Share Dealers are sometimes called outside brokers, but there are very, very few of us in the association who are outside brokers and who deal as principals in stocks and shares. A great number of our members find it convenient to be members of the association purely because in the course of their business they might have to deal in stocks and shares. Some people get a licence from the Board of Trade, and some prefer to be members of our association. Quite a large proportion

of the members are not outside brokers, though I believe a large number of people think all the members are. There is one well-known firm in our Association, for instance, which specialises in reversions and life policies, and things of that nature, and they did not have a licence to deal in stocks and shares for many years, until it was brought to the notice of the Board of Trade and they said "You must come under the aegis of some organisation or have a licence"; and they applied for membership of our association and of course they were elected.

2720. The position is that some of your members are licensed dealers?—No, Sir. The membership of the association does confer upon you a licence to deal in stocks and shares, but you cannot be licensed by the Board of Trade to be a dealer, and be a member of the Association. There is very little difference between us. In fact, I cannot tell the difference between the business performed by a Board of Trade licensed dealer and by a member of the Association of Stock and Share Dealers.

2721. Does your newly admitted member have to make any deposit or anything of that kind, to ensure that he is able to meet his commitments?—No, Sir, there is no deposit required at all.

2722. I suppose your inquiries would extend to his financial position?—Yes, indeed.

2723. Have you done anything like setting up a compensation fund to compensate people who lose money through the default of members?—No, Sir, we have not. It is a point which is perhaps always brought up against us. As members of the Association, and dealers as principals in stocks and shares, we do not take money on deposit from the public, and it would be very difficult for any of our members to default by misappropriating the public's money, which I believe is called misfeasance. We operate in such a different fashion, but I know it has been levelled against us that we have not got a compensation fund, should it be necessary. Only in one case would it have been of use. We did endeavour to take out an insurance policy similar to that adopted by one Stock Exchange or Association of Stock Exchanges in the north,

but unfortunately the experience of that particular insurance company was such that they have never issued such a policy again. I did make inquiries through all the other Stock Exchanges—I do not mean the London Stock Exchange; I mean provincial Stock Exchanges—and I was surprised to find that not all of them have a compensation fund, so I have more or less dropped the matter for the moment. I did feel at one time that the smaller organisations might get together and have a combined fund, but so far it has come to nothing. It could be a good idea.

2724. With whom do your members deal in stocks and shares?—The outside broker deals practically entirely with the small investor. The other members are generally finance houses and people who deal casually in stocks and shares. They might be dealing in shops, properties or small businesses which change hands, and it might be necessary for them to become involved in a share transaction.

2725. It is an incidental activity so far as they are concerned?—Yes.

2726. Why do you think your members, who are outside brokers, prefer to deal as such, instead of becoming members of one of the recognised Stock Exchanges?—We use an entirely different technique. I am head of the biggest of the firms of outside brokers and our technique for meeting the requirements of the small investor is so entirely different from the Stock Exchange that it is very difficult to make a comparison. We deal as principals and I run what is really comparable to a shop. I am not a stockbroker, because I believe the word "broker" means agent, but I have my shop and I have bought my goods, which are various stocks and shares. I have had to buy them and then I sell them to the public at a fixed price, what we call the net price. I do not charge commission, and I cannot do so because I am the principal. I send my circular out to the public informing them of my wares, and I offer them shares at a fixed price, which stay at that price until the stock is gone. In the Stock Exchange the price may be higher, or it may be lower, but the public like dealing this way; they like being able to see at a glance how much the stock is going to cost them, and where they

stand. The ordinary member of the London Stock Exchange could not do that. If he was allowed to circularise as an agent, it would be awkward for him to send out a circular and get orders from the small investor. There might be orders for 100,000 shares—and I must add that we do deal in a very substantial way—but if he went into the London market with a demand for 100,000 shares he would not get them all at one price. The small investor has come to know about that and we find that they like our method of recommending investments to them, in preference perhaps to the actual stockbroker who is a member of an exchange.

2727. If I want to buy a share in the XY Gold Mine can I go to your premises and state my wishes? Would you take the documents of title out of a pigeonhole and say "My price for one of these shares is £x"?—If I had that stock on my books I would say that, having regard to the current market price.

2728. How do you fix the price to the customer?—I buy stock for which I have to pay. If I have bought it through the London Stock Exchange—which I generally do—I have had to pay full commission on it and I know how much it has cost me. Then I put my own profit on it—and the profit I must add here and now is slightly larger than the stockbroker's because not only is it my profit but it also has to include the very substantial cost of circularising. But when my circular goes out to the public I think you will find generally my price is comparable to that actually ruling in the London Stock Exchange. In fact if we were outrageously different we would soon be out of business altogether. The small investor is so well educated now about share prices and where to look for them, that he will check up very definitely and make sure he is not being overcharged.

2729. How often do you change your price?—We operate like this: more or less I try and buy one big line of stock every week. I cannot do it all the time. I am offered continuously from the London Stock Exchange and the country brokers, lines of shares which they would like us to look at. If I decide upon one that is suitable I buy that line—a very

substantial line generally, and for this reason we are usually able to negotiate a price which is below the ruling market price. By the time I have bought and, quite often, paid for it and added my own profit, when the circular goes out it is more or less at the London Stock Exchange price.

2730. It need not necessarily be if the shares are moving?—No, Sir; it does happen that sometimes we have offered a share at below the London Stock Exchange price, and sometimes it has been above. The London market is constantly changing; it is rather hazardous and one has to exercise pretty good judgment to stay in business.

2731. *Professor Gower*: Will all the shares you deal in be quoted on the Stock Exchanges?—Yes, it is a rule in my firm that all the shares are quoted on a Stock Exchange. In the old days one could deal—and we still are entitled to deal—in unquoted stocks, but it is a very dangerous practice. I have never seen any of our members doing it in recent years for the simple reason that to offer unquoted securities for sale to your clients—even though they have been dealing with you for quite some time—you have got to produce what is tantamount to a prospectus.

2732. *Chairman*: In your memorandum, which I must say I found very interesting, you propose the setting up of an Institute of Dealers in Securities. Can you give us any further detail as to how you think this body should be constituted, what its powers should be and how it should be operated?—I visualise an institute on the lines of the Institute of Chartered Accountants, or a similar one—a sort of paramount body overlooking the City. All the merchant banks, the stock brokers, the jobbers, the outside brokers—everybody concerned—would be under its aegis, and it would be responsible for maintaining a very high standard. I feel strongly about the fact that a broker is not a qualified person; I think he ought to be, and if he had an institute it would be able to confer some sort of degree and insist on its members being qualified before they could practise dealing in stocks and shares.

2733. Have you thought out at all what qualifications would be required of members or intending members?—I think that a qualified member of such an institute would be required to have a reasonable knowledge of accountancy and of the law, both of which I feel at the moment so few of us do know much about. It is of importance to be able to read a balance sheet and I find so many people who recommend shares to me are unable to read a balance sheet, or even have the slightest idea how to set about analysing such a thing—which is not too difficult a task.

2734. Then I suppose you would have to have exemptions for existing members and so on. I suppose you would have some period of tutelage and some sort of professional examination?—Yes, definitely, Sir.

2735. I suppose there would be a minimum standard of general education of some kind?—Yes, certainly G.C.E. or of that standard, just as though a person were entering one of the professions in the normal way. Could I just enlarge on that? What I feel about it is if you took up residence in a small town you would find that the skilled services available to you were the doctor, dentist, accountant, lawyer—all of whom you have probably never met before or been introduced to, but you are perfectly happy about going to them for advice or attention because you know they are highly qualified—they must be, to be practising; but there is one figure there whom you turn to with your savings and that is the local stockbroker, but he is not qualified in any way whatsoever. One has no idea as to his capability, but he is the local man and therefore one has got to use him—or at least is more or less expected to use him. I feel that is wrong because the public—the small investors of whom I have had a great deal of experience—do tend to believe that we are qualified people. They may spend a lifetime earning savings amounting to two or three thousand pounds, then they will turn round to a stockbroker and say “Would you invest this for me?” And that is, I think, putting responsibility on the unqualified stockbroker that is far too heavy a burden for him.

2736. Yes, I see.—I must say at once this happens more in the country than it does in London, although there are in London people I know—youngsters—going around who are stockbrokers, and if you could bear them—the way they try to advise you—it is rather pathetic. I know it is easy to criticise.

2737. *Mr. Bingen:* Is Mr. Smith referring to members of the Stock Exchange or outside brokers in a small provincial town?—In the latter instance I was talking of members of the London Stock Exchange. I was in the London Stock Exchange myself, and I received part of my training there. I have a large number of friends there—and I do not want anybody to think that I have any dislike for the Stock Exchange, in fact I have not. I have a great deal of loyalty towards it myself, but it is a fact that there are a lot of young people who should be qualified but who are authorised to go around recommending to their friends stocks and shares, and I get rather horrified sometimes when I hear them doing it.

2738. *Chairman:* Then this institute would be a sort of paramount body, would it, with jurisdiction over all dealers in stocks and shares, whether belonging to the Stock Exchanges or otherwise?—Yes, Sir.

2739. And it would be compulsory—the corollary of that—for every person following this particular calling to be a member of the institute?—I would say so, yes. If a person wanted to practise as a stockbroker he should be a qualified member of the institute.

2740. That is an interesting suggestion, but obviously fairly long-term?—Yes, I can imagine that, Sir. I do not know whether it would be possible to have an examination of some sort now, but that would rest with the individual associations and the London Stock Exchange. I was hoping once that the London Stock Exchange itself would suggest a form of qualifying examination and that we could use their papers for our own members. Unfortunately I do not think that suggestion ever got as far as the Council of the London Stock Exchange, but it was talked about at one time amongst some friends of mine. But if we could have an institute

then I do think it would become a profession and it would be a highly satisfactory state of affairs as far as the investing public are concerned.

2741. Yes. Of course I suppose you would have to allow the existing middle-aged stockbroker to go on, would you not?—I think there would be honorary fellowships handed out fairly liberally at first.

2742. You could hardly call upon them to pass the General Certificate of Education whether at advanced level or otherwise. So it would take some time to bring it into force?—It would certainly take a long time to bring it into force, Sir.

2743. Anyhow, that is a constructive suggestion but how far it would be practicable would of course really remain to be seen when somebody started trying to get it on its feet, I should think.—Yes.

2744. I gather that your Association does not much like the system of licensed individual dealers, or am I wrong about that?—No. The licensed dealer does not come under that discipline which I feel he should do.

2745. I gather you would prefer them all to belong to one of the recognised organisations?—I think they ought to, Sir, yes. If I may say so, Sir, judging from the enquiries I received from some licensed dealers when the new Board of Trade rules were recently introduced, I do not think any of them knew that such rules had previously existed. Several of them who were licensed dealers rang me up to ask me to interpret them for them, and as far as I could make out they did not know there had been rules in existence.

2746. How do the rules under which your members work compare with the Board of Trade rules?—At the moment, Sir, they are almost identical. We are this year—at this very moment—in process of having our bye-laws, rules and regulations, brought up to date, and in fact we are putting in such things as more stringent penalties, disciplinary powers, and also we are going to include as part of our bye-laws the Board of Trade's take-over rules. We have of course brought those rules into force already.

All our members have been informed that they must abide by those rules now.

2747. I am informed that there are at present 38 licensed dealers, of which 33 are limited companies. Do you happen to know roughly how many of these people are engaged in dealing and how many do it merely as a sideline? I suppose you could not say that?—None of them I would say, Sir, acts as an outside broker in the same way as I do, that is by circularising the public. There was one well-known firm no longer in business, the Whitehead Industrial Trust, who were licensed dealers and acted as outside brokers, but I do not think there is any person now amongst the licensed dealers who actually does an outside broker's business.

2748. Thank you. I believe you have seen the memorandum about dealing in securities submitted by the London Stock Exchange?—Yes, I have, Sir.

2749. In paragraph 3 (b) of that memorandum, recommendations are made as to the associations which should be recognised for the purposes of the Prevention of Fraud Act, 1958. Have you any comments on this list, especially as the name of your Association is omitted?—I know; I noted the omission. Unfortunately—and I am sure the Deputy Chairman of the London Stock Exchange will agree with me—there is a distinct dislike for the outside brokers by some of the older members of the London Stock Exchange, and I must say that they have every right to it. It goes back a long time. In the old days the outside broker was a person to avoid. He was the real "bucket shop", and unfortunately the name has stuck. Although we are now a recognised organisation with our own code of conduct and rules and regulations, there still exists in the minds of a lot of people in the City the view that the outside broker is a bucket shop. I have had the most awful time myself over the fact that I am an outside broker and therefore the view is taken by some people on the Stock Exchange that I must in some way be dishonest, and I am afraid the Stock Exchange for the time being will never get over that. There have been many incidents which I could cite, of this extraordinary antipathy towards us by the

London Stock Exchange. I think we shall get over it. More and more members of the London Stock Exchange are getting to know me, and are beginning to understand how we work. We are in competition with the Stock Exchange, but we are so small that we cannot be in very serious competition at the moment. I was aware of that memorandum by the London Stock Exchange. I felt particularly hurt when it started off "For the sake of the good name of the City . . ."—I believe it does—then it continues with the very significant omission of our Association. I thought, "Well, this old antipathy still exists".

2750. I quite appreciate the importance of this question to you, but at the moment I am not quite clear what a new Companies Act or a new Securities Act can do unless you find another name which, although descriptive of your activities, will not be linked with the horrid past.—The word "outside" broker has come to stay. You can never get rid of that, and "outside" in that sense is not a complimentary description; "outsider" is never very complimentary in the English language anyhow. I am afraid we shall have to suffer it for some time but I do feel now there is less antagonism towards us. We have a large number of friends on the London Stock Exchange and on the provincial Stock Exchanges who certainly do not seem to feel that way, but what they say when they get into consultation I do not know.

Chairman: That is all the questions I have; I do not know if any other member of the Committee has any?

2751. *Mr. Althaus:* With regard to your suggestion about an institute, I think perhaps you would agree that the principal qualities which make a good broker would be judicial faculty, integrity and a flair?—Yes.

2752. He should also naturally have access to information of all kinds which help him in forming his judgment?—Yes.

2753. My point is that if you agree that, you will perhaps also agree that it is difficult to frame examinations which would usefully help him in performing these. Most of us—you yourself—have

served an apprenticeship in the Stock Exchange, and I suppose most people who have to deal with stocks and shares do the same. It is unusual for a man to walk straight into the middle of anything?—I quite agree.

2754. And I suppose in your business, as in the Stock Exchange, it is more and more desirable that people who are coming along should be trained to use their judgment and brought up in the careful and honourable way of life?—Yes.

2755. And therefore I just want to put it that while everyone appreciates the desirability of raising professional standards, it would be in fact very difficult to frame the kind of examination papers which would really confer on the individual any greater element of dependability than he will acquire by his apprenticeship and by his experience and by the exercise of those faculties I have mentioned.—That is true, Sir, but a stockbroker should be a person with a tremendously wide general knowledge, and I cannot see any reason why we should not qualify for, say, the intermediate examination of the Institute of Chartered Accountants. The preliminary examination, of course, is very simple, but the second would raise us to that point where we could employ the knowledge we had got to great advantage in our business. Also I believe that particular examination does include a great deal of commercial law which, I think, members of an institute would also need. I do not think it is beyond us. Some of the young brokers in the House, are very clever and have a great deal of ability. They would find no difficulty in passing such an examination—in fact they could do it very easily; and it would be an enormous help to them. That is one idea. You talked about the training in the stockbroker's office. I think experience on the floor of the House as a blue button—an unauthorised clerk, Sir—is very valuable for getting to know your way round the market and to learn that very difficult art of dealing by word of mouth alone. But I do not find the average younger broker does get training in the office in actual investment knowledge—for example as to whether XYZ Company is sound even though it gives a high yield. I possibly disagree with you, Sir. He does

get experience in the technique of dealing but not so much in the investment knowledge which he should have as a grounding.

2756. I should disagree with you, I think, over that because I think that many reputable firms would be most careful to see that their young men were given a very careful grounding in all branches of research and of general business technique.—That is true. You referred to the reputable firm. There are in the London Stock Exchange some firms of a very high standing, and there was a young man I happened to know who wanted to get into one of those firms, but they were full up, they just could not take on anybody else. Eventually he got into another firm, and certainly there he is not getting the training which you have just mentioned.

2757. *Mr. Bingen:* You said that when you go to a small country town you will find the doctor, dentist, lawyer, all qualified men whom you can call on and be sure of good advice, but the broker is an unqualified man. I would say that not everybody who qualified as a doctor, dentist or solicitor is necessarily a good one; you may get bad advice; it is still a question of selectivity. But, in any event, I do not see how exactly you would get a professional qualification for being a dealer in securities or an investment adviser, because surely you must be able to read a balance sheet? You must be able to read what is going on in the *Investors' Chronicle* week after week and in other papers? It is not an exact science. If you knew all the answers you would not deal—you would deal for your own account, would you not?—Yes, you would, Sir, I know, but all the same the doctor, the dentist and other professional people—while their standards do vary, they vary on and only sink down to a very high level. They never come below a qualifying level. There may be an odd exception to the rule, perhaps, but they are people trained in every aspect of their profession. They have taken difficult examinations and they have passed them, indicating that they have full and comprehensive knowledge of their subject.

2758. But surely the leading firms of brokers and of course the merchant banks and others who might decide to deal, have

a statistical and actuarial department, and could be as fully equipped to give judgment as anybody else. There is no lack of able people willing to advise.—I believe that the number of firms who do employ these professional actuaries and chartered accountants to provide these statistics and investment advice for the use of their partners are not by any means in the majority. I do apologise for talking about the London Stock Exchange when I have nothing to do with it—I hope the Deputy Chairman will forgive me—but I am quite sure I am correct in stating that they are not all that common.

2759. Surely whether you go to the large firm or the small firm—you may assume the large firm has background information—you get the same charge?—But unfortunately, Sir, the small investor rarely gets the opportunity of obtaining the services of the big firms.

2760. You described the business of an outside broker. He buys stock on which he forms a view, he then circularises his clients offering it to them at a fixed price. By the time the response comes in the market price of the shares may be above or below the price you quote. If the price you quote, at the time your circular is received by your clients, is below the market price, why do you still go on selling at that price rather than selling yourself?—Turning round and selling them back to the Stock Exchange?

2761. Yes.—The first time I turned round, having bought a line of stock from the London Stock Exchange, just because the jobbers had seen fit to put the price up, and sold them back to the market, would probably mean I should never be asked to deal there again.

2762. In other words it would be bad business?—Very bad business.

2763. The third point relevant to this whole discussion is that we are here considering what changes should be made in the company law. I am not quite sure what action you hope we might take having heard your evidence—after the Prevention of Fraud Act so as to eliminate licensed dealers or what?—I hoped there would be a fresh outlook. I stressed this idea of the broker becoming qualified, or raising

the standard of knowledge. Against that, on that principle, I did think that perhaps the licensed dealer, who is a person on his own—Independent, completely independent—I thought that he ought to come into an association which has high standards—and I must stress we have high standards—there ought not to be anybody outside the jurisdiction of a council. You have these people who are exempted. Now there are some pure outside brokers amongst these people who enjoy that privilege. Why they have that privilege I do not know, but they were lucky just after the Bodkin Committee's recommendation came into force. They applied for exemption and got it.

2764. Your view is that members of the Association of Stock and Share Dealers should be treated broadly on an equality with members of the Stock Exchange, and secondly that some sort of examination should be applicable to all dealers?—Yes, I do think that.

2765. *Professor Gower*: I would like to ask one question to which I ought to know the answer. Do the Board of Trade Regulations limit the extent of the margin that you are entitled to add when you have bought shares?—None at all.

2766. Neither under the Board of Trade Regulations nor under the rules of your Association?—No. I could be foolish and buy a share at 5s. and try and sell it to the public at 15s. even though they were still 5s. on the market: I should not get any orders; there would be a lot of letters sent to the Stock Exchange and probably the police.

2767. There are people in the United States who are very comparable to yourself?—I believe so, yes, but I think that there are very few dealers there who act as principals; they are mostly brokers who advertise rather than act as a principal like myself.

2768. With respect, I do not think so. The outside brokers in the United States of whom there are a large number, do act as principals.—They take a commission?

2769. No.—There is no jobbing system.

2770. The regulations of the National Association of Securities Dealers (N.A.S.D.), which is virtually the equivalent of your body, prescribe the margin which the dealer is entitled to add.—The increase in price? Is that not the same principle as in France where the price is not entitled to fall more than so much per day?

2771. In the United States members of the N.A.S.D. partly deal like you, buy a line and sell it; they also act like brokers as well in that if they have a client who wants to buy and they have not got the shares, they ring up a colleague and see if he has. In that respect they are brokers. It is more extensive over there. For instance in an original issue the shares will be placed with these "over the counter" dealers. They can get them as an original issue which I gather you cannot. Do you ever have shares placed with you by an issuing house?—Yes, indeed.

2772. To that extent you get in at the beginning?—Yes. If there were any suggestion of having a profit margin or level imposed here, I myself would not mind in the slightest.

2773. On the face of it it looks as though there ought to be.—Perhaps if there is any evidence of abuse or of the public being "taken for a ride"; but I have never seen it myself. Please remember the small investor is not quite as inexperienced as people make out. Thanks to Mrs. Naylor and her colleagues of the Press, they are becoming very knowledgeable indeed especially where share prices are concerned. It is no good trying to squeeze that extra sixpence hoping they will not notice—they will not play.

2774. I quite see there is a controlling element in that all the shares you deal with are quoted on the London Stock Exchange. There would be this possibility, though, would there not? Certain companies which have published prospectuses might make issues of shares which are not quoted. You could deal in those surely without having again to send out a prospectus? All you would do is send out the prospectus the company had already published?—We could do that. There is one prospectus I expect you have

in mind about some preference shares. It is quite true members of the Association could send this prospectus out all over the country, but there again the cost of doing it would be tremendous and the return very small. The *Investors' Chronicle* next week would carry a blistering article why you should not put your money into that—and the other newspapers as well. The public have a good amount of protection there. If by any chance any member of our Association did send out that particular prospectus now they would be summoned before the Council very quickly I can assure you.

2775. *Mrs. Naylor*: It would help us if you could give us some idea of what kind of action by your members would demand disciplinary measures.—The last one I can recall was where one of our members tried to sell the public a line of shares in a Canadian oil company. There was no doubt that it was a bad one, but that of course does not matter.

2776. Did it have a quotation on the Stock Exchange?—It was being quoted.

2777. The London Stock Exchange had not seen fit to suspend?—It was quoted under the special rule. But this man in his circular to the public made statements which appeared outrageous—untrue and misleading—and accordingly we brought it up before the Council. I brought the complaint myself. They were suspended for twelve months.

2778. Could you think of one more?—It is usually a case of making reckless statements in circulars, but there are so few. There has only been this serious one where a member was suspended. I myself have written once or twice to members reprimanding them on minor things which I thought were bad manners, shall I say, and not upholding our high standards.

2779. Generally it would be because the language in the circular was rather too dashing, too exhilarating?—Yes.

2780. The Provincial Brokers' Stock Exchange, have they not got some kind of examination?—They have indeed.

2781. Is it any good?—Some details of it were published in the Press the other day, and all I can remember was one

question: how do you carry out dividend stripping.

2782. That would be a very good test of mental capacity.—I believe they are on the right track, but of course they have not got the authority of the industry as a whole.

2783. *Quite*. When you buy stock wholesale and retail it, what is the position on stamp duty? Do you have the same privilege as jobbers?—No. If I have not resold the stock in time our name goes to the Stock Exchange and we have to pay the full stamp duty on that. But if we are able to buy the stock and resell it by the time the Stock Exchange requires names, then we are able to supply the names of the public and they are put direct on to the transfer deed. In that case the stamp duty is, of course, only paid by the public.

2784. *Mr. Bingen*: Mrs. Naylor asked about disciplinary proceedings and you said that on one occasion you suspended somebody for twelve months for extravagant statements. Does that mean their licence was automatically withdrawn?—It does mean their licence was automatically withdrawn.

2785. You can override the Board of Trade's powers?—That is true and it is a danger. One of the things we are discussing now with counsel is this question of our having to be at the same time prosecutor and judge, which I do not think is just. I am sure you would be able to agree how difficult it is for us. Somebody comes up before us and we have to charge him and then try him as well. I do not find it easy.

2786. *Chairman*: One way of avoiding that is to provide that the Association should appear by solicitor and counsel—that does something to meet the charge of the members being judges in their own cause. It is true solicitor and counsel would be retained by the Association, but that would give an element of impartiality.—In this particular case the Association's solicitor was present, and also the accused had the right to bring his own solicitor. He had probably been to counsel and would have been entitled to have brought counsel if he had wanted to.

I must confess I did not find it very easy. We were telling him what we thought he had done, then prosecuting him, and then having to sit round and find him guilty. He could have been pre-judged, I know that.

2787. *Professor Gower*: It would be easier if your members were individually licensed by the Board of Trade. You could then bring a complaint to the Board of Trade and they would remove the licence if they thought fit.—That would be one way out of it. I cannot see any real reason for that. Why saddle the Board of Trade with all these complaints? They are not part of the judiciary.

2788. *Mr. Mackinnon*: Surely some of the complaints would be about unethical conduct by the members, not necessarily matters of public interest at all?—That does happen, Sir, yes.

2789. *Mr. Scott*: In order to qualify as a member, does a person actually have to carry on the business of dealing, or could he just be an adviser or an investment analyst?—He could be.

2790. And he could write to the papers about certain shares or something of that sort?—He could do, yes indeed.

2791. Would it be a disciplinary offence if he were to write to the papers cracking

up the merits of a certain share and then try to sell that share by advertisement?—If he sold it to his clients? It has its dangers, yes indeed. But I tell you what he could not do. He could not buy a block of shares on Monday, write it up in the newspaper on Friday and then try to sell the stock back to the Stock Exchange just because he had pushed the price up by his article. That is about the only method of "share pushing" left. It does happen in the Sunday newspapers, but it is never done deliberately; I do not think the Stock Exchange would stand for it.

2792. If someone were to apply for membership, it is not necessary for him to be established in business as a dealer?—It is not necessary, but he would not become a member if he had no established office. I would not personally elect a person who wanted to be just a casual member of the Association.

2793. And the admission, of course, is a matter for the Council?—Yes. Our articles of association require members to be in the business of marketing securities and to have an established office.

Chairman: Gentlemen, those are all the questions we have to put to you, and it only remains for me to express the thanks of the Committee for coming this afternoon and helping us.

(The witnesses withdrew)

APPENDIX XXII

Memorandum by The Council of Associated Stock Exchanges

INTRODUCTION

We have considered the various subjects set out in the Annex to the letter of 15th January, 1960, from the Secretary to the Committee and append our views below. Where we have not commented, it is because the subject is either one upon which other professional bodies are more directly competent to speak, or one which does not fall within the range of our experience.

THE PARAGRAPHS OF THE ANNEX

1. Incorporation of Companies—Memoranda of Association

(a) Requirements as to minimum number of members, and other conditions of incorporation

No comment.

(b) Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects

From the Stock Exchange point of view it is important that the nature of a company's business should be known to investors. The practice of diversification is having the effect of creating, admittedly in a relatively small degree, a number of investment companies under the cloak of some name which either by repute or definition is primarily connected with one particular industry. We believe that the investor should know the nature of the business in which his money is invested and that the best safeguard for this principle would be a more strict insistence on conformity to the principal objects clause of the Company's Memorandum of Association. The present procedure for altering the objects clause is fair and can be applied by companies wishing to diversify. In this connexion we recommend an increase in, or a more vigorous use of, the powers of the Board of Trade to enforce compliance with the principal objects clause and a prevention of the power to endow companies with a plethora of unrelated objects all stated as principal objects. Companies wishing to have such powers should adopt as their principal objects clause one suitable for an Industrial Holding Company. It is possible that one way to achieve this would be to magnify the significance of the principal objects by relegating all the remainder to a statutory table similar to Table A for Articles of Association.

(c) The company as a legal entity distinct from its members—"one-man" companies

No comment.

(d) Shares of no par value

No comment except that we are in favour of shares of no par value.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) Fundamental changes in company's activities

See answer to paragraph 1(b).

(b) Disposal of undertaking and assets

We consider that the power normally given to Directors in the Memorandum of Association to dispose of the Undertaking is too great because it can bring the business to an end. Such a disposal should require the sanction of a Special Resolution of members.

(c) Issue of shares

Issues of shares for cash or otherwise can swing control of a company into hands sympathetic to the directors and possibly against the interests of the shareholders. We recommend that control should be exercised by the shareholders over an increase in the issued share capital (which is the significant item) just as is now required over an increase in the authorised share capital (which by itself is of little consequence).

(d) Borrowing money and charging property

Unsecured borrowing should be left to the directors to arrange but a company's undertaking should only be charged with the approval of the shareholders.

(e) Lending money otherwise than in the ordinary course of business

No comment.

6. Directors' Duties*(a) Should their duties be stricter and more clearly defined, and if so, in what respects?*

See 5.

(b) Are Directors generally aware of the legal duties arising from their fiduciary position?

No comment.

(c) Directors' and officers' dealings in their own companies' shares

It is impossible—and in any event undesirable—to prevent directors buying and selling shares in their companies on their own account. We think, however, that it is desirable that directors should not invest Pension Fund money in the company's shares and so increase their voting strength.

(d) Disclosure of directors' interests

No comment.

(e) Should bodies corporate be allowed to be Directors?

No comment.

7. Shares with Restricted or No Voting Rights

We are not in favour of non-voting Ordinary Shares.

11. Disclosure of Ownership and Control

We consider that the crux of the problem posed by this question lies in the responsibility of the principal for whom the nominee is acting. If that principal is a public quoted company, then its obligation to its shareholders will be governed by its objects clause (see paragraph 1) and by its compliance with the General Undertaking to the Stock Exchange regarding disclosure of factors affecting the nature of the business and the value of the shares.

16. Take-over Bids

This subject is adequately covered by the directors' duties under the General Undertaking to Stock Exchanges and their statutory duty to manage the company. Bearing in mind the recent full treatment of the subject by a City Committee, we have no further comment to make.

18. Control Over Business of Dealing in Securities

The general opinion is that licences to deal in securities should be granted with more care. Exemption from the provisions of the Prevention of Fraud (Investments) Act, 1958 is granted to Licensed Dealers in certain circumstances. We consider that the conduct of Licensed Dealers in this context varies widely and that care should be taken to see that all Licensed Dealers apply the same standards as are required by the Board of Trade. We realise that these are not matters for amendment of the statutes but for stricter control by the Board of Trade.

(Note: Since writing the above the draft of the Licensed Dealers (Conduct of Business) Rules, 1960, has been published and deals precisely with the point.)

24. Company and Business Names

We consider that companies which have become Industrial Holding Companies (see Paragraph 1) should have some distinguishing feature to their names.

28. Problems of Administration and Enforcement of the Law

We consider that companies should publish in their Accounts details of the total remuneration of directors including that received from subsidiary companies.

May, 1960.

Supplementary Memorandum by the Council of Associated Stock Exchanges

(Information supplied by all member Exchanges except Dublin and Cork and by the Oldham Stock Exchange)

Number of applications in the period 1st January, 1956, to 1st December, 1960, granted by the undermentioned Stock Exchanges for permission to deal and official quotation where no such application was made to the London Stock Exchange.

Aberdeen	..	..	3	(of which 1 jointly with Edinburgh and 1 jointly with Glasgow)
Belfast	..	..	3	
Bradford	..	..	3	
Birmingham	..	..	57	(of which 2 jointly with Manchester, 1 jointly with Cardiff, 2 jointly with Nottingham and 1 jointly with Sheffield)
Bristol	..	..	34	(of which 2 jointly with Liverpool)
Cardiff	..	..	10	(of which 1 jointly with Birmingham)
Dundee	..	..	6	
Edinburgh	..	..	11	(of which 3 jointly with Glasgow and 1 jointly with Aberdeen)
Glasgow	..	..	42	(of which 3 jointly with Edinburgh and 1 jointly with Aberdeen)
Greenock	..	..	Nil	
Halifax	..	..	3	
Huddersfield	..	..	6	(of which 4 jointly with Oldham)
Leeds	..	..	7	
Liverpool	..	..	45	(of which 5 jointly with Manchester and 2 jointly with Bristol)
Manchester	..	..	61	(of which 5 jointly with Liverpool and 2 jointly with Birmingham)
Newcastle-upon-Tyne	..	..	8	
Newport, Mon.	..	..	Nil	
Nottingham	..	..	11	(of which 2 jointly with Birmingham)
Sheffield	..	..	13	(of which 1 jointly with Birmingham)
Swansea	..	..	Nil	
Oldham	..	..	8	(of which 4 jointly with Huddersfield)

APPENDIX XXIII

Memorandum by Mr. Charles Clore

With the assistance of my professional advisers I set out below some views on the terms of reference of the Company Law Committee and have followed numerically the paragraphs in the annex to the Secretary's letter dated 15th January, 1960.

1. Incorporation of Companies—Memoranda of Association

(a) *Requirements as to minimum numbers of members and other conditions of incorporation*

I am of the opinion that the absence of any minimum capital contribution provided an opportunity for abuse of the privilege of limited liability. My suggestion is that in this respect there should be a minimum authorised capital for any company, which if not fully subscribed in cash or for moneys worth, shall be a personal liability of the subscribers or promoters in the event of insolvency of the company.

(b) *Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

The doctrine of *ultra vires* should either be abolished or be made capable of strict enforcement.

The rule could be that any company could carry on any trade or business considered expedient by its Board.

Alternatively, the company's objects should be specifically stated and the doctrine which permits each subclause of the Memorandum of Association to be separately construed should be abrogated. The Registrar of Companies could refuse to register any company whose objects clauses are not specific or which are too wide. It could then be made statutory that any change in the objects must first be approved by a Special Resolution of the Company and the amended objects must still be acceptable to the Registrar of Companies as if they were part of the Memorandum of Association as originally lodged. This would prevent the business of a company being radically changed without the knowledge and consent of the shareholders.

(c) *The company as a legal entity distinct from its members—"one-man" companies*

The distinction of the company as a legal entity distinct from its members should be retained.

It is difficult to see how "a one-man" company can be avoided in spite of the fact that the privileges of limited liability are sometimes abused thereby. The suggestion made in 1 (a) above of a minimum authorised capital to be fully subscribed may alleviate this position.

(d) *Shares of no par value*

The recommendations of the Government Committee on shares of no par value should be implemented.

2. Prohibition of Partnerships with more than 20 Members

This has very limited application, applying in practice to professional firms, but there would appear no real reason why a partnership should be limited to 20 Members as is provided in section 434 of the Companies Act, 1948. There should perhaps be a limit but it might usefully be raised to, say, 50.

3. Classification of Companies

The distinction should be between public companies and private companies—all the latter to have the status of present private "exempt" companies. Unlimited companies and companies limited by a guarantee have a very limited application and usage and would not appear to require any further legislative control.

4. Donations by Companies for Charitable and Political Purposes

This should be allowed (certainly for charitable purposes) within reason, taking into consideration the activities and profits of the company.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

Shareholders' control should be strengthened to provide that none of the matters enumerated under this paragraph should be within the directors' powers without a Resolution of the Company in General Meeting except (d) the borrowing of money and charging of property if in the ordinary course of the business of the company.

6. Directors' Duties

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

Whilst directors' duties need not be made stricter than at present they certainly should be more clearly defined.

(b) *Are Directors generally aware of the legal duties arising from their fiduciary position?*

Directors are not, generally speaking, aware of the legal duties arising from their fiduciary position and this should be more clearly defined.

(c) *Directors' and officers' dealings in their own companies' shares*

There is no reason why a director or an officer of a company should not buy or sell shares in that company.

(d) *Disclosure of Directors' interests*

Directors' interests should be disclosed but the present system is cumbersome and usually ineffective. There should be kept a register showing all beneficial interests of directors in the shares of the company, which should be available at all times for inspection and a copy of which should be obtainable in the same way as a list of shareholders. There is no necessity for details of every transaction with date and price to be recorded although such details might be required to be supplied to the Board of Trade on the occasion of any enquiry or investigation into the affairs of the company. From a practical point of view, the Register could be required to be made up quarterly or half-yearly and particulars at the end of the year could be incorporated in the Annual Return.

(e) *Should bodies corporate be allowed to be Directors?*

Directors and Secretaries of bodies corporate should be individuals with personal liabilities for defaults or misconduct.

7. Shares with Restricted or No Voting Rights

This is essentially a matter of contract. If any legal restrictions were placed on the issue of non-voting shares an elaborate system would no doubt be set up to avoid the section and from a practical point of view any effort to interfere with the freedom of contract would fail. As a domestic matter if it is considered of any real importance Stock Exchanges might refuse to give a quotation for non-voting equity shares, etc., except where there is already a quotation for such shares in any particular company.

8. The Protection of Minorities

Generally speaking, a minority position arises quite voluntarily and usually in private companies and whilst the principle behind the present Section 210 is good and there is now judicial decision on it, the scope of the section should be widened having regard to experience obtained since 1948.

9. Protection of Special Classes of Shares

These are matters of contract and the position seems to be adequately covered by the present law and practice.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders*

The company should be entitled if it so desires to require any shareholder to disclose the name and address of the beneficial owner of shares and debentures in the company. The Special Commissioners have this power under the Income Tax Act, 1952, section 250(4), to require this information, and it is considered that the company should have the like right for tax and for other purposes.

(b) *Control through nominee directors*

Control through nominee directors seems to be covered by the provisions of the Companies Act, 1948, section 195(10), which should be made a general rule of company law.

12. Share Transfer and Registration Procedure

Generally speaking, this works well although Company Registrars complain that there is too much detail and paper work involved. Generally speaking, however, the paper work involved is for the protection of both the Vendor and the Purchaser and for the company's records and could be reduced by administrative action.

13. Multiplicity of Directorships held by One Individual

There is no reason why the present position should not remain. One man cannot be an effective director of, say, 1,000 companies; on the other hand, a director can be quite effective, say, in respect of a large number of companies if he can be satisfied with the efficiency and competency of the executive staff and proper provision is made for frequent financial returns with strict budgetary control.

14. Practice of Carrying On Business through Associated and Subsidiary Companies

It is quite common nowadays for a parent company to have many subsidiaries and associated companies each engaging in some branch of or even in a different business from the main business of the company, and for the group to be co-ordinated by the Board of Directors of the Parent Company. This enables the existence of separate companies with its own executive directors, being responsible only to the Parent Company Board, which controls policy and finance.

15. Loan Capital

It would be an advantage if a copy of the Trust Deed, the Debenture and any document creating the loan capital is filed in addition to the Form 47 (a) or (b). I also think it would be an advantage if it is made compulsory to file the Memoranda of Satisfaction.

16. Take-over Bids

There are many points raised in the seven separate sub-headings of this paragraph and a few general observations follow.

The Issuing Houses Association in October, 1959, produced a booklet entitled "Notes on Amalgamation of British Businesses". The authors of this book emphasised four points:—

- (a) That a free share market be maintained.
- (b) That a shareholder himself must decide whether or not to sell his shares.
- (c) That Directors have a duty to give shareholders the full facts at the right time.
- (d) That disturbances in normal share prices should be avoided until all information is available.

There can be little argument with the four principles mentioned above and therefore it is necessary to give some thought to the details or procedure to be adopted in order to see that these four points are sustained:—

(1) Whilst it is not the duty of a Board to negotiate the sale of the holdings of its shareholders, there is no one to whom a person wishing to make an offer for all the shares can approach, other than the Board. The Board therefore should consider any approach of this kind on its merits. They should request information with regard to identity of the proposed bidder, the price proposed to be offered, the ability of the proposed bidder to satisfy the price, the effect which the passing of control would have on the company's business generally, the customers, the staff and all other relevant factors, bearing in mind that overall the Board are trustees for the shareholders.

(2) Once the Board have decided that the offer is a serious one from a responsible source they should issue a statement to shareholders and to the Stock Exchange and the Press in appropriate terms, if possible indicating the price offered, but generally speaking, advising shareholders that an approach has been made and that they should not sell their shares without taking into account the effects of such an approach. It is felt that to stop dealings in the shares would be too drastic a step and might completely upset freedom of dealing if there were a number of such approaches in a short period of time. If there were violent fluctuations in the price of the shares the Board could then be empowered to ask the Stock Exchange to suspend dealing for a short period of time to enable the position to become clarified.

(3) On being satisfied that the offer made can be fully implemented the Board should, at the expense of the Offeror, be required to circularise an offer and a form of acceptance with a stamped or franked envelope but at the same time should be entitled to send a circular with its own comments with regard to the offer.

(4) With such comments it should be the duty of the Board to give the shareholders a full up to date statement of the position of the company, together with any other material information which might influence the minds of shareholders in deciding whether or not to accept the offer. The material information so required would include information with regard to the beneficial interests of the Directors in the shares of the company and particulars of any arrangements offered or made between the Directors and the Offeror with regard to compensation, new service agreements or other matters which might benefit the Directors.

(5) The name of the Offeror should always be disclosed and there should be a legal obligation on the part of the Offeror to arrange irrevocably for the full implementation of the consideration offered in the event of the offer becoming unconditional.

(6) No offer should be open for less than 21 days or more than 35 days before it is declared unconditional or withdrawn. If the initial period is to be extended notice is to be given to the company not less than 3 days before the expiration of such initial period. If the offer is declared unconditional it should be capable of being extended beyond the 35 days period, for late acceptances.

(7) Any acceptances, notwithstanding any agreement to the contrary, should be capable of being withdrawn by notice in writing given not less than 7 days before the closing date for the offer, as extended if applicable.

(8) The Companies Act, 1948, section 209, requires to be redrafted as it is not satisfactory as drawn. The general principles are correct, namely to enable an Offeror who has acquired 90 per cent. of the issued share capital of a class of shares compulsorily to acquire the balance. The reciprocal right given to dissenting shareholders should however apply if the Offeror obtains in excess of 50 per cent. of the shares in question on the footing that such a control can be just as effective for most purposes as a 90 per cent. control.

17. Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issue of Shares to Existing Shareholders

Generally speaking the present provisions appear to be adequate for public protection—section 39 of the Companies Act, 1948 (Certificates of Exemption) is a power which has been given to the Share and Loan, Stock Exchange and seems to work adequately. There is a danger that further detailed legislation will create more problems than it will solve.

18. Control over Business of Dealing in Securities

No comment.

19. Unit Trusts and "Open End Mutual Funds"

No comment.

20. Reduction of Capital and Purchase by a Company of its own Shares

Generally speaking the reduction of capital provisions cause no undue hardship and contain within reasonable bounds companies dealing in its own share capital. Companies Act, 1948, section 54, requires further detailed consideration and should be strengthened.

21. Accounts

This is mainly a matter for Accountants to offer advice on technical matters but from the point of view of a person concerned with business and industry the following observations may be material:—

(a) *Revaluation of fixed assets and use of any resulting surplus*

Fixed assets of a company should be revalued not less frequently than at 5-yearly intervals but there is no need for the surplus resulting from such revaluation to be incorporated in the accounts. A note could perhaps be made of the revaluation in the same way as the annual revaluation of quoted investments is noted.

(c) *Use of pre-acquisition profits of subsidiaries*

Pre-acquisition profits of subsidiaries should be available for use in the current year if declared as a dividend by the subsidiary whilst the shares of the subsidiary are held by the parent company. The company could have the option of writing off the amount of pre-acquisition profits after tax, from the cost of acquisition of the subsidiary if it so desired.

24. Company and Business Names

The administration relating to the approval of Company and Business Names should be amalgamated in a single department of the Board of Trade. The Registrar should have the right to require that the choice of any particular name for either purpose be advertised for objections and to consider such objections, if lodged, before issuing a Certificate of Registration.

28. Problems of Administration and Enforcement of the Law

The Board of Trade should have wider powers to appoint an Inspector to investigate the affairs or certain aspects of the affairs of any company. These powers should be exercised more freely and speedily. Provision should be made for these powers to be able to be exercised without public notice so that the Board of Trade could, at short notice based on reasonable evidence, appoint an Inspector to investigate certain specific aspects of a company's activities, the Inspector's appointment and terms of reference being notified only to the company. The Board of Trade could then if so desired require the company to circularise to its shareholders a copy of the Inspector's appointment and Report. On this footing no harm would be done by the appointment if there were no material grounds of complaint against the company, but if there were any such grounds, the shareholders would be protected by speedy and effective action and publication.

The existing powers of appointing an Inspector by public announcement could be retained but would only be exercised within specific limits on the lines of the present legislation.

CHARLES CLORE.

April, 1960.

APPENDIX XXIV

Memorandum by The Association of Stock and Share Dealers

The Association of Stock and Share Dealers is pleased to be given this opportunity of presenting its views to the Committee but wishes to state that any comments or recommendations suggested for the further protection of the small domestic investor are made entirely on the principle that its members and all those engaged in the investment business are members of an industry and not a learned profession.

We attach the greatest importance to this principle for it is an unfortunate fact that the Stock Exchanges have so framed their rules to give the impression that their members are officially qualified. No doubt this policy was adopted for good reason but we contend that it is misleading to the general public who tend to treat their dealings with their investment broker with the same confidence as they utilise the services of their doctor, legal adviser or accountant who can be safely assumed to have a high degree of skill. It is unfortunate for the small investor that the degree of skill attained by the investment broker of his choice is an unknown factor and only too often is of a pathetically low standard.

We would like to recommend therefore that the fullest consideration be given by all branches of the industry to the formation of an Institute of the same calibre as those which embrace the prestige of other industries.

It is our belief that the formation of such an Institute with its demands of competence amongst its Members would automatically raise and maintain the standard of trading to a satisfactory and safe level.

Needless to say, membership of such an Institute would have to be made compulsory for all those who in the course of their business have to solicit capital from the public on which interest is paid, or trade in securities. It would also have the valuable advantage of conferring a quasi-professional status on the broker or agent, or others who receive commission for their services.

We would like to say again in all sincerity that the small domestic investor will be safe from undue exploitation when the standards of competence and moral rectitude are universally high throughout the industry. We do not believe that further legislation will be of the slightest help as far as the small investor is concerned until these standards are raised to a satisfactory level. At the moment there is the Companies Act, 1948, The Prevention of Fraud (Investments) Act, 1958, and the Rules, Regulations, By-laws, etc., of the various bodies engaged in investment business, to say nothing of the several Councils and Committees with disciplinary powers and a highly competent Fraud Squad to keep the industry in a clean condition. The fact that these have proved insufficient can only be due to an unfortunate lack of leadership and example from the highest quarters in recent years.

Happily, there are positive signs that this matter is being rectified, but we would like to recommend to the Committee that it could be greatly expedited by not only the foundation of an Institute on the lines suggested above but also by a reorganisation of the licensing system which authorises all sections of the industry to carry on business.

At present the authorised members of the industry are split up into four categories, namely:—

1. Licensed Dealers
2. Members of Recognised Stock Exchanges and Recognised Associations of Dealers in Securities
3. Exempted Dealers
4. Authorised Unit Trust Schemes.

Of these four categories only Nos. 2 and 4 are so organised that their Members are subject to a measure of discipline imposed by their respective Councils. On the other hand Licensed Dealers have no such guardian, except that their licence can be revoked by the Board of Trade. We believe that this places an undesirable burden on a Government Department who cannot be expected to act as an arbiter of standards or conduct. We would, therefore, like to recommend that the Committee may consider it desirable that Licensed Dealers should be required to join an Association such as our own.

Again in the interests of expediting the raising of standards of business conduct we would like to recommend that consideration be given to a revision of the members of the industry who enjoy the privilege of being Exempted Dealers in securities under section 16 of the Prevention of Fraud (Investments) Act, 1958. In the belief that this privilege of "exemption" was designed to permit the great Finance Houses to operate unfettered by rules and regulations, it is, unfortunately, the experience of Members of this Association that some would not appear to conform to the standards of business conduct expected from those entitled to be included in this category.

As we have stated above, we do not believe that further restrictive legislation will bring complete protection to the small domestic investor with whom we understand the Committee is concerned.

No doubt, however, the opportunity does exist now for the modernisation of various sections of the Companies Act, 1948, in the light of current business trends, but we prefer to leave such recommendations to the Legal and Accounting professions.

18th October, 1960

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
NINTH DAY

Friday, 16th December, 1960

Present :

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D. (*Questions 2794 to 3013 only*)

MR. W. H. LAWSON, C.B.E., F.C.A.

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. H. A. WALTERS, MR. J. B. H. PEGLER, MR. J. F. BUNFORD, MR. H. J. HENDERSON
SMITH, MR. L. W. KEMPE and MR. R. C. W. BARDELL *called and examined*

2794. *Chairman:* Good morning, gentlemen. We are very much obliged to you for coming to help us this morning and also for the excellent memorandum which you have submitted. For the purpose of the record, you are here as representing the British Insurance Association: Mr. Walters, Chairman of the Association; Mr. Pegler, Chairman of the Life Offices Association, and also a member of the Council of the Institute of Actuaries; Mr. Bunford, Chairman of the Investment Protection Committee of the Association; Mr. Henderson Smith, Chairman of the Association's Companies Act Sub-committee; Mr. L. W. Kempe, Secretary of the Investment Protection Committee of the Association; and Mr. Bardell, the Assistant Secretary of the Association.—*Mr. Walters:* Yes, Sir.

2795. Now I understand from your memorandum that, generally speaking, you think the operation of the Companies Act, 1948, is satisfactory. I gather that you are in principle opposed to trying to legislate for every possible abuse because this would hinder the activities of the honest majority in order to catch the occasional rogue?—Yes.

2796. Thank you. You have, one might say, two capacities, or your constituent companies do: in the first place, they carry on insurance business all over the world, and in that connection, I think, you are particularly concerned with certain matters regarding accounts?—Yes.

2797. On the other hand, you carry on an extensive business as investors and in that capacity you are concerned to get as much information as you can out of other companies in whom you may have invested your money?—I think that is a fair statement.

2798. You say, in effect, that you would prefer to see legislation directed to giving the authorities, as you call them, adequate safeguarding powers, rather than the creation of hard and fast rules?—Yes.

2799. When you refer to the authorities have you in mind the Board of Trade?—Basically, the Board of Trade, yes; that would be the body that we would consider as being most concerned with all the details.

2800. Then there is the Stock Exchange and existing legislation attaches considerable importance to their rules and procedure?—Yes.

2801. The type of safeguarding power you have in mind, I suppose, would be something like the Board of Trade's power to appoint inspectors, possibly strengthened in some way or made more extensive?—Yes, that would be our view; it is what could apply in the case of our own business in insurance and it could be extended more widely.

2802. That is over and above the Board of Trade's existing powers to appoint inspectors as regards companies generally?—*Mr. Bunford*: I really feel, Sir, that they have probably got very adequate powers already, but under heading 10 we do make certain suggestions.

2803. Yes, I was about to refer to that. You do suggest that in certain respects that procedure should be strengthened and expedited?—Yes.

2804. I do not think we need go into it in detail now; but those would broadly be the authorities and the safeguards which you think might be feasible?—*Mr. Walters*: Yes, Sir.

2805. Then there is the question which has been much discussed in this Committee, and that is the question of the doctrine of *ultra vires* considered in conjunction with very wide forms of memoranda of association now commonly adopted.—Yes.

2806. I understand that you are in favour of continuing, or not interfering with, the practice of stating the object clauses in very wide terms. What is your view upon that?—We really feel that if the object clauses are too narrowly drawn it may have a rather hampering effect. We do think they should be reasonably wide. If they were drawn very narrowly we feel that there might have to be constant references back to shareholders for not very important extensions and that does not seem entirely practicable to us.

2807. If you get a very wide set of objects within the framework of the memorandum, and if directors have delegated

to them by the articles all the powers of managing the business, which is, I think, common practice now, would you not agree that there is a danger of directors being able to indulge in adventures which ought properly to be submitted to the shareholders before they are embarked upon?—Yes; if they are drawn too widely. I think we would rather try to distinguish between a fair width of objects clause as distinct from a very narrow one.

Mr. Bunford: Under heading 5 we deal with an aspect which is closely related to the objects, namely, the exercise of the powers which are conferred by the memorandum, and we have suggested that shareholders should be kept informed of any material change in activities within the powers and, furthermore, that where it is a really fundamental change they should be consulted, not merely told afterwards: "This is what we have done". This, Sir, is all in the spirit of closer association between the directors on the one hand and shareholders on the other.

2808. Yes. So that you would retain a wide memorandum and provide for reference to the shareholders in proper cases?—Yes. I think that we have rather come to the view that widely-drawn memoranda are with us to stay; they are a feature of modern life.

2809. It would really be impracticable to go back on what has been done in the past and say, "Henceforth memoranda must have only two clauses", or something like that, specifying very narrowly specific objects?—Yes. I do feel that would be taking too stern a view altogether, but it is difficult to decide exactly where to draw the line between over much power and over much restriction.

2810. You would not agree with the Cohen Committee's view that the modern memorandum with its very wide provisions was no longer a protection either to the shareholders or to third parties dealing with the company?—I think, Sir, that the passage of another 15 years has somewhat changed the view which was held by the Cohen Committee in comparison with what the view might be today.

2811. What the Cohen Committee thought was that it would be a good idea simply to give companies the same powers as an individual person, and that the objects clauses should serve really as an agreement between the company and its shareholders as to the powers exercisable by the directors. On such a view the memorandum would simply have an internal or domestic effect, but the third party would not be concerned as he would be entitled to assume that anything the company did was within its powers.—Yes.

2812. But I gather from your previous answers that you would not regard that as a feasible proposition?—Not I think in today's conditions.

2813. Could you amplify that a little? Are you just coming back to the point that it is too late in the day to alter the type of memorandum in common use?—Really, Sir, yes.

2814. Yes. Of course, the result of that is that, wide as the provisions of a memorandum may be, you do still get the odd case of *ultra vires*; for instance, there was the case of *Jon Beauforts (London) Ltd.*, in 1953. I gather the facts in that case were that the company was engaged in the textile business and then thought fit to abandon that and embark on a business of making wooden panels, or something of that sort; and that was held by the Court to be *ultra vires*, with the result that creditors in the winding up who had dealt with the company during its *ultra vires* career lost their money, because any *ultra vires* act of a company is a mere nullity.—Yes. We have said that in our view the principles of the *ultra vires* rule should remain, although, with the growth of powers, it is obvious that the chance of exceeding them becomes smaller.

2815. But where they are exceeded, as in the case I have just mentioned, would not you regard it as a great hardship on the third party?—I think it might be a hardship on the third party.

2816. I think the debts which were disallowed included such things as debts for fuel—for coal or coke or something of the

sort—necessary in order to keep the factory going, and moreover, supplies which would have been equally necessary if the factory had never abandoned its original object. Does not that strike you as a little unfair to the honest coal and coke merchant who supplies these goods to a company?—In those circumstances, I agree it does seem unfair.

2817. While not going so far as to abolish the *ultra vires* rule altogether, would you favour legislation designed to mitigate the consequences of its breach where third parties have had dealings with the company in good faith and for valuable consideration?—That would seem reasonable to me, Sir. I think it would be unreasonable to expect every third party to demand to see the memorandum to make sure that what the company sought to transact with him was within their powers. I think that is stretching conditions too far.

2818. As you know, a memorandum is technically a public document, thus a third party might, under the existing law, be technically affected by the notice of the contents of the memorandum, although, as you say, it is not to be expected he would in fact demand a copy of it and read it before he agreed to supply goods to the company. So that you would regard my earlier suggestion as reasonable if it was practicable to introduce it?—Yes, Sir.

2819. Then under heading 1 (b), paragraph 2 of your memorandum, you say that the law ought to require class consents to any alteration of the company's objects and you go on: "Doubts have been expressed to us as to whether it is competent for a company's regulations to provide that the objects clause of its memorandum shall not be altered without the consent of a class or classes of the company's share capital. In our view legislation should make it clear that a company's articles may so provide." Have you considered the existing provisions of the Act as to objection by particular classes to an alteration in the objects? As the matter now stands, a dissentient minority consisting of the holders of 15 per cent. of any class of shares is entitled to apply to the

Court under section 5 (2) (a) for the cancellation of any proposed alteration. They are entitled to make that application when they go before the Court, and if their objections are held by the Court to be of substance then the Court may refuse to make the alteration. Do you think it is really possible to protect particular classes of shares any further than that?—Our suggestion, Sir, does put forward what I think is a rather stronger protection, namely, that there should be class meetings on a proposal to change the objects clause; that is deliberately obtaining the views of the classes concerned, whereas the operation under section 5 of the Act depends upon voluntary action and the collection of a view among the shareholders.

2820. That would involve a considerable alteration in the existing position; and you would have to provide in the Act, I think, that the Court could only allow or approve a resolution for the alteration of the objects if it was assented to by the classes at classes meetings in accordance with the usual modification of rights clause; that is what it would come to, is it not?—I think perhaps I may have given a wrong impression. What we are seeking is put in the last sentence of our submission under heading 1 (b) (2), namely, that "legislation should make it clear that a company's articles *may* so provide."

2821. But then one runs into this difficulty, that the articles are by statute alterable, and a provision that they shall not be altered is no good.—This, Sir, would be a provision that they could be altered only by, and subject to, among other things, certain class meetings if the particular company's articles so provided.

2822. It would be possible to provide in the Act that the alteration of the company's memorandum with respect to its objects should only be carried out, as you say, with the consent of the various classes of shares obtained at a meeting; in other words, you would equate the alteration of the objects to the scheme of arrangement where the jurisdiction depends on the requisite majority being obtained?—I think our point was that there were doubts arising out of the word "may" in the opening line of section 5—as to

whether it was permissible for the objects clause of a particular company only to be varied subject to consent by each class.

2823. Yes. That would be, I think, an important change in the position as it exists today; there would be nothing impossible about legislation in that way if it were thought fit; and then the section of the Act as to alteration would require not only a special resolution of the company but approval by the different classes of shares at separate class meetings?—Yes; we are not seeking to make that universal but to make it permissible for a company to do it.

2824. Then one would have to say in the Act that if the articles so provided separate class meetings should be required?—Yes.

2825. That no doubt will be considered; but the trend as I see it at present is all against making it more difficult to alter objects and in favour of making it as easy as possible; that is the general trend of opinion I think. Would you agree?—Yes, Sir, I would agree. One can visualize changes in objects which might hold attractions, for example, for ordinary shareholders, but because of the rather speculative nature of the new object it might not be equally attractive to the preference shareholders.

2826. A preference shareholder for instance might prefer a jog-trot type of business that brings him in a steady 5 per cent. to a gold-mining business where the ordinary shareholders make a mint of money but where he still only gets his 5 per cent.?—Yes.

2827. *Mr. Richardson:* But is it not putting it pretty high to say that the holders of fixed interest shares shall have a right of veto?—I see the point; it could be said to be putting it pretty high. But all shareholders are corporators in the company and they have different interests—preference shares have certain prior interests—and if the new object were so speculative that it might affect the chance of dividend on the preference shares, then I would have thought it was proper for them to have, as you put it, Sir, a veto.

2828. Would you think it a rather remote case?—Yes, I think it would be remote.

2829. *Chairman:* The point is that while all the corporators share the risks, if they switch over to gold-mining, it is only the ordinary shareholders who get the benefit, and that would be the preference shareholders' case, would it not?—I think so, Sir; a preference shareholder has a ceiling to his profit but has no floor.

Mr. Bingen: On the other hand, if the gold mine turns out to be a loss, then primarily the losers are likely to be the ordinary shareholders; you might lose some of the capital but not all.

Mr. Brown: Is not the point rather that the preference shares are raised originally on terms which take account of the stability of the company and that it would be unreasonable if it was turned into a very risky business?—That is basically the view that I was seeking to express.

2830. *Chairman:* Another small point, or a smaller point, on the memorandum. What would you think of the proposal that the voluminous common form powers now appearing in most object clauses and in memoranda of association should be relegated to a schedule in the Companies Act on the lines of Table A, with provision that all those powers were to be taken to apply to the company unless they had been expressly excluded by its memorandum? Do you think that would be helpful or merely an additional complication?—I would support that, Sir.

2831. Then we come to heading 5 (a) which has already been referred to, as to fundamental changes in a company's activities. You are of the view, according to that passage in your memorandum, that in the case of a fundamental change the shareholders should be consulted in advance. That I take it is your view?—Yes.

2832. Have you ever attempted to define the word "fundamental"? That is always a difficulty. Can you suggest a definition?—No, Sir; I can only admit that it is difficult.

2833. But it might not be beyond the power of the Court to do it?—*Mr.*

Walters: I would not think it would be beyond the power of the Court to define it. I admit that at this stage, if we ourselves defined what a fundamental change was, then necessarily some would be obvious and some would be doubtful.

Mr. Bunford: The example which you gave just now would qualify as a fundamental change.

2834. You get cases where the change is obviously fundamental and you get a number of marginal cases. But, as against that, you would hope that directors would, on the whole, act on the safe side and seek the consent of the shareholders if there were any doubt about it?—Yes.

2835. Do you think that would unduly hamper the company in carrying on its business?—No.

2836. It has been put to us that if they have to get the consent of their shareholders they may lose so much time that the bargain is off?—I do not think that there is any reason why the bargain should not be made conditional upon approval by the shareholders. A little time would be lost and the intended bargain would become known perhaps a little earlier, but I would have said that it was the right way, where the thing was clearly fundamental, for provision to be made for consultation with the shareholders.

2837. And the other risk that is put—you have mentioned it yourself, I think—that the approach to the shareholders by summoning a general meeting to approve the transaction would of course become common knowledge, and might excite competitors to go to the proposed vendor and offer somewhat better terms. Would that be a risk, do you think?—One must admit it would be a risk.

2838. Nevertheless, if the operation was really fundamental, then you think the shareholders should be consulted?—Yes.

2839. Then you refer also in heading 5 (a), in effect, to transactions which, though perhaps not meriting advance approval by shareholders, ought to be put to them by way of information in order

that they can tell how their money is being used?—Yes.

2840. And there you refer to section 157 which concerns the directors' report; that section is in fairly comprehensive terms, but it is limited in terms to matters the disclosure of which will not in the directors' opinion be harmful to the business of the company or any of its subsidiaries; so that the directors do have discretion as to what they shall put in their report?—Yes.

2841. Would you consider it feasible to strengthen the section by attempting to prescribe what the contents of the report are to be? For instance, would you make it obligatory on directors to include in their report any happenings of this or that kind set out in the section which might have occurred during the year under review? Do you think that would be practicable?—I do not think it would always be practicable. Take, for example, a really big company with many activities—take Imperial Chemicals: I think it would be expecting too much to ask a company which already has so many activities to be bound by law to include in the report to the shareholders all the new activities in which the company was taking part. That we see is the difficulty about legislation on this point, and yet it is not one which one can readily see how it could be dealt with in any other way than by legislation. The Stock Exchange regulations, for example, would not help here.

2842. In order to make it enforceable, the obligation would have to be clearly expressed and any breaches of it should be visited with the appropriate penalty?—Yes; we have used the phrase in the fourth line, "the main activities". Those words were deliberately used; and in that sense we still feel that it is desirable that the shareholders should know the main activities of their company.

2843. I take it that you think that it is very desirable that there should be a report on the lines indicated in section 157 and that it should tell the shareholders of the main activities of the company during the period under review, but that it is difficult to impose by legislation a cut and dried

document containing information as to every conceivable activity there may have been?—Yes; I think one is in the same difficulty in trying to define the word "main" as the word "fundamental".

2844. *Mr. Richardson:* Do you feel there is any difference between whether the information is notified to shareholders in the directors' report, which is now tending to become in practice a rather formal document, and in the chairman's speech, which is a fuller one?—One has a feeling that reports are read more thoroughly than a chairman's speech which, as you say, is apt to be a bit more discursive. The point we are making here is that we would prefer a notification of this kind to be in a formal report rather than in a chairman's speech.

2845. The distinction does not imply any difference in timing, and you would be happy that it should be disclosed in the directors' report, which is going to be issued at the same time as the chairman's speech? You are not indicating that there should be an earlier reference to the shareholders?—No; this is not a question of timing. In point of fact, it would generally be at the same time, because very often the chairman's speech goes out with the report these days.

2846. *Mr. Bingen:* Mr. Bunford is saying that he would like the directors' report to describe the nature of the company's main activities. Would you look at section 157? The reference there is to a change in the nature of the company's activities. But are you asking that each year the company should describe its main activities, even though there has been no change?—The report would naturally make some comment upon existing activities which are already known through the figures, but changes, in our view are important and should be reported.

2847. Which is what the Act provides for.—*Mr. Henderson Smith:* May I make one comment? There is a tendency also amongst the auditing profession to ask to see a company's report but that at the present time does not apply to the chairman's statement. I think that is an additional reason for requiring this information in the report rather than the speech.

2848. *Chairman*: Yes. The report, under section 157, has to deal with the "state of the company's affairs" as well. —And you were also asking what we thought about it being obligatory. Were you thinking that subsection (2) of section 157 might be strengthened, because you do not feel it is even now obligatory?

2849. It is obligatory in a sense, but it is left to the discretion of the directors and in that sense it is not, so to speak, effectively obligatory. —When you used the words "making it obligatory" you were suggesting that the wording of the existing section should be strengthened?

2850. Yes. That is what my question was directed to, and I was putting it that in a matter such as making a report under section 157, it is very difficult to prescribe a cut and dried or a sufficiently definite duty so that it could be enforced by imposing penalties for its breach—that is the difficulty that I feel and I gather that you gentlemen would not differ from that. Then I think we can pass from that to the next question which is this matter of the issue of shares. You express the opinion that "shareholders should retain some control of the issue, by the board, of capital already authorised where such issues would materially affect the control of the company or radically change the nature of its business." Then you say that you recognise the difficulties, "particularly as the creation of such authorised capital must be the subject of a resolution at a general meeting of the company." In that connection, how would you view the suggestion that where it is proposed to issue for cash equity shares created by a resolution for increase of capital such shares should in the first instance be offered *pro rata* to the existing shareholders? —*Mr. Bunford*: We agree.

2851. That would in effect be an offer of rights which is now very common as a method of raising capital? —*Yes*.

2852. Would you consider that reasonable? —*Mr. Walters*: Yes, I think that is entirely reasonable.

2853. Have you observed that such a power was in all versions of Table A, I think, from 1862 down to 1929 and that

then it was dropped in the 1948 Act? Have you observed that rather curious circumstance? —*Mr. Bunford*: I am afraid I had not, Sir.

2854. I am told it was due to the fact that when the Table A for the 1948 Act was being settled there was in force legislation which imposed a tax on bonus distributions. It was thought that an offer of rights almost invariably included some element of bonus and that that might attract tax. That I believe may be the explanation. On the other hand until 1948 it seems to have been considered a reasonable provision to put in the articles. Would you agree to that inference? —*Mr. Walters*: Yes, it seems a very reasonable one.

2855. Following upon that is this, that a company's initial authorised capital can be anything the promoters choose to make it. Do you think that the *pro rata* principle should be applied to any part of the shares in the original authorised capital? —*Mr. Bunford*: You mean, if more are issued for cash?

2856. Yes, if the company has shares surplus to its immediate requirements, so to speak, and it is not subject to commitments which preclude their issue for cash and it is decided to issue them for cash? —I would agree; it would be desirable for issues of equity shares within the authorised limits to be offered *pro rata* to the existing ordinary shareholders.

2857. But my difficulty about that is this. You start a company and the only ordinary shareholders to start with are the two or the seven original members. Then there are certain obligations in connection with the flotation of the company under which shares have to be offered to certain particular individuals, and my difficulty is at what point one could bring in the application of this *pro rata* rule? —I would think that they still should be offered to those original shareholders. They probably would have their own reasons for not wanting to find more money, and a way would be found of making the shares available more widely, but with the consent of those who are already the equity holders.

2858. One could perhaps limit the requirement as regards the original capital, to any balance of shares in the original capital available for issue for cash, so as to exclude shares which were subject to some other commitment?—Yes, I think so.

2859. Again as to this *pro rata* rule, would you think it would be right to make this a provision of the Act, or do you think it would be reasonable simply to restore it to the place it formerly occupied in Table A?—Table A, Sir. I would not make it a provision of the Act.

2860. Would you see any merit in the suggestion that the Act might provide that a clause to this effect should be included in Table A and should not be excluded from any articles of association excluding Table A wholly or in part except by special resolution of the shareholders passed, say, at the statutory meeting, or on the first occasion when you could really have a representative body of shareholders to vote on the matter?—I think that would be appropriate.

2861. As it is the articles of association, which are a very important document, are settled as regards terms by the promoters and their solicitor and their solicitor simply uses the form he favours, so that points like this may be lost sight of and not really advisedly excluded at all?—I think your halfway house would meet the point of view that we are seeking to put forward. We did say that we saw some difficulties in legislation, but that does provide a guide and yet avoids forcing it upon every company.

2862. The Act would be saying: This is a reasonable matter to include in the articles of association of any company. If a particular company does not want to have it, then there must be a special resolution excluding it?—Yes.

2863. Passing then from this *pro rata* principle, what about shares issued for a consideration other than cash? Do you think it reasonable that a resolution of the company in general meeting should be required if it is proposed to issue shares for a consideration other than cash to an amount which would increase the issued

capital, say, by 25 per cent., or something like that?—I would think in that case, Sir, that reference to the shareholders was desirable.

2864. You see no difficulty about that provided that the amount was a sensible one so as to exclude minor transactions?—No.

2865. Then perhaps we might refer briefly to the question of voteless shares which has attracted much attention in the Press of late. Now your position there is that you do not favour voteless shares but that you do not think it would be feasible to legislate for their abolition?—That is so, Sir.

2866. Of course, it is a question which has two sides to it. On the one hand, it is said that every shareholder should have some right of voting; on the other, it is said that the shareholder's right to vote depends upon nothing else but his contract of membership, and if he chooses to contract on the footing that his shares are to carry no vote, then there is no reason why he should not be held to his bargain.

—Yes. May I add this, that the views which are expressed in paragraph 7 dealing with this subject are the majority views which are generally held in the insurance industry. It is fair to say that not all our members would hold those views with the same strength, or even perhaps at all in some cases. But they are views that are generally held, namely, that the fundamental principle is that each person who has a share in the equity and the risks should have a proportionate voice.

Mr. Walters: Even in individual insurance companies there might be certain members of the board of directors who would not take the view that non-voting shares were undesirable. It is a very large majority view, though not a unanimous view.

2867. Then there is this point. Some witnesses have said that they prefer non-voting to voting shares because they give them the same financial benefits at a cheaper price.—*Mr. Bunford:* Yes, some people do hold that view.

2868. And that is reasonable, and it would be a strong thing to say that that

view ought not to be given effect to if shareholders prefer it?—Yes, Sir, it is perhaps a strong view. We have had quite a good deal of experience of the problems which arise through companies having voting and non-voting shares, as is said in paragraph 2 of our submission under heading 7; but the very existence of the two classes creates problems when it is desired to issue fresh capital.

2869. And it is reasons of that kind which lead the majority of your Association to say they do not like voteless shares and would be quite happy if there were no such thing?—No, Sir, what I said was only an ancillary reason; our reason is deeper than that; we do feel that every equity shareholder should have a proportionate voice in the conduct of the company's affairs.

2870. Yes. I think we have your position. We have also had the other view put to us. It will be for the Committee to decide between those two views.—We have said that we realise how very difficult it would probably be to enforce enfranchisement of existing non-voting shares—that is clear. But we have said that if such a proposal were made it should be submitted to both classes of equity shares, both the voters and the non-voters, because clearly to award votes to the non-voters is affecting the rights of the existing voters. There have been quite a number of cases where companies have enfranchised their non-voting shares, at the same time giving a bonus issue to the existing voting shares.

2871. There is one other point on voteless shares. You favour the view that, although they have no voting rights, it would be reasonable to allow them to have notice of and to attend meetings?—Yes.

2872. Would you be prepared to go so far as to accept the suggestion that possibly they might be given a special right to vote in certain circumstances? Do you think that it would be feasible to introduce the same sort of limited voting power as many classes of preference shares have today; that is to say, they should be entitled to vote, for example, on the resolution for a winding-up of the company

or if there had been no dividend paid for a period of five years—that type of thing?—That would certainly be feasible, Sir, and it would be a step in the right direction, but only a small step in the view of those who hold the views expressed in our evidence.

2873. But I suppose a step in the wrong direction from the view of those people who would hold shareholders strictly to their contracts?—Yes.

2874. *Mr. Watson:* Paragraph 4 of your written submission under this heading says: "Companies should be prohibited from creating or issuing non-voting shares unless, at an appropriate date, they already have such shares in issue. A company having such shares in issue at the appropriate date should be prohibited from issuing further non-voting shares except by way of free bonus shares to be allotted to existing holders of non-voting shares." I wonder how far that is practicable. Is it not true that normally where there are non-voting and voting shares in issue the voting shares are worth more on the market than the non-voting shares?—Yes.

2875. If this proposal were adopted it would mean that the non-voting shares would get a bonus in non-voting shares and presumably all the voting shares would get a bonus in voting shares?—Yes.

2876. Therefore the value of the bonus issue would be greater to voting shareholders than to non-voting shareholders?—Yes; that was the view which we held originally, those of us who discussed this problem fairly deeply—that by the issuing of voting shares to voters and non-voting to non-voters one was giving something different to the members of the two classes. On the other hand, you are giving to each of those classes issues proportionate to what they each had before, so that their relative positions remain the same.

2877. So that you think it is not unfair that the non-voting shareholder should get a bonus worth less than that of the voting shareholder?—We have come to the conclusion, Sir, that, provided the bonus issue in the form of ordinary or ordinary and "A" to "A" is within the

view ought not to be given effect to if shareholders prefer it?—Yes, Sir, it is perhaps a strong view. We have had quite a good deal of experience of the problems which arise through companies having voting and non-voting shares, as is said in paragraph 2 of our submission under heading 7; but the very existence of the two classes creates problems when it is desired to issue fresh capital.

2869. And it is reasons of that kind which lead the majority of your Association to say they do not like voteless shares and would be quite happy if there were no such thing?—No, Sir, what I said was only an ancillary reason; our reason is deeper than that: we do feel that every equity shareholder should have a proportionate voice in the conduct of the company's affairs.

2870. Yes. I think we have your position. We have also had the other view put to us. It will be for the Committee to decide between those two views. —We have said that we realise how very difficult it would probably be to enforce enfranchisement of existing non-voting shares—that is clear. But we have said that if such a proposal were made it should be submitted to both classes of equity shares, both the voters and the non-voters, because clearly to award votes to the non-voters is affecting the rights of the existing voters. There have been quite a number of cases where companies have enfranchised their non-voting shares, at the same time giving a bonus issue to the existing voting shares.

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2877. So that you think it is not unfair that the non-voting shareholder should get a bonus worth less than that of the voting shareholder?—We have come to the conclusion, Sir, that, provided the bonus issue in the form of ordinary to ordinary and "A" to "A" is within the

powers of the articles, then it is not unfair in the sense that a member of either class is left relatively in exactly the same position as he was before. Take as a simple example a 100 per cent. bonus issue of voters to voters and of non-voters to non-voters, their relative holding is exactly as it was before the bonus issue: they have merely got a larger piece of paper.

2878. *Mr. Mackinnon*: Surely in the normal case where you have voters and non-voters the constitution takes special care of the situation by providing that when there is an offer of shares or a capitalisation the voters shall get voting shares and the non-voters shall get non-voting shares. Is not that standard practice with a great number of companies?—I am not aware of it as standard practice, but it is done in some cases.

2879. It is very common, and if you do not have that situation you are then faced with the problem of having to issue non-voting shares to everybody?—Yes.

2880. Because that is the only way in which you can produce parity?—Yes. We do not feel this is a good thing because it enlarges still more the volume of non-voters which we, generally speaking, regard as undesirable.

2881. Even at the risk of doing some slight injustice to one group of shares?—Yes. We have discussed this question of justice a great deal and, as I said, having started off with the feeling that by giving ordinary to ordinary and "A" to "A" one was not dealing fairly by not giving the same to both, we came later to the conclusion that that method was as near fairness as one could get, assuming that there is nothing in the articles to the contrary.

Mr. Pegler: The situation is obscured in this case because it is called a bonus, whereas in fact it is not giving the shareholders anything; they are left in the same position as before, and the bonus is therefore not a gift at all.

2882. *Mr. Watson*: Yet it is true that the share that the voting shareholder gets is worth perhaps 60s. on the market and the share the non-voting shareholder gets

is worth perhaps 50s.—*Mr. Bunford*: It is possible to do a sum which will show that, in spite of the apparent unfairness at that stage, there are other stages—for instance, you have to consider what the voting share is giving up—and I think it is true to say that in the end, after the completion of this particular manoeuvre, the equity is in fact divided as to value as it was before.

2883. But is that a matter of importance? After all, the voting control is in the hands of the voting shares. Does it matter what the ratio of non-voting to voting shares is in this context?—I think it does matter, Sir. One can think of a number of instances where the number and volume of non-voting shares is far more than the voting. Take, for example, a family business—one which has been extremely successful and has grown over the years: the voting shares have remained small in number and probably restricted within a small family, whereas the non-voting become more and more widely held. This came into particular prominence in the Carreras matter some few years back.

2884. *Mrs. Naylor*: Regardless of the ratio of voting shares to non-voting shares, if a scrip issue of voting shares were made to both classes of shareholders you would simply be transferring some of the market value of the equity to the non-voting shareholders from the voting shareholders? Is not that so?—Yes.

2885. *Mr. Brown*: If no par value shares were allowed, we would then get the position of no par voting shares, and it is unlikely then you would have any scrip issue, but by splitting the shares you get the position that you have been visualising?—Yes.

2886. *Mr. Lawson*: You referred just now to the view that equity shareholders should have a proportionate vote, and I am wondering how far you carry that. There are occasionally companies which limit the number of votes that any one shareholder may have. Again there are companies where one class of equity shareholder would have one vote per share and another class would have one vote for 20 shares and so on. How far do you go in

opposing that type of arrangement?—Arrangements of that sort are in existence, but they do conflict with the fundamental principle which is enunciated in our memorandum; in fact, we would on the whole prefer not to have shares with an unbalanced voting power.

2887. *Mr. Althaus*: On an issue of capitalisation shares, assuming that people do in fact buy non-voting shares for reasons which they consider good, do not they therefore consciously put themselves in a position of inferiority *vis-à-vis* the voting shares and accept that position, and therefore, if there is in fact some slight variation in the capitalisation issue, is not that part of what they accept by making this voluntary choice?—Yes, I think that is a fair comment.

2888. *Mr. Scott*: It is equity shareholders who created these voteless shares in the first instance.—Yes, but I do not know of any case where a company has been launched with voters and non-voters.

2889. Most unlikely.—There probably have been some with votes unbalanced, but I cannot think of any case where there has been initially a class of shares with no votes at all.

2890. So that your suggestion is that equity shareholders should be prevented in future—except, in the case of companies who already have non-voting shares, to the limited extent you have referred to—from having the right to create voteless shares?—Holding the views which are expressed here, we do feel that any reasonable steps which can be taken to prevent the growth and spread of non-voting shares are desirable; and it did seem to us reasonable to propose for the Committee's consideration that companies which had not got non-voters should by law be prevented from creating them in future.

2891. *Chairman*: That I think has been a very interesting discussion. Now I think we can probably pass to another topic. The next matter that you briefly touch upon is the question of disclosing the names of subsidiary and associated companies in the company's accounts and you intimate that you object to that. Do

you wish to develop your objections any further? You give some of them in your memorandum.—*Mr. Walters*: We do have one point on that in regard to companies that work overseas through locally established subsidiary companies. In these days, in certain areas with nationalistic legislation and also, if not nationalistic legislation, then very nationalistic feelings, such a company might be prejudiced if it were disclosed openly that it was a wholly-owned subsidiary of a foreign company. Actually where that position does arise there is a favoured position, and this applies especially so far as we are concerned in insurance with regard to obtaining business, etc.

2892. Would objections of this kind be met by allowing the Board of Trade a dispensing power as they have got as regards some provisions now?—I think they would entirely.

2893. It would be met by satisfying the Board of Trade that in this particular case it would be harmful to the interests of the business if disclosure were made?—Yes; I think that would meet our point there.

2894. There are other objections which have been raised, such as the company wishing to operate in two different price ranges and preferring to do that under different names?—Yes.

2895. Do you see any harm in that?—Basically, no, I do not see any harm.

2896. Then the next one is quite a different subject. Do you think the rules recently made by the Board of Trade in relation to licensed dealers make satisfactory provision for the conduct of take-over bids?—Yes.

2897. I am not sure whether your memorandum was produced before the regulations came in.—*Mr. Bunford*: It was, Sir, and we were rather pleased to find that we were thinking on very much the same lines.

2898. That is what I thought, that broadly speaking, if provisions of that kind were incorporated in any new Companies Act to cover all bids, you would be content?—Yes, Sir.

2899. Then the next one, again quite a different and unrelated point. You would like the remedies given by section 43 extended to subsequent holders. Section 43 deals with the civil consequences of untrue prospectuses?—Yes.

2900. Under heading 17 (3) of your memorandum you say: "We feel that the protection given by section 43 of the Act to persons who subscribe for shares or debentures of a company should be extended to a subsequent holder, and any legal remedy open to an original subscriber should also be open to any subsequent holder." That opens a very wide door, does it not?—Yes.

2901. Do you think it should be opened, nevertheless?—Possibly subject to some period of time. Take one particular instance of a purchaser of shares or debentures on a prospectus: those shares or debentures, having been fairly soon sold to someone else, it would seem strange that by virtue of the share or debenture having passed through one hand on the way and in a fairly quick time, the second purchaser should not have the same protection as the original purchaser on the prospectus had.

2902. Provided he shows that he bought on the faith of the contents of the prospectus?—Yes; I think that must be assumed.

2903. The position you envisage is that somebody should have bought on the faith of the prospectus and then gone to somebody else within a few weeks and sold him the shares, showing him the prospectus and saying, "This is the prospectus on which I subscribed"; and then you say the purchaser should be in the same position as if he had been the original subscriber?—Yes. In those circumstances, we would put forward the suggestion that he should have the same protection as the original purchaser would have had.

2904. But the difficulty is knowing whether the second purchaser in point of fact did have the prospectus pointed out to him, or whether the shares were bought in the market in the ordinary way. What would you say in the case of a man who

finds a prospectus blowing about in the road and says, "This looks rather good"; he reads it carefully and then goes and applies for shares? Is anybody liable then?—Some time after the issue, Sir?

2905. Let us say immediately after the issue.—I think I can only say that such an example shows what a difficult bit of country this particular one is!

2906. Perhaps we ought to pass from that. The next one brings us to the question of accountancy exemptions accorded to insurance companies amongst others, and I would like to refer to what you say under heading 21: "(1) Companies to which paragraph 8 (1) (a) of the Eighth Schedule applies should be required to show as separate items in their profit and loss account, dividends and interest received from (i) the company's trade investments, (ii) quoted investments other than trade investments and (iii) unquoted investments other than trade investments." Then you say: "(2) Companies should be required to show, by way of note or otherwise:—

(a) the basis upon which the profits of particular activities are brought into account, when the period in which such profits were earned is longer than the accounting period" and then (b) is the one which I think is interesting here:

"(b) an estimated fair value of investments, showing separately the market value of quoted investments, the directors' valuation of unquoted investments, and their valuation of trade investments (not being subsidiaries), if the company is one to which paragraph 11 (8) of the Eighth Schedule of the Act applies."

Then, if one looks at the Eighth Schedule, actually these are provisions from which your constituent companies are immune, are they not? Paragraph 8 (1) (a) says: "There shall be shown under separate headings—(a) the aggregate amounts respectively of the company's trade investments, quoted investments other than trade investments, and unquoted investments other than trade investments". Then 11 (8) says: "The aggregate market value of the company's quoted investments, other than trade investments, where

it differs from the amount of the investments as stated, and the Stock Exchange value of any investments of which the market value is shown (whether separately or not) and is taken as being higher than their Stock Exchange value." Now, those two provisions, as you have told us, do not apply to your constituent companies but, notwithstanding that, it appears they are matters of disclosure to which you attach great importance, because you think that in respect of companies that are not within your exempted area the information given under 8 (1) (a) and 11 (8) should be improved upon and made more comprehensive, so that in your capacity as investors you do attach importance to the making of full disclosure?—Yes.

Mr. Walters: That is so. We feel as regards our own affairs that the reasons for which we were given exemptions as a result of the recommendations of the Cohen Committee are just as valid today as they ever were. On the question of our disclosure of market values of assets, I think—and this applies especially abroad, since most of the big companies do more of their business abroad than at home—the wide publication of fluctuations which for the moment, and just at one moment, are material fluctuations, but only at that moment, is undesirable because they may suggest that there is a loss of strength which, after all, may be only a loss of strength for one moment of time—it may go back again—the disclosure of those figures, it seems to us, might therefore be misleading and might not give really useful information.

2907. I think I follow your general position, but the actual question I was putting to you was really on the lines of what is sauce for the goose is sauce for the gander!—We do realise that, Sir.

2908. You would like to have that information in your capacity as investors, and you say there is no sufficient reason why it should be given in the case of insurance companies, but you would agree that in the absence of some special circumstances it is information of the kind which well-prepared accounts ought to

contain?—Yes; it is only the special circumstances of insurance companies which justify these exemptions.

2909. I think I follow that. As to the general aspect of the matter, would this be right? You take your stand on the views expressed and the recommendations made by the Cohen Committee, which you quote at some length, and you contend that nothing has happened since that Committee reported in 1945 to justify the withdrawal of the accountancy exemptions allowed to insurance companies by the Eighth Schedule to the Act. That does fairly state the basis of your contention, does it not?—Yes.

2910. Then, these exemptions, with variations, apply to banks as well as to insurance companies, do they not?—Yes.

2911. Now, in the case of insurance companies, the position is rather complicated by the fact that, as I understand it, insurance companies are under a statutory obligation, under the Insurance Companies Act of 1958, to render certain accounts to the Board of Trade and no doubt the contents of those accounts become public property. What I should like to know is whether the Insurance Companies Act requires disclosure of any matters exempted from disclosure under the Eighth Schedule of the 1948 Act as applied to insurance companies, and is there any case in which Board of Trade requirements are more stringent than those of that Schedule?—The returns we have to make to the Board of Trade under the Insurance Companies Act are very voluminous indeed, and I think I am right in saying they go further than the Companies Act.

Mr. Pegler: On the liabilities side very much more detailed information is given, while on the assets side we have to classify our investments under some 26 different headings.

2912. Do the accounts to the Board of Trade require disclosure of any matters exempted from disclosure by the Eighth Schedule?—*Mr. Henderson Smith:* They do not require disclosure of exempted matters such as the market values of

investments, or capital reserves; they merely require more detailed classification of the heads under which the assets have to be shown.

2913. If that be so, would it be right to say that to that extent exemption is allowed under the Companies Act because the matter in question is sufficiently covered by the Board of Trade's requirements?—No, Sir, I do not think that would be a correct presentation of the case.

2914. Could you tell me very briefly indeed what the relationship is between the two sets of accounts?—For a fire and general company, dealing, say, with its fire underwriting account and its balance sheet, the information is almost identical in the two documents, except that under the Board of Trade's regulations and forms we have to give much wider *asset* headings than we do in the shareholders' accounts.

Mr. Pegler: In the case of a life assurance company, on the assets side, apart from the detailed classification of investments, the information is the same, but on the liabilities side very much more information is given to the Board of Trade than is published in the accounts.

2915. The Eighth Schedule makes the keeping of those accounts a condition of exemption, does it not? That is the position of an insurance company which makes the return prescribed by the Insurance Companies Act?—Yes.

2916. *Mr. Watson:* Does that mean on the liabilities side that there is disclosure of something not required by the provisions of the Companies Act?—Yes, Sir, very much so.

2917. *Chairman:* Then the next thing is, if a given matter has to be disclosed under one Act, is the question whether it should be disclosed under another Act of any great importance? If the Board of Trade say you have got to include such and such a figure in your accounts, and the Eighth Schedule says you need not disclose it, if you have to disclose it under one or other of the Acts, does it matter much under which Act?—The only

importance would be that it would be impracticable in the setting out of the accounts for the shareholders to disclose information about liabilities that we have to give to the Board of Trade because it covers a vast number of pages. But there is no importance in the principle of the disclosure to the public: if we disclose it to the Board of Trade, there is no reason in principle why it should not be disclosed in the accounts.

2918. So that any item to which that applies really is out of the sphere of controversy because admittedly it has to be disclosed to the Board of Trade?—Yes.

2919. So that it does not matter whether it enjoys exemption under the Eighth Schedule or not?—No.

2920. As to the Eighth Schedule, I confess I have always found it rather difficult to follow, but would you agree that broadly speaking the exemptions we are talking about now, and which you are anxious, or some of which you are anxious, to preserve, fall under these four headings. First, the company is allowed to make reserves and provisions out of revenue before arriving at its published profit and without disclosing the amounts so deducted? Is that right?—*Mr. Henderson Smith:* That is a correct statement.

2921. Then, secondly, the company is not obliged to distinguish between reserves and provisions or to disclose transfers to and from such accounts?—That, I would say, is not correct; we are subject to the Companies Act definitions of provisions and reserves, and that is one of the very important points why we feel that from an accounting point of view alone full compliance with the Eighth Schedule for an insurance company is almost impossible.

2922. Do you not have in your books a fund compounded of reserves, provisions and liabilities of various kinds without distinguishing between them, without showing what you have got separately under each head?—No, Sir, it is not as simple as that. Take the Fire Revenue Account. It is struck by the premiums that have come in during the

year and those are added in the account as income. Outgoings consist of claims paid and outstanding expenses, commission, and so on; and then the fund at the end of the year is shown which is a statutory requirement placed upon us by the requirements of the Board of Trade in regard to the revenue account in the Board of Trade returns. The difficulty comes in the establishment of that fund, and it is usually fixed at a conventional percentage of, shall we say, 40 per cent.—purely arbitrary. To establish from an accounting point of view how much of that fund, which, when the Companies Act terminology was established changed its name from "reserve" in the Board of Trade returns and is now called "provision"—to establish to everybody's satisfaction how much of that is reserve in the present Companies Act definition and how much is provision, would be an arbitrary process and a very difficult thing to do from the book-keeping point of view.

2923. So that you do not claim the exemption which I have endeavoured to indicate in my second point, which was that the company is not obliged to distinguish between reserves and provisions or to disclose transfers?—Yes, we are obliged to distinguish between reserves and provisions. Our auditors will require us to do that.

2924. I think that we have probably been at cross purposes.—I am afraid we have, Sir.

2925. It was my fault. You are referring to paragraph 4 of the Eighth Schedule to the Act?—Yes.

2926. That applies to you only as regards fixed and current assets—I think that is right?—That is right, Sir.

2927. So that there is an exemption there in respect of reserves and provisions?—Yes.

2928. Then my second point, broadly speaking, is right, is it not—the company is not obliged to distinguish between reserves and provisions or to disclose transfers to and from such accounts?—Yes—though on the first point, "not required to distinguish", we are required

to distinguish, but the second point is a valid one in that we are not required to disclose—that being one of our exemptions.

2929. . . . to disclose transfers to and from such accounts?—Yes.

2930. Then, thirdly, the company need not state the market value of its investments, but can simply describe them, as "at or under cost"?—That is true, subject to the point that under the requirements of the Board of Trade returns we have to give a certificate that the assets are fully of the value stated in the balance sheet; that is an additional obligation placed upon us as an insurance company under the assurance companies legislation, but we are relieved under the Companies Act from disclosing the market value of our investments, subject always that any deficiency would be safeguarded by the auditors' obligation to certify that our balance sheet gives a true and a fair view of the company's affairs.

2931. Then the last one, I think, is this: the company need not disclose the method adopted in the valuation of fixed assets or show separately any amount allowed for depreciation. Is that right?—Yes.

2932. Do you agree that these are the four main categories of exemptions?—Yes, we would, Sir.

2933. Then you do say that all of them are necessary to your constituent companies?—*Mr. Walters:* We feel they are, Sir.

2934. And are they to your knowledge used by most insurance companies, or what proportion of all insurance companies use them?—I would say that so far as I know practically all insurance companies use them.

Mr. Pegler: I do not think we would claim that the life companies need use all those; they require those that relate to capital valuation, but as regards income it is not necessary for us to conceal transfers from income. Our feeling is that to disclose the market value of our assets would be misleading; the information which it gives is misleading. Further, if you have a hidden investment reserve,

there is no point in disclosing transfers to and from hidden reserves. On the income side we already make a disclosure of our income and there is no reason why any reserves taken out of income should not be disclosed.

2935. That is so far as life business is concerned?—Yes.

2936. Then the only one of these exemptions you really want is No. 3, that the company need not state the market value of its investments. Is that right?—*Mr. Walters:* That is the most essential one.

2937. That is the most essential one?—Yes.

Mr. Henderson Smith: I feel we would ask for continued exemption from disclosure of movement in reserves because that is fundamental. If I may, Sir, with deference suggest it, in the public thinking on these matters (I am speaking now of the financial Press) there has been considerable stress laid on the assets side of insurance companies' balance sheets. I would suggest that this Committee give consideration more to the liabilities side of an insurance company's balance sheet because it is there that the complexity of our position arises. We do nothing more than sell a promise to pay in the future. It is short-term for fire or motor, it gets a bit longer for marine, and it gets even longer still for life. But it is our methods of assessing the balance sheet values of these liabilities which in my opinion and in my own personal thinking contain the key to the problem and to the difficulty in which we all find ourselves.

2938. I see. Then those are the main exemptions. The life offices I gather want, broadly speaking, the third one, but they also want the non-disclosure of transfers to and from reserves. Other insurance companies require all these exemptions. Is that right?—*Mr. Walters:* Yes.

Mr. Pegler: We would not be concerned about the exemption in regard to No. 4, the valuation of fixed assets.

2939. I want to clear this up. Am I right in saying that life offices really need only No. 3 or do they need Nos. 1 and 2

as well?—The disclosure of reserves and provisions is bound up with the disclosure of the market values, because if you do not disclose market values you will have an undisclosed investment reserve, and therefore there is no point—indeed, it would probably be misleading—to disclose transfers to and from an undisclosed reserve.

2940. Yes, I follow that. Then you refer at the end of this section of your memorandum to various practical difficulties, but apart from those have you anything further in support of your claim, which you desire to add to the passages from the Cohen Committee's report set out in your memorandum and the paragraph I thought I might quote from the memorandum itself? I do not think I need read the passages from the Cohen Report—I think we are all familiar with them—but a little later, after referring to the submissions made to the Cohen Committee by the Committee of London Clearing Bankers, you go on in these terms: "This is equally true of insurance companies. The very nature of their business demands that their published accounts should show a position which creates and maintains confidence in their ability to meet their contracts—not only at home but also overseas, and not at a particular date but also taking a long-term view. Insurance contracts are based on good faith and the stability of the companies themselves as supported by the annual published accounts must continually demonstrate an assurance of reliability and trustworthiness." And you continue: "It is therefore important that temporary financial disturbances or fluctuations in market values of their investments must not appear to disturb their financial strength more than need be. It must be apparent from their accounts that such factors have been withstood without affecting their stability and this is achieved by the companies having substantial undisclosed reserves, the published reserves being looked upon as minimum reserves and being maintained at a reasonably stable or increasing level." And then, the last paragraph of the section: "We are, therefore, convinced that from the national and public point of view and in the interests

of both the policyholders and shareholders it is of the utmost importance that exemptions on accounting matters, particularly hidden reserves, already granted to insurance companies, should be continued."

Do you desire to add anything to that? It seems to me to set out your case on general grounds pretty fully, does it not?
—*Mr. Walters*: I think so.

2941. As to the practical difficulties you have raised at the end of that section, would you say that if none of these exemptions had ever been enacted it would be impossible to draw up proper accounts for an insurance company? Supposing you had simply the Eighth Schedule applying to everybody, would it have been impossible for insurance companies to draw up a true and fair account? —I do not think we can say it is impossible.

Mr. Henderson Smith: No, Sir, I do not think it would be impossible. I think it would increase beyond a reasonable margin the complexity of our position which we have at the moment.

2942. It would make the complications greater?—Very much so. We are always subject to discussions between the company and its auditors before they will sign the accounts, in the tradition of their profession, and in those discussions these matters of any hidden inner reserves and provisions are discussed at very great length. We are subject at that stage to checks which I am sure this Committee could rely on. But it would not be impossible to produce accounts; with respect to this Committee, Sir, it would be impracticable. It would take a long time to go into every item and bring it out in the narrow, restricted form in which the Eighth Schedule would apply to us. The Eighth Schedule requires disclosure of Income Tax information. To attempt to put that into an Eighth Schedule form for a life fund, for a non-valuation year, I think Mr. Pegler would agree, could be a very complex problem.

2943. *Mrs. Naylor*: Do you not do such accounts for internal purposes?—Your use of the word "accounts", Madam, is

not valid. We have running controls, obviously, on the way our business is going, but to suggest that those running controls are produced in strict accord with the provisions of the Companies Act for shareholders' accounts is a very different proposition.

2944. *Chairman*: You are not concerned with banks and discount houses, but I am under the impression that you would agree that they should continue to enjoy their exemptions—or do you not take any view on that?—*Mr. Walters*: I think it is difficult for us to take any view on that.

2945. I see. This subject has been canvassed a good deal on the Committee, and a variety of detailed criticisms of the exemptions you enjoy has been advanced. If I might give you a summary of them, perhaps you could comment on them. The first is that the shareholder cannot judge if he is getting a fair return on his share of the assets or a fair price on a take-over bid, that the directors can conceal inefficiency, and that the shareholders are deprived of the knowledge necessary to enable them to exercise proper control. I do not know if I took that too fast for you. Have you any comments on the point that the shareholder cannot judge if he is getting a fair return on his share of the assets or a fair price on a take-over bid?—*Mr. Pegler*: As regards life companies, Sir, you would not get any useful information from any further disclosure. The shareholder would in fact be misled, because the value of his shares on a take-over depends on the income which the life company is earning, not the market value of the assets at any particular time.

2946. I see. So as far as life offices are concerned, the answer is that they would be misled. What about other kinds of insurance?—*Mr. Walters*: I think that would be a similar position, but perhaps not quite so strongly as in the case of life offices.

Mr. Pegler: Can I just add that as far as life companies are concerned, as regards the concealment of any inefficiency, again the important thing is to earn a good income and not to produce a particular market value. If the asset worth was

disclosed at market value it might be that the cry would be for the preservation of market value rather than the earning of a good income. This would have an adverse effect in the long run.

2947. Then there is the very rude suggestion that the directors can conceal inefficiency. You say that is nonsense?—I would say it is complete nonsense.

2948. *Mrs. Naylor*: Could it not conceal varying degrees of efficiency—without using the rude word “inefficiency”?—If you are going to judge the efficiency by the size of the market value of the shares, then you are using the wrong criterion to judge the efficiency with which the directors are running a company.

2949. Is there not a third alternative to market values and book values? Is there no way of discounting the future income and capitalising that?—*Mr. Henderson Smith*: Is the test, then, of the directors' efficiency the market values of the investments? Is that the point, Sir?

2950. No, the anticipation of future income.—In a non-fire company that is shown quite clearly in our profit and loss account, which carries the income from investments on the one hand and dividends paid on the other. It is also shown in the shareholders' accounts in the departmental revenue accounts, which will show the premium volume, the movement in that premium volume since last year, the profitability of that premium volume; what better test is required of a director's efficiency or inefficiency than those figures I would not know. It is all available in the shareholders' accounts.

2951. Could Mr. Pegler add something about life offices on that point?—*Mr. Pegler*: It is a fair question. I cannot think of any way in which one could give additional information about the future income which would be valuable. The whole of the income is disclosed, and it is that which is really the criterion of a good life insurance company. I am afraid my answer is that I do not know of any other method which could be used to give information.

Mr. Henderson Smith: I think it is an unfair question, if I might say so, because

I do not think the number of hurricanes and the number of motor accidents or the rate at which people die is a reflection on the directors' efficiency or otherwise.

2952. The directors' investment policies vary, do they not?—That is perfectly true, and that can be seen by examining the Board of Trade returns which we lodge, where all balance sheet investments are closely analysed under balance sheet headings—with the exception, of course, that from the Board of Trade return you will not get the market value. You will, however, see the broad trend of investment policy quite clearly. The Board of Trade balance sheet headings as we conventionally know them in our own industry are much wider than the shortened form which is put sometimes into shareholders' accounts. You have all the information that you want in our Board of Trade return or in our shareholders' accounts, and in the valuation year of a life fund you have the valuation summaries which, with regard to life funds, are wider still.

2953. *Mr. Lawson*: You did say earlier that you have to assure the Board of Trade that your assets are fully of the value stated, or something like that. If the market value of investments at the date of the balance sheet happens to be below its cost, do you have to disclose that figure to the Board of Trade?—We do not disclose the figures. We still have to give the necessary certificate. We have to say that the balance sheet value is still the value on the basis stated, which would imply some variation of the balance sheet figure. But the market value as such is not disclosed.

2954. Do you mean it is fully of value to you, as an insurance company, because of the income that would be derived from the investment, and so on? In the method of bringing it into the accounts you ignore the market value, do you?—Let us take two years; a company has assets on its balance sheet which total £10 million. At the market valuation in one particular year they are valued at £15 million on, shall we say, middle market Stock Exchange prices (because in addition we would have to show the basis of the valuation). In that year obviously

nobody is worried. Now we come to a year in which the balance sheet values still stand at £10 million, and the market valuation on a disclosed basis stands at £5 million. That would not be a valid Board of Trade return for us, because we could not put to that the certificate, that the assets were fully of the value stated in the balance sheet. We therefore have to make the necessary adjustments to the balance sheet values in order that we can comply with the Board of Trade requirements.

2955. Do you write the balance sheet values down?—We may have to. It is a question of satisfying the auditors and the Board of Trade. We are controlled; we have to give that certificate every year.

2956. Am I right in thinking that the position could not arise in which the values on the balance sheet of quoted investments could be above the market value?—That is a true assumption.

Mr. Pegler: When you say that could not happen, that is not quite true of life offices. It would not happen in the case quoted where, with a balance sheet figure of £10 million, the discrepancy was as large as £5 million. But if the market value were £9 million, and the investments were redeemable securities which had depreciated owing to the high long-term market rate of interest, one would not necessarily be inhibited from giving the certificate, because it is the ultimate redemption value of the security which is important from the life office point of view rather than the market value.

2957. But with ordinary shares, for instance, it would not happen; it could only arise on redeemable securities. Is that right?—Yes, I think it is unlikely that one would be happy about giving the certificate if the market value of ordinary shares was below the balance sheet value.

2958. You could not give it, could you, very well?—No, I do not think one would give it in the case of ordinary shares.

2959. Then you would write the investments down under your undisclosed investment reserves?—Yes.

2960. Chairman: Does anyone want to say anything about the point that the shareholders are deprived of the knowledge necessary to enable them to exercise proper control?—The same point applies. The controls should be over the income rather than over the capital value.

Mr. Henderson Smith: I feel, with respect, that it is not a fair accusation to make.

2961. You must not look on these in the light of accusations. We are merely trying to find out what is to be said pro and con.—May I remove that word? "Comment" is a more gracious word, Sir. I beg your pardon.

2962. Then the next one is that the customer—that is to say, the policyholder—cannot judge if he is getting a fair share of profits. That, I suppose, refers to life policies with profits.—Mr. Pegler: Yes, Sir.

2963. Is there anything in that, Mr. Pegler?—No, Sir, I do not think so. The market value of the investments would not help him to reach a correct assessment there. The bonuses are payable out of income, and market values, of course, discount future income, and would be a very bad guide as to what it is possible to distribute at any particular time.

2964. Then the last of these objections I have summarised here is that the employee cannot bargain effectively because he does not know what the insurance companies can afford to pay him. That is a trade union point.—Again, Sir, wages are paid out of income and not out of capital. The capital value, I submit, is irrelevant at this point.

2965. Returning to the question of public confidence, is it really your view that the confidence of policyholders and shareholders in the insurance company would be shaken by fluctuations in the market values placed on the investments, if those values were disclosed? It is suggested that this would not affect either the policyholders' or the shareholders' confidence at all.—I think it would, Sir. I think in a year in which there had been very heavy falls in Stock Exchange values,

and the Press came out, for instance, with "£80 million lost by Insurance Companies in 1960", it would have an undesirable effect. It would be quite irrelevant to our true financial position, but would give an unfortunate impression to the public, and an even worse impression abroad.

2966. That view is called in question, but it is a difficult point to develop one way or the other.—Yes.

2967. *Mr. Watson:* Have there been any cases of a life company producing a balance sheet which disclosed the fact that its investments were in the balance sheet at a figure in excess of their market value?

Mr. Brown: Yes, there have been cases where the certificate has been reworded to meet that position but they have been very rare.

Mr. Watson: I wonder whether the effect of that disclosure having to be made public resulted in a lack of confidence developing in that particular company?—I think it would.

2968. You cannot recollect a case, Mr. Pegler, yourself?—I do not know of a case myself.

Mr. Brown: I can remember a case. Whether it had an effect on my confidence in that company I would not like to say. It did not worry me. I noted it; it was not my company!

2969. *Chairman:* Still on this point of the market value, I understand the accounts of large pension funds show the market value of their investments. Is there any evidence, so far as you know, that the beneficiaries of these pension funds have expressed alarm or dissatisfaction when the published accounts have shown marked fluctuations in the market value of securities?—*Mr. Pegler:* I have not heard so, Sir.

2970. We have had some evidence from the Institute of Actuaries. I understand their conclusion to be, with respect to life offices, that the exemption should be continued only as regards the requirement to publish the market value of assets. That I understand to be their view. Would you disagree with it?—No, Sir,

except the point that I raised, the exemption for the transfers to and from capital reserves really goes in with that.

2971. I think it would help us if you could tell us what precisely would be the effect on the accounts of insurance companies—that is to say, of the life offices primarily—if the exemption was withdrawn with respect to everything except the disclosure of the market value of investments. If everything else had to be disclosed, what repercussions would there be?—Would you put with that, Sir, the movement of capital reserves that really goes with it?

2972. That goes with it, does it?—If that goes with it, then I think the effect would be very small. There would be some difficulties in arriving at some of the answers, but it would not be a very serious matter.

2973. Provided you had the exemption as to market value and as to the movement of capital reserves, that would give you substantially what you want?—Yes.

Chairman: I think those are all the questions I can usefully put, but I would like Mr. Lawson if he would, to add any questions on the accountancy problems.

2974. *Mr. Lawson:* I think these accountancy problems are frightfully difficult, and not very easy to discuss in this type of meeting, but there are one or two points I would like to try and clarify. Taking the liabilities first of all, it is clear that an insurance company faces a very great difficulty in assessing what is the present-day value of its liabilities. That applies, I suppose, to life funds in particular, but also to other insurance as well. You have, in a life fund, to take the present value of your liabilities and assume a certain rate of interest, and so on, and then make what assessments you can. Again, with annual accounts, as far as accident insurance or any other kind of insurance is concerned, you have to take a percentage of the premium income, or something of that kind, and make a rough and ready assessment of the liabilities. I take it that normally actuaries do that, and do it on a conservative basis; there is no risk of your liabilities being under-estimated.

Now, given that situation, if this exemption did not exist, if you had to do the same as other people, the actuaries would still have to make those calculations to the best of their ability, and would still presumably have to be prudent in their estimations. What precise advantage, in a sense, therefore, do the insurance companies get from this exemption? Would it in fact make a great difference if it was not there, on the liability side?—The actuary already makes a full disclosure of the basis on which he does his valuation. I do not think he makes use of any of these exemptions in his examination of liabilities.

2975. That is what I thought. Is that true also about other types of insurance, or not?—*Mr. Henderson Smith*: I think, Sir, the conception has got to grow in people's minds that insurance companies are dealing with averages, and anything which could cause the future experience of the company to depart from what has been the past average is our difficulty. With respect to my actuarial friends, I would almost suggest that it is perhaps easier for the actuary, because he is equipped with mortality tables and with his rates of interest and, as Mr. Pegler has said, he makes a publication of the table he has used and the rate of interest he has used. The problem is nothing like so easy for a non-life underwriter. To attempt to forecast liabilities in a marine fund with long standing bull contracts, can be an item of great complexity. You can only be guided by what has gone on in the past and try to assess whether your experience is going to be the same in the future.

2976. I see that, but I am wondering how far the exemption really helps you. If the exemption were not there you would still have to make the calculation as best you could, honestly and to the best of your ability. That would presumably be as true and as fair a view as you could reasonably arrive at. I am not sure whether you are really in fact getting any benefit from the exemption.—The benefit is not an exemption from making the calculations which, as we have said, we do for our own internal records. We must

do them to see what the profitability trend of the business is: that is obvious, and prudent management. The exemption is against publication and disclosure in the accounts, and that is where the benefit arises. I think the very high volume of non-life business which is received from and ceded to overseas territories has been overlooked, and if we were compelled by statute to reduce our accounts to the restricted basis of the Eighth Schedule, the impact that full disclosure could have upon our receiving re-insurance from abroad might be quite high, and that is one of the dangers, in our mind. We always publish accounts which show the company as stable; we would wish not to have to show the width of that stability. We feel we are entitled to ask for margins, because we are dealing with averages.

2977. I see that. I was not quite clear whether you could not still do that without the exemption. That is to say, you have obviously got to be prudent and conservative, have you not, but you take the view that without the exemption you could not be as prudent in that direction as you would like to be?—That is a fair presentation. I would like to repeat that the exemption does not exempt us from making these calculations, but it exempts us from the responsibility of having to make public exactly what calculations we have made.

2978. I am thinking, so to speak, aloud, but does it follow that if the exemption was not there, you would have to make public the basis of your calculations; provided those calculations were honestly made to the best of your ability, would you have to publish how you arrived at them?—With respect, Sir, I am back to our discussions with the auditors. It is the definition of provisions and reserves again. The terminology in the Companies Act rightly leads gentlemen of your own profession to discuss with us fully what we are doing, and we have to satisfy them very fully that we are not publishing figures which are misleading and unfair. "Claims paid and outstanding" is a most difficult item to build up year by year in normal fire and general business in the light of the Eighth Schedule definitions.

2979. Yes, I see. Well now, could I ask one more question about the investments, and particularly as regards these transfers from reserves? I suppose it could be said, could it not, that shareholders in particular might be interested to know the policy of the board as regards particular types of investment—that is to say, how far the funds of the company are invested in equities, for example—and it might not be unreasonable, or it could be put that it might not be unreasonable, for shareholders to be able to assess whether the policy of investing in equities at a particular moment had been successful or unsuccessful, as reflected in the market price at the date of the accounts. By these transfers to and from reserves, of course, that type of information is not available, and I think following on this—really it follows on Mrs. Naylor's point, I suppose—it could be said in that respect that any bad judgment on the part of the company could be concealed. Could you comment on that?—*Mr. Pegler*: I do not think that is a fair suggestion. The success or otherwise of a life office investment policy must be judged in the long-term on the income it produces. The fluctuations from day to day or year to year in the market value are quite irrelevant. If there were any inefficiency in investment, that would come out in the income figure, which is already fully disclosed and, we feel, should be.

2980. If you are investing permanently, I can see your point, but if you say at one time, "This is the time to go into equities", and at another, "Let's go out of equities", that swopping to and fro would affect the position, would it not?—It comes out to a considerable extent in the balance sheet already, because we have to show the holdings of equities separately from the other classes.

2981. But you do not want to make a further statement and show the market value?—No, I think it would result in pressure being put on us to adopt a policy which in the long run would not be in the interests of the policyholders.

Mr. Henderson Smith: Speaking from memory, Mr. Lawson, I think in the Board of Trade return, under the Stock

Exchange investment item, there are some 18 or 20 statutory balance sheet headings, including ordinary shares, preference shares, British Government securities, etc. These we are under statute compelled to analyse for the Board of Trade return, which is a public document. Very frequently one has requests from shareholders and policyholders and investment statisticians for copies of the Board of Trade return. It is a public document, and from that they can see under these 20 odd headings, a full analysis of the balance sheet presentations of our investments. We have some hesitation in going further and disclosing the market values, because of the considerations which we feel are important and which we have already explained. But investment statisticians by application of indices would be able to get a very shrewd judgment as to the market value.

2982. If statisticians by doing their own calculations are able to arrive at a market value, is there not something to be said for telling everybody the market value, rather than leaving it to the relatively small number of experts to work it out?—No, Sir, because then we have this other dilemma that the value will be published far and wide and that is our reason for hesitation.

2983. *Mr. Althaus*: I would just like to come to something Mr. Bunford said under heading 5. That related to the revelation of fundamental changes in the company's business and I think Mr. Bunford said that the Stock Exchange could do nothing to ensure this. But is it not a fact that such disclosure would be covered by the general undertaking given to the Stock Exchange by all companies seeking a quotation? Would that not really cover your point?—*Mr. Bunford*: I think it would.

2984. Am I right in saying it is the practice of the Stock Exchange, where businesses are purchased for shares and where the purchase involves the issue of more than a certain proportion of the issued capital, that the nature of that purchase should be made clear? Although it clearly would not cover all cases, it would cover those where there was an issue of

shares involved, which would presumably cover the larger transactions of that kind. Would you feel that that requirement helps to meet the views you have expressed?—I would.

2985. Finally, with regard to the issue of shares *pro rata*, I think I am also right in saying that it is a requirement of the Stock Exchange that where there is a bonus element involved, unless some very good reason, such as the smallness of the issue, is involved, these shares must be offered in the first instance to existing shareholders? Would you feel that that protects the matter sufficiently, or that you would prefer it to be made a statutory obligation?—In all those cases I think there is a great advantage in the elasticity which is provided by the Stock Exchange regulations as distinct from legislation.

2986. *Mrs. Naylor*: I would like to go back to disclosure in the accounts. I am going to ask Mr. Pegler if he could tell us what the practices in other countries are about the disclosure of assets and market values.—*Mr. Pegler*: Across the Atlantic there is full disclosure, in the United States and Canada.

2987. And the main objection to such disclosure in this country is the question, am I right, of confidence?—Not only confidence. It is very important from the life point of view; we think the information will be misleading.

2988. But the information given now is misleading, is it not?—No, the important information, which is the income, is already fully disclosed.

2989. But what about movements from the reserves?—In fact, I doubt whether that is made use of to any appreciable extent, and we would part with that.

2990. With the concealment, from the income account, of movements to and from the reserves?—Yes.

2991. But confidence is a very important factor, is it not, in your attitude?—Oh, yes.

2992. Other reasons have been put to me which have not been discussed today, and one of them is that when they are in

a relaxed mood, insurance managers feel first of all that it is a nice, gentlemanly industry with no cut-throat competition, and if the truth were revealed policyholders and investors would shop around more, and the insurance industry would not like that situation to develop.—I would not like to accept the suggestion that there is no cut-throat competition in our industry. There are about 80 life offices, and it is about as competitive as it can be. There is very keen competition indeed, I would say, but if the competition was concentrated on taking out a policy with the company that showed the highest market value of its assets, then policyholders in the long run would be misled.

2993. Another suggestion put to me is that the top executives in insurance companies feel the policyholders rightly are their main concern, and if the true position, or the position of the hidden reserves, were revealed it would encourage not only shareholders but also the directors to press for higher dividends. Would you comment on that?—You mean, higher dividends to shareholders?

2994. Yes, and that the directors of insurance companies tend to be slightly more interested in the dividend paid than the top executive level in the insurance companies.—I should not have thought that was so. A substantial proportion of life companies are mutual and have only policyholders, and in the cases where they are not mutual I would not accept the suggestion. In most cases the interests of the policyholders are something like 90 per cent., as against 10 per cent. for the shareholders, and I think the directors are well aware of that proportion of interest, and run the company with that point in mind.

2995. *Mr. Scott*: These mutual societies, of course, have no shareholders, so the question of dividend obviously does not arise, but would you say that if the exemption which is at present enjoyed by proprietary companies were taken away, that would unfairly benefit the mutual societies at the expense of the proprietary companies, because the mutual societies are under no obligation under the Eighth Schedule?—I think it would be unfair

if the proprietary companies had to disclose and the mutual companies did not. I think that would be a very false position.

2996. But that would be the result, if the exemptions were withdrawn in the Eighth Schedule, is that not so?—*Mr. Bunford*: I am a little surprised at that, Sir.

2997. The mutual societies are not subject to the Eighth Schedule?—*A*: A certain part of it, yes.

2998. As investors in bank shares, and no doubt you have large portfolios of banking investments, do you have any difficulty in assessing the value of the bank shares by reason of the exemptions which they enjoy in not publishing the value of their securities?—*Not at all*. It is certainly very difficult to judge the value of a bank share, but I do not know that that is only because of their freedom from certain types of disclosure.

2999. But you would feel a difficulty if, for instance, investment companies enjoyed a similar exemption? You are holders of investment company shares; you would not suggest that the benefit should be extended to investment companies, presumably?—*No*. Just as we have the problem of policyholders in insurance offices, particularly life, so we do recognise that banks similarly have the problems of depositors. There again, I think the aspect which has been referred to a good deal this morning, about confidence, is of considerable importance. As investors we would naturally like to have all the information that is available. That is certainly true, but I feel that we should not as investors object to a continuation for banks if it were continued for insurance companies. May I just add one point? I do not want to say much on this, but so much of what we have been discussing this morning is really contained in one paragraph of our memorandum where we say towards the end of our evidence under heading 21: "Assume for example that this disclosure had been required of insurance companies during recent years. At the end of 1954 the public might have concluded that the position was one of strength; at the end of 1957 one of serious

weakness; at the end of 1959 one of excessive strength."

There, within a very short period, you have violent swings of market value, and if you are taking market value as your measure you have three quite different measures of something, the intrinsic value of which has varied very little. That was, I think, what Mr. Pegler had in mind in referring more than once to the misleading effect of having to show market values.

3000. *Mr. Bingen*: Assuming that full information had been disclosed in 1954, 1957 and 1959, some years being good ones and others bad as regards the market value of the shares, do you suggest that you would not have got the same volume of business from policyholders, or that the shares of the insurance companies would have fallen catastrophically?—*Mr. Pegler*: It is the interests of the policyholders that we have in mind, and it would perhaps have an adverse effect on the confidence of the policyholders.

3001. I was just wondering what the real effect would be, had you been forced to disclose that information.—*Mr. Bunford*: It might have affected the flow of new business, of course.

Mr. Bingen: That is conjectural, I think, because people have to insure against their day-to-day risks, third party and things of that kind. Sometimes it is compulsory.

3002. *Mrs. Naylor*: Would it upset the life offices if they had to publish the market value of the preceding year, or two years earlier? One would then get a trend of market value, but it would not be contemporary.—*Mr. Pegler*: It would still be just as misleading as before, because it is really quite irrelevant to the success of our business.

3003. But would it upset the insurance companies, even if it was misleading?—*Yes*, it would upset us to provide any information which was misleading. The whole purpose of this, I think, is to guide policyholders and shareholders; therefore anything which was misleading would upset us.

3004. But you are already misleading shareholders, are you not?—No, I do not think we are.

3005. You are not giving them all the facts, and you have been moving things to and from reserves occasionally, so the income figure is not an accurate one?—I think the extent to which the exemptions are used in arriving at that income figure are very small. As I say, we would willingly part with them.

3006. *Mr. Watson:* I have one question about the non-life companies. Mr. Henderson Smith, I gather your argument against disclosure was that it might upset confidence, and injure the competing power of the industry abroad. Am I right?—*Mr. Henderson Smith:* That is our concern, yes.

3007. Do I get it right that you have undisclosed reserves against the eventualities arising on the underwriting accounts?—Yes.

3008. And that in your accounts you show the underwriting experience of each one of these different categories of insurance, do you not?—No, we show our underwriting accounts according to the definitions of the Insurance Companies Act—fire, accident, motor, marine, separately.

3009. And in these accounts you include an estimated figure for unexpired risk on the year's premiums?—Agreed.

3010. That estimated figure is, I think you said earlier, arrived at by some broad rule of thumb basis?—Agreed.

3011. But in the circumstances of marine experience, where that may have been exceptionally unfavourable, do you take action against your marine underwriting account to increase the reserves shown from the unexpired risks?—No, in the marine the position is that a fund is allowed to accumulate. Marine is not dealt with on a one-year basis. The Board of Trade form for marine is on a three-year basis, which is the conventional run of the marine account. Everything lies in the fund and one judges the stability

of that fund according to estimated running off experience according to the year in which the risk was written.

3012. And your anxiety is that that fund should remain undisclosed in case the British marine insurance business should be adversely affected by foreign competition arising, say, from the knowledge that the fund was running down a bit at certain times?—No, I am sorry, but I could not have made myself clear. The fund is fully disclosed; it is the closing item of the revenue account, and it is carried from there as a liability into the balance sheet. The fund is fully disclosed, and our anxiety is that if we are not allowed this exemption we shall have to break that fund, and break all funds, into provisions and reserves.

3013. And then, in these circumstances, you might be disclosing a somewhat low level of reserves at any one particular period, when you had had an exceptionally adverse experience?—That is the sort of thing that might happen.

3014. But that would be detrimental to the interests of the insurance industry of this country as opposed to foreign competition?—That is our opinion, very definitely.

Mr. Walters: Talking about non-life, I should think it is probably more overseas than anywhere else that we think it would be detrimental.

3015. *Chairman:* Mr. Walters, if it would not be asking too much, I think it would be most helpful to us if you could let us have a supplementary memorandum saying exactly what exemptions it is essential to retain and, I think, distinguishing between the life offices and general insurance.—Yes.*

We are very much obliged to you all, as I said before, for your memorandum, and also for coming here and helping us. We have had a most interesting discussion, and we are grateful to you.—We should like to thank you for the consideration you have shown to us.

*See supplementary note to Appendix XXV, page 633.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

THE RT. HON. SIR OLIVER FRANKS, MR. F. KEIGHLEY, MR. R. G. THORNTON and
MR. H. B. LAWSON *called and examined*

3016. *Chairman*: Good afternoon, gentlemen. We are very much obliged to you for your memorandum of evidence and for coming to help us today. So that we can keep our record in order, I should like to know if these particulars are right. You represent the Committee of London Clearing Bankers and you are individually, Sir Oliver Franks, Chairman of that Committee and Chairman of Lloyds Bank; Mr. F. Keighley, Chairman of the Chief Executive Officers' Committee and Chief General Manager, National Provincial Bank; Mr. R. G. Thornton, General Manager, Barclays Bank; and Mr. H. B. Lawson, Deputy Chief General Manager, Lloyds Bank?—*Sir Oliver Franks*: Yes.

3017. I understand from your memorandum that your general impression is that the Companies Act, 1948, has served well and you would therefore regret any wide extension of legislation. That, I think, is your view generally?—That is the case.

3018. You also express the view that the great number of companies are conducted regularly, wisely, and with due regard to the interests of all.—Yes, that we believe to be true.

3019. That is to say, you have no crying abuses which demand redress?—No.

3020. If I could start with a question I do not think you have dealt with, it is one of some general importance; it relates to what are known as exempt private companies. What I should like to ask you is whether, having regard to your banking experience, you would favour continuance of their privileges or have you no views one way or another?—Could I say before I attempt to answer the question you have just put, that I expect the Committee may address most of the leading questions to me but I am in no way expert in matters of company law and therefore I should be glad if you and the Committee would allow me to lay off points on my colleagues quite often because they in fact know a great deal more about many of these subjects than I do. Coming now to the question which

you have just asked, I think that our position is as you suggested, namely that as bankers we have no particular view to put forward. This is so because in our relations with the exempt private companies we are not prejudiced by the fact that they do not file accounts, because normally we get all the information that we need from them in the ordinary course of doing business with them and therefore we are not deprived of things which we need to know.

3021. I follow. That is to say, if somebody asks you for accommodation when he is running an exempt private company, probably the manager concerned will say, "I should like to see your balance sheet and accounts", and that would solve that?—Yes.

3022. So that you are not really interested one way or the other?—No.

3023. Then under heading 5 you proposed certain changes in article 79 of Table A. That is the article which limits the extent to which the company's borrowing powers can be exercised by the directors, and I think you particularly call attention to the proviso. There is a proviso upon the power given to directors which is in these terms: "Provided that the amount for the time being remaining undischarged of moneys borrowed or secured by the directors as aforesaid (apart from temporary loans obtained from the company's bankers in the ordinary course of business) shall not at any time, without the previous sanction of the company in general meeting, exceed"—and then the maximum amount permissible is given. As I understand it, you would welcome an amendment so that the passage in brackets, "apart from temporary loans obtained from the company's bankers in the ordinary course of business", would read "apart from loans and/or overdrafts obtained from the company's bankers in the ordinary course of business". I would suggest that the exemption afforded the temporary loans was put into that article for the very reason that the loans were temporary; that is to say, the bank might have an account with its customer which was

varying from day to day, so that the balance outstanding would differ from day to day. So temporary loans were excluded so that it would be reasonably possible to arrive at the amount of the company's indebtedness. Have you any comment to make on that?—I should like to say generally that these suggestions which we have made under this head are not designed in any way to deal with substance. If they do, it is by a misapprehension on our part. We were simply concerned with words which are at present in the clause and which seem to us difficult to interpret and to apply. Our suggestions are designed only to remove these possible causes of obscurity. This applies both to what we say about the word "temporary" and our suggestion that instead of saying "loans" we should say "loans and/or overdrafts"; and thirdly, equally to the phrase "in the ordinary course of business" which so far as we know has never been given a legal interpretation. I should be very glad if you would allow me to ask Mr. Lawson to amplify these points, but the only thing we have in mind is the one I have mentioned which is clarification. We do not want alteration.

3024. I appreciate the need for clarification of those words, but I am suggesting that if there was an unqualified description of loans from banks, that would mean that the limit on the directors' borrowing powers would be illusory; that is to say, the power would extend up to the limit to which the banker would be prepared to make a loan.—Yes, I think that is the reason why we hesitated at the word "temporary", simply that while all bank lending is temporary in the sense that it is repayable on demand, with the exception of those relatively smaller sums which are fixed for a medium term, in fact not all borrowing from the banks is as temporary as the form of it suggests.

3025. You might, I suppose, have a mortgage where the debt is expressed to be repayable on demand and there is no intention of calling it in within any foreseeable time, and yet the form of the obligation would be immediate?—Yes.

3026. *Mr. Leslie Brown*: Is it a case of the word "temporary" being almost a

transferred epithet: should it really be expressed as "loans for temporary business"?—I think that might well be a true account of what the word has come to mean; whether that was what it was originally intended to mean is a separate matter.

Mr. H. B. Lawson: Our purpose in drawing the Committee's attention to this was merely that if Table A is going to be looked at again as a result of the recommendations, then we would rather hope the opportunity would be taken of tidying up what to us are really minor irritations. In practice the word "temporary" does not in my view actually place any limitation at all upon the use of the directors' borrowing powers from the banks, because all lending from the bank, it can be argued at any rate, is temporary and so treated in practice. Of course, the other alternative might be merely to convert the article into the modern article that is used by City practitioners in the articles of public companies, under which there is nowadays simply a straight limit moneywise, or relative to the issued capital of the company, upon the borrowing powers of the directors. We face that quite comfortably and easily when we are dealing with public companies and there is no reason why we should not do that when we deal with the smaller companies under Table A if you felt that you could not dispense with these particular words.

3027. *Chairman*: In other words, you would prefer one of the other forms in common use to Table A as being clearer?—No, Sir; on the whole I personally would prefer Table A because it is the smaller companies that adopt Table A and the limitation on borrowing relative to their issued capital is not normally appropriate. I would personally prefer Table A with the word "temporary" omitted, the word "overdraft" as well as "loans" referred to so far as the borrowing is concerned, and if possible dispense with the words "in the ordinary course of business". But if, as I understood you to suggest, that would in effect leave the directors' borrowing powers unlimited and at large, then I put the other suggestion to you.

3028. I see. The next point concerns section 195, that is to say the register of

directors' dealings in shares of the company. On that you are opposed to extending the time during which the register of directors' shareholdings is to be open to inspection by the members under section 195, because you think immediate disclosure to shareholders could lead to misunderstanding and would therefore be more likely to injure them than to benefit them. The present position, as I understand it, is that the register is open for inspection during the 14 days before and three days after the annual general meeting. You are still of the opinion, are you, that no extension should be made?—*Sir Oliver Franks*: Yes, we feel generally that it is satisfactory.

3029. But I find it difficult, with respect, to see any positive objection to the shareholders having access to that register at all times, as in the case of the register of members. Could you develop your objection to that extension?—*I think* our main point here is really a matter of opinion. If one takes the case of a board of directors who are behaving normally and properly, there will from time to time be sales of or purchases of shares in the company. Normally the sales are for reasons quite unconnected with the course of the company's business: for example, money has to be found to build a new house or something of that kind. I think it would be extremely easy, if the register were open from day to day, for all sorts of motives to be imputed, guesses to be made, about why now, this day, this month, this particular sale or purchase of shares had been made, and in fact the reasons which prompted it would have little or nothing to do with the speculations that arose. It therefore seemed to us that provided at regular intervals the shareholders were fully aware of what had happened either by way of sale or purchase so that, if any action should be taken, it could be taken, then you would not be exposed to all the rumours which can so easily arise. This becomes more complex when you consider that many directors are in fact trustees of settlements, and you get for example shares being bought or sold because of the way a marriage settlement works or something of that kind; and again, the reasons for which the transaction is done have nothing whatever

to do with the business of the company, but it might easily be supposed so. These are the reasons which led us to think that, so to speak, a regular *post mortem* was better than a running commentary.

3030. Yes, I see your point. But suppose the market value of the shares of the company suddenly went up by some really substantial amount, say 70 or 80 per cent., in a matter of two months, would it not be desirable then that the shareholders should be able to find out fairly quickly whether that rise in price was due to speculation by the directors?—*I think* that here, Sir, we come to another matter of opinion. Our view on the whole is that rules are best made having regard, so to speak, to the generality of well-behaving boards of directors, and that if you seek to make rules to catch the much more infrequent cases where a director or a board of directors does not behave well, then while there is the satisfaction of having the rule, normally the means of evasion are also relatively easy. You do not catch much but you have done something which may not be a good thing in relation to the very large number of steady and honourable boards of directors.

3031. Yes. The honest man is harried for the purpose of catching the hypothetical and possibly rather infrequent rogue who would evade it?—Yes.

3032. How would you view a proposal which has been made to the effect that a summary of directors' dealings in their companies' shares during the year under review, and the financial results of such dealings, should be included in the directors' annual report? Do you think that would be a reasonable thing or not? That would mean that once a year the shareholder had presented to him as part of the directors' report, or attached to it, a summary of all these dealings so he would have the opportunity of knowing annually what the position was.—*I think*, Sir, that if I am consistent with what I have just said, I must begin by saying that I see no objection in principle to that. On the other hand, I am in doubt whether it is a very good thing. I am not sure how helpful it would be; it would cover quite a bit of space, and we as clearing bankers

are doubtful whether the advantage you would gain as a matter of expediency is worth it. I do not know if any of my colleagues would like to elaborate on that.

Mr. H. B. Lawson: I should like to add this. If you were contemplating it, I would advocate if possible that you should exclude from the section the directors' interests as trustees. It is every interest, as I understand it, of the director which now has to be disclosed and I think to put in the annual report a mass of dealings by directors as trustees of settlements and so on would create quite a misleading impression and be absolutely valueless.

3033. I agree that would be a point of substance that would have to be considered before this suggestion was adopted.—If it were limited to the director's own dealings in shares held in his own beneficial interest then in logic one must support what Sir Oliver Franks has said.

3034. *Mr. Bingen:* I see the logic of Sir Oliver Franks' comments: in other words, that if the register of directors' dealings were open at all times, a director who had made perfectly honest transactions would be suspect and so on. In fact, it is the same sort of argument we have heard, and which I have advocated myself, that honest directors avoid dealing in their own companies' shares when they possibly can. Would you say generally that you had, as clearing bankers, examples of directors dealing in their own shares wrongly before and after declarations and doing it through the guise of nominee companies? One has the impression, certainly sitting here listening to those people who represent the City, on occasions there are a number of things which could be suspect and are under a cloak of anonymity. I do not know whether Sir Oliver Franks would like to answer that general question.—*Sir Oliver Franks:* Could I make one short general point and again ask Mr. Lawson to elaborate it. I think we would say in answer to the question asked, there are occasions when—and this is anticipating the discussions which may come later, about nominee holdings—the banks are able to scrutinise the use made of these nominee holdings and the case which you have raised is precisely the sort of case which, if a bank came across it, it would do something

about. So that my reply is that this can happen, it occasionally does happen and the point at issue is how far you think it important or desirable to make rules which will catch these relatively infrequent cases when again evasion is so easy.

Mr. H. B. Lawson: I would only add to that that if a request were received by a bank to permit a nominee company to be used for such a purpose the answer would be "No". But, as Sir Oliver has said, occasionally one has come across a few, very few, cases. I suggest to the Committee that if they want to probe methods of concealment by directors of unethical dealings in the shares of their own companies, the Committee should look not only at the nominee companies of the banks, but at the wives of directors.

3035. *Chairman:* I do not think you have commented in your written evidence about voteless shares. That is a matter which has been the subject of much discussion in the Press lately. Have you any views to offer on that subject?—*Sir Oliver Franks:* I do not think we are really in a position to make any constructive addition to the general discussion. I do not know whether Mr. Thornton would like to add anything there.

Mr. Thornton: No, Sir, I think at this stage not. We did discuss this question between ourselves beforehand and decided that perhaps for the time being we would prefer to say nothing. It is one of the questions where, if the Committee would like to have evidence from the bankers, we would fulfil our offer to submit a memorandum on it.

3036. You really have not got any particular views about that?—I can give you a purely personal view. I do not myself believe that there is all that harm in them. I would not care to express that as the view of the banks. If you would like a memorandum we would gladly submit it.

3037. Thank you. Then we come to the matter of nominee holdings and disclosure of beneficial interest. You have made out a case which seems to me impressive for the view that it is neither necessary nor practicable to insist on disclosure of the beneficial ownership of shares in all cases. You would say, as I understand it, that it would be quite impossible that a

register should be kept in every case of beneficial interests where the registered proprietor is not himself the beneficial owner.—*Sir Oliver Franks*: Yes. I do not think, though, that our intention in the reply which we have given in writing is simply to be destructive. I think our point of view really begins with the feeling that, generally speaking, matters of property are thought to be fit matters for confidential dealing. This is a matter of property, so that the first assumption that we find ourselves making is that this, like other matters of property, might well remain confidential. It was with that in mind that we then asked ourselves whether there were any particular occasions for removing this normal and conventional secrecy or confidentiality and, as I think we said in our written evidence, we thought there were two: there are the questions of behaviour of directors and the questions of public interest. We thought, generally speaking, that both these two cases were looked after by already existing provisions; the first by the provisions which deal with the disclosure of the directors' transactions; the second by the provisions which deal with the intervention of the Board of Trade. So that I think I ought to say as a beginning of the answer to what you have said, that we start wondering whether there is in fact a special case for treating this form of property differently from the way in which other forms of property are treated. It was then, with that in mind, that we investigated the very widespread uses which are now made of nominee shareholders, with the result that you have before you the printed table in our written evidence which we think goes to show that the room in the whole matter of nominee holdings for misbehaviour is really in fact very small and very limited. It is then that we go on to ask, supposing that it nevertheless was thought worth while to try to frame a body of rules which would catch up these cases of misbehaviour, can you in fact do that successfully? Now, at that point I move quite out of my depth and turn over to Mr. Lawson who has studied this for some time. Might I ask him to say a word?

3038. By all means.—*Mr. H. B. Lawson*: I expect you will be asking quite a number of other questions about this

and therefore I would like to preface my answers by saying that one is naturally very conscious that it is much easier to raise difficulties and objections than to make a constructive proposal. I say that because the Clearing Banks would not wish to appear unhelpful should you, contrary to the general views of the Clearing Banks enunciated by Sir Oliver, conclude that something more than has already been done should be enacted in this field. I do not think I am betraying any confidence if I say that following the publication of the Report of the Cohen Committee some of us in an informal manner spent months going into the problems with the Board of Trade and Parliamentary draftsmen and indeed with members of the Cohen Committee themselves, but no solution emerged which satisfied the criteria that were then under consideration. I think those criteria were three: first, that the legislation should be comprehensible to the persons likely to be involved; second, that the legislation should be comprehensive in the sense that evasion would be sufficiently difficult to make the results to be achieved by the legislation really worth while; and thirdly, that the legislation should be enforceable and in fact vigilantly enforced.

3039. Yes, I appreciate those points. In your printed table in your memorandum you have reduced the cases where the nominee system may be being abused, in effect, to those mentioned in category 10, the small residue of unidentifiable purposes. But would you agree that categories 7 and 8 might possibly include nefarious purposes of one kind or another? No. 7 is "For convenience: (a) of customers' Stock Exchange dealings; (b) due to absence abroad; (c) general". And then No. 8 is "For Investment Management". I dare say there is not much in the point.—It is impossible to give an undertaking, but we have made a very close analysis of these holdings and I think you might accept the fact that concealment is almost wholly limited to that last category, No. 10.

3040. I certainly agree that any scheme devised must be intelligible and I certainly agree that it should as far as possible be capable of enforcement, which means that

one must be able to assign a definite offence with a definite penalty, so that anyone so penalised should know what it is he is supposed to have done wrong. I agree with that completely. But there are critics of the present position who do not go as far, by any means, as saying that there should be disclosure in all cases, but they would like to see something done to enable directors and shareholders to force a buyer operating through nominees to come into the open. It is suggested that the nominee system is used for the purpose of obtaining control of companies and, according to this view, it is undesirable that that should happen. Would you regard that as a worth-while objective?—If I am not out of order, may I go back for one minute to what you were saying about category 10, because although we know that some of those holdings are probably for the purposes of concealment, I would not like the Committee to think that those purposes are necessarily nefarious. The commonest purpose of all is merely that a trader wants to get his competitor's balance sheet without him knowing. The second commonest is probably the employee who receives shares from his company on a basis relative to his salary (there are several such schemes), and in order to conceal his salary from his co-employees uses the nominee company of the bank to receive the shares. The third category which is quite a common one is that professional men, particularly in the provinces, do not like it to be known that they are investing in local businesses. There is nothing improper, in my view, in any of those.

3041. That may be. Then would you say it was improper quietly to buy up all the shares in a company under various names, through various nominees, and then confront the directors, as it were, with a *fait accompli*?—If shares have a quotation on the Stock Exchange, I see nothing unethical in purchasing in the names of nominees. The shares are exposed for sale.

3042. That is a perfectly logical view and I imagine held by many people. But there is the other side of it, that members of a company ought to be able to find out who their fellow members are.—Under

modern conditions can it really be suggested that shareholders in a public company are, as it were, in the relationship of partners and are concerned one with another who holds the shares? The shares are passing in thousands day by day on the Stock Exchange.

3043. *Mr. Bingen*: Do you not think the directors would like to know for whom they are working on a trustee or quasi-managerial basis?—I think it might make their life easier and cosier but I am not sure they could do anything about it even if they knew who were the beneficial owners. I think the view of the Clearing Banks is that one should approach this question according to principle. What is the principle that lies behind the suggestion that this particular class of property should be subject to exception from the privacy that is accorded to ownership of property generally?

3044. *Chairman*: This is a particular class of property, I quite agree. There seems no logical reason why one should not have one's shares in names of nominees, just as one might have one's house in the name of a nominee. But I would commend to your consideration this, that shares in a way are like playing cards: if you have got more than a certain number in your hands you may get an enormous advantage. Is that not a consideration? If you get 51 per cent. of the shares of a company, you get control of that company. That rather places shares in a different category from ordinary property?—If one was thinking of one company acquiring control of another company, that point might be met by requiring the acquiring company to state the names of its subsidiary companies in its annual accounts. I would have thought there are so few cases of private individuals getting control of public companies, it hardly arises. If the issue was limited to disclosure of a controlling interest, I agree that would be better.

3045. Then there is the case of a man who will buy shares over a period and in small lots, if he is thinking of getting control.—My colleagues could speak better to that but my experience would be that if anybody is out for control they buy the shares very quickly, not over a period of years at all.

Sir Oliver Franks: I think you are taking us into quite deep water with your last question which perhaps as bankers it is not very easy for us to answer, because you are in a way, I think, really asking whether or not the purchase of shares should normally be thought of as part of a market economy or not. If one says "Yes", then I think the consequence follows that anyone must be free to buy shares if he wants to. It begins to turn into a question of social and political philosophy to which as bankers we are unaccustomed.

3046. In view of what you, Sir Oliver Franks, and you, Mr. Lawson, have said I do not know how worthwhile it is pursuing the various suggestions which have been made to procure some measure of disclosure of beneficial interest. Perhaps you would perform a feat of imagination, and imagine for the moment that it would be a good thing to do so if it were practicable to do it, and I would put to you these suggestions. It has been suggested that every transferee of shares should state on the transfer whether he is taking the shares as a nominee of some other person. Without going into detail as to who the nominee was, it was suggested that if that was done it would give the board some clue as to what was going on and then if they thought there was something wrong going on they could put in motion the provisions in the Act with regard to investigation by the Board of Trade.—Putting ourselves in the position you suggest, I think we would feel on that question there are two points which perhaps should be considered. The first one is that it would tend to complicate the forms of transfer, whereas there is quite a considerable movement for trying to simplify them. I will not go further into that; I think you will have to give weight to that. The second one is that what in fact would be disclosed would be the bare nominee, so to speak, and it might well be that was singularly uninformative.

Mr. H. B. Lawson: May I add two points to that? I think you would have to devise a definition of "Nominee". That would take up a considerable space, I imagine, on the transfer form and I think if transferees were going to treat the matter

seriously they would probably seek legal advice on some occasions before making the declaration one way or the other leading to further delay. You come very near, I think, to the problem that you have of defining "beneficial owner", because trusteeship and nomineehip are pretty closely allied on occasions; and if this proposal goes so far as to suggest that all non-beneficial interests should be included in the definition of "nomineehip", then the whole thing would become more uninformative than ever. I think the company would get a mass of information that would be quite useless to them. Secondly, I think the problem of transfers out requires a lot of consideration, but I have not sufficient technical knowledge to help you there. Companies would presumably keep records of the holdings that are marked as nominee holdings and would have to deal with transfers out. I can imagine block transfers out which would consist of some shares that had been declared as nominee holdings and some that were not nominee holdings; all sorts of technical difficulties would arise for registrars and company secretaries. If this was a serious proposal—I mean, if you really would like it to be considered—I would advocate that the technicalities, particularly of the transfer out problem, should be specially examined. We could, if desired, arrange for such an examination by a committee of our own registrars and secretaries and let you have the result. I am sure the Stock Exchange would also be concerned.

3047. *Mr. Bingen:* I see the difficulty Mr. Lawson refers to there. Suppose the objective was merely to try and let a company know whether another company was trying to control it, so that if a purchase were made by a nominee for a British limited company he would have to disclose the name of that company, would that meet the difficulties? In other words, suppose XYZ Ltd. was trying to acquire ABC Ltd. through nominee names, then the buyer would have to give the name of the company who was buying on the transfer deed.—Supposing you had three nominees, one behind the other: anyone who wanted to avoid disclosure could accomplish his objective by employing a series of nominees one behind the

other. Let me put an example: the buyer of shares of another company asks for the use of Lloyds Bank's nominee company. Then Lloyds Bank's nominee company has got to make a declaration. Lloyds Bank's nominee company acts for Lloyds Bank, not for the buyer. You get now-where on the first declaration at all.

3048. You do not seem to think very much of that one.—I do not think that is a runner, Sir, if I may say so.

3049. *Chairman*: The next one, which was recommended by the Cohen Committee, is to put the duty on the beneficial owner of shares in the company when he has become beneficial owner of a given percentage to disclose his position to the directors. I think it was put as low as 1 per cent. in the Cohen Committee's report, though one might make it 10 per cent. Do you think there is any future in that expedient?—That, Sir, is the scheme that I mentioned just now which was examined for months. I was a party to the examination with the Board of Trade and Parliamentary counsel; we just could not find a way of making the thing work, although we had come to the conclusion (I still hold the view, for what it is worth) that if anything was to be accomplished in this field at all, the obligation must rest upon the beneficial owner. It is hopeless to approach the problem through the registered holder. Therefore this was the most likely proposition, but the difficulties were overwhelming as we point out in our written paper and the clauses which eventually were introduced into the Bill were described by Lord Simonds as completely incomprehensible.

Sir Oliver Franks: Could I make two observations there? One is that I have the impression that something like the suggestion you have made is in force in the United States. I think it may be worth considering that insofar as the procedure works in the United States it is in fact very largely due to two things: one is the length of the prison sentence for infringement, which I think is up to five years; and the other is that the Securities and Exchange Commission has a discretion in the matter and its decisions for practical purposes are treated as equivalent to law. Now that is something which might or might not be imported into this country, but it

involves questions which are too wide for me to follow out, about what sort of institution would suit us. The other one which I think is just worth mentioning is that it seems to me in an amateur way that there must be very great difficulties in a beneficial owner knowing whether at any time he has a certain percentage of a company's shares, and this on two fronts: first, that the number of shares that there are of a company may always be altering with convertible debentures and things like that turning into ordinary shares at odd moments of time, which will affect this percentage; and secondly, if as an investor he has also invested in things like investment trusts, these trusts may have holdings of the company in question and therefore he will as one shareholder in an investment trust have a beneficial interest of some degree, and how he adds these different interests together to know whether or not the permitted percentage has or has not been exceeded seems to me to present preliminary difficulty.

3050. One does not want to multiply examples, but I suppose the individual might have had a very wealthy aunt who died in Australia leaving him 90 per cent. of the capital of a concern of which he had never heard, and it seems rather unsatisfactory that instead of getting the share certificate from the executor he should be served with a summons for infringement.—Yes.

3051. *Mr. Watson*: May I ask a question about disclosure of beneficial ownership? I am not quite sure I am following your objections to that, Mr. Lawson. You mentioned that a buyer of the type described by Mr. Bingen, namely a company wishing to acquire shares in another company, might conceal its beneficial ownership behind one or two or three nominees. The first duty of the nominee would be, would it not, if this were enacted, to disclose on the transfer coming to the company that so far as it was aware the beneficial ownership of these shares belonged to so-and-so or such-and-such company?—*Mr. H. B. Lawson*: Are we back on the question of the transfer now?

3052. I am afraid we are.—I have just said to Mr. Bingen that it might be impossible for the nominee to declare who

is the beneficial owner. If there are a number of nominees under him, he does not know who comes at the end of the line and that would be an easy way of evading what is intended.

3053. Yes, but these would be nominees who were not attempting to have a transfer executed to them. Am I right there?—The idea was that if the transferee was a nominee, that fact should be stated on the transfer deed itself and then it was proposed to add for whom he was nominee, and I said he might be a nominee for a nominee. The proposal leads nowhere.

3054. Then it would be his duty, would it not, to inquire from the nominee below for whom he was acting?—Can you impose on the transferees an obligation to trace the thing right down through layers of nominees and possibly abroad into foreign companies? I do not think that is a practical proposition. I am thinking of people who are prepared deliberately to conceal their interests and who have got a reason for doing so. It is those people I do not think you can catch.

3055. You think in the case instanced by Mr. Bingen a company really wishing to hide its identity could do that through two or three different types of nominees?—Yes.

3056. Of course there is the question of registration of shares at the end of the day in the name of Lloyds Bank nominees, is there not?—Again, anybody buying for control who did not want to disclose that fact, could simply delay the act of registration indefinitely. That is another way round it.

3057. Yes. It just seems possible that you might catch the odd adventurer into this field by a rule of this kind.—You might just catch an odd one but look at the trouble the honest man would have.

Mr. Watson: I think the knowledge of the fact of that loophole existing and that nothing is done about it, might mean it is more frequently availed of. However, I do not want to take the point further. I have my answer.

3058. *Chairman:* Perhaps we could pass from that. The next question I have noted is whether you think the rules for

the conduct of licensed dealers recently made by the Board of Trade provide a satisfactory code for the conduct of take-over bids generally.—*Sir Oliver Franks:* Our answer generally is "Yes".

3059. Then the question of take-over bids leads on to section 54, a section prohibiting the provision of finance by a company for the purchase of its own shares. As regards these take-over bids, am I right in thinking that a bank, before it would allow its name to be used in connection with the transaction, would satisfy itself that sufficient funds would be available to carry the matter through?—Yes.

3060. And the bank might be actually supplying finance for the acquisition of the shares, might it not?—Yes.

3061. In such a case how would you regard the duty of bankers? Do you consider it would be legitimate for the bank to be party to this transaction: company A borrows from the bank and with the loan buys all the shares in company B, and company B then lends to company A the amount required to make the payment; so that the bank loan is paid off out of available assets in the hands of company B. Do you think the bank would consider it right to be party to a transaction of that kind, having regard to the prohibition in section 54?—*Mr. H. B. Lawson:* Our difficulty about section 54 is that we are continually plagued with this kind of problem, particularly in these times when so many companies are taking over other companies; the problem grows almost weekly. If the bank says to the customer "What about section 54", the customer will probably reply "My solicitors advise me this is all right". I suppose there are as many different opinions about the correct construction of section 54 as there are solicitors practising in the City of London. If the customer does not go to his solicitors he is apt to say "My accountants say this is perfectly all right" and the customer may add "Supposing it is technically wrong, my accountants are satisfied that no one can be injured, and the penalty is only a default fine of £100". It is extremely difficult for the banks to resist such representations because—although we may not wholly

understand section 54—we can see nothing whatever wrong in a transaction of the character posed provided that the acquiring company, company A in your example, is able to repay the money that is borrowed from company B, giving security for it if necessary. All that is happening in company B is that the asset of cash that it held is being exchanged for an asset in the form of a loan to company A, for which company A is good. We in the Clearing Banks cannot see anything wrong in that.

3062. So that your answer, may I take it, would be that if there were a prohibition against such a transaction anyone would of course pay due regard to it and comply with it, but as it stands at present you say it is by no means clear that such a transaction is caught and you see no reason why it should be caught, because in your view it is in itself intrinsically a perfectly harmless transaction?—Quite.

3063. *Mr. Bingen:* Would Mr. Lawson's view be limited to the case of 100 per cent. acquisition by A of B, or is it the same where A acquires only part of B?—We have said something in our written evidence about the case possibly being rather different where there are minority shareholders left. But if one takes the creditors first and then the shareholders, the principle in my view is the same, provided that the directors are acting honestly and provided that the acquiring company is a good obligor for the repayment of the loan. We have in our paper made a suggestion for a protecting declaration where there are minority shareholders. We have suggested that before the transaction is put through, there should be a statutory declaration from the directors, supported perhaps by a certificate from the auditors. I am sure you appreciate that in the ordinary way of business, with regard to these cash balances that accumulate in the acquired company it is only natural that the acquiring company will want to merge them in its banking account for the whole group.

3064. *Chairman:* What really emerges, I am afraid, is that section 54 ought to be recast in a more precise and intelligible form.—We do not really understand the purpose of section 54. The section is not related to the problem of reduction

of capital when a company acquires its own shares; that was settled as long ago as 1887. The predecessor of section 54, section 45 in the 1929 Act, was introduced following the recommendations of the Greene Committee. This is the history of the matter. In the City in the early '20s there were one or two transactions which, under section 54, as it now stands, could be regarded as breaches of it, and I can remember quite well some people in the City saying "How disgraceful", although I am not sure that anyone lost money through these particular transactions. The Greene Committee put a short paragraph into their report, as no doubt you have seen, recommending that legislation (section 45) should be introduced, but without particularising in much detail the mischief aimed at. I have looked at some of the evidence witnesses gave to the Greene Committee (I have not had access to it all) and I have been unable to find any written evidence at all on the point, let alone any statement directing attention to what the alleged abuses were to which legislation was eventually directed. Later Lord Greene made some observations about the matter in *re V.G.M. Holdings Limited* 1942, the case which gave rise to the addition to the present section dealing with subscription as opposed to the acquisition of share capital. Lord Greene said that the whole matter had given rise to grave scandal and so on, but with great respect I do not know that he really had the evidence to warrant that statement. We know of no case in the Clearing Banks where anyone has lost money through what might appear to be a breach of section 54.

3065. Then could you say what you would recommend about this? Would you recommend a repeal of section 54 or its modification or what? From what you have just said, you would favour repeal?—We would recommend a repeal of section 54, certainly. And then simultaneously you would need to take a look at the sections that render directors responsible for misfeasance; I am quite sure that if the directors act fraudulently in what I may call the section 54 field, they ought to be caught in misfeasance proceedings and proceeded against, if necessary.

3066. Then we might pass to another and quite different point under prospectuses. I understand that you would like the period prescribed in section 50 (5), during which applications for shares are irrevocable, to be extended from three to five days?—*Sir Oliver Franks*: Yes. I think the broad answer to it is that in the present position those three days do not prove adequate time if you are dealing with people in the North of England or Scotland or outlying parts of the country; it just does not work like that.

Mr. Keighley: That is so. Really we need more clearing time; a cheque could take five days, meantime the allotment could have gone out. And of course there have been cases where quite a number of cheques have been returned to us unpaid after the allotment has had to be made—because of the short period.

3067. What would you say about the period prescribed in section 50 (1) which is also three days? That is designed, as I understand it, to give the investing public sufficient time to consider whether they want to subscribe or not.—*Mr. Thornton*: I should have thought that was quite all right. I do not see any reason to suggest that that should be altered.

3068. I was wondering whether it was long enough. The object of it, I understood, was to give the investing public time to consider the terms and contents of the prospectus before they put in an application for shares, and it has been suggested that the period is rather short.—We would see no objection to lengthening it. But the difference between this three days and the three days to which we have drawn attention is based on the fact that here we want more clearing time and there is a lot of work to be done. It is really that aspect of it that leads to our recommendations as regards section 50 (5), which does not apply in subsection (1).

3069. So you see no particular necessity for changing the period in section 50 (1)?—We were not aware of any necessity.

Sir Oliver Franks: We do not take a view here. If you, for other reasons, thought this period ought to be lengthened, we should have no objection.

3070. I suppose those concerned in underwriting might object, might they not, on the grounds that it kept them at risk longer than necessary or something of that sort?—I think that sounds highly probable.

3071. Then we come to the difficult matter of the exemption afforded to banks from certain of the accountancy provisions of the Eighth Schedule to the Act. As a preliminary matter will you agree that the Cohen Committee's view was that full disclosure should be made as a general rule and that special circumstances ought to be shown by any company claiming exemption from the general rule of disclosure?—Yes, Sir, I should agree with that.

3072. That is probably the starting point. Then one goes from that to the provisions of the Eighth Schedule. I confess that the Eighth Schedule appears to me to lack something in clarity of expression, but would you agree that the points I am about to state are the main exemptions in question? As I have got them they are four points: the first, a company qualifying for exemption is allowed to make reserves and provisions out of revenue before arriving at its published profit and without disclosing the amounts so deducted. Would that be right?—Yes, that is right.

3073. Then the second one, the company is not obliged to distinguish between reserves and provisions or to disclose transfers to and from such accounts.—That is also true.

3074. Thirdly, the company need not state the market value of its investments, but can simply describe them as "at or under cost"?—Yes, that is so.

3075. And finally, the company need not disclose the method adopted in the valuation of fixed assets or show separately any amount allowed for depreciation.—Yes, that is also the case.

3076. Those are the four.—My colleagues are pointing out to me that there is a further exemption which is that we are relieved from showing the charge for tax before we come to the published profit, an additional point, I think, to the ones which you enumerated.

3077. Yes. That makes five. Do you say that all these exemptions are necessary to banks?—Sir, I think that we say without doubt most of them hang together, in the sense that if one of them were taken away, it would be possible for ingenious people with a certain amount of intellectual effort to arrive at approximate answers on the other subjects also. But I say at once that I am not certain how far that applies to the depreciation of physical assets, and if the Committee wished us to look into the possibility of dealing with that particular exemption separately and see whether or not it, so to speak, gave too large perspectives on all the other figures, we will be very ready to do so. But we would ask leave to make a particular study of it and put in a written submission.*

3078. I think that would be most helpful, if you were able to do that. I do not want to burden you unnecessarily.—In the other cases I think it is our opinion that they all hang together. It may well be that in this other case as well it hangs with the rest; but when we were discussing this we were not clear that immediately its connection with all the other exemptions was so close. But we would not like to give an opinion now without having it thoroughly investigated.

3079. If you can let us have a supplementary memorandum, that would be most helpful. You made a very convenient summary of your case for exemption in your memorandum under six heads which perhaps I might read. You say: "(1) In the case of banks, the interests of the depositors outweigh those of shareholders. (2) Unquestioning confidence in the stability of the banking system is a national asset of the first importance. (3) While it is important enough that the banks should enjoy this unquestioning confidence at home, it is even more important that they should do so in the eyes of the outside world; and some overseas countries which are not so happily placed watch the evidence of stability very closely and react very quickly to any unusual symptoms. (4) But the earnings of the banks are subject to wide fluctuations from year to year since the results may be

much affected by changes in the value of their investment holdings and by their experience in respect of bad debts. (5) In consequence, reserves, which in any other business would be considered large in relation to the capital employed and to the normal trading profit have to be built up in good times, in the knowledge that equally large drafts on those reserves may be required in other years. (6) Full disclosure in the accounts might embarrass the banks in their policy of making large provisions in good years, while the spectacle of heavy drafts on those reserves at other times might undermine that unquestioning confidence in the stability of the banks which is acknowledged to be a national asset of the first importance." Those six paragraphs summarise your views, do they not?—Yes.

3080. And that accords with the recommendations of the Cohen Committee and their discussion of this topic?—I believe that to be so.

3081. Does it put it rather high when you speak of "unquestioning confidence in the stability of the banks which is acknowledged to be a national asset of the first importance"?—Mr. Thornton: I do not think, Sir, that is an overstatement.

3082. You think "unquestioning" does not put it too high?—I would not have thought so. This question of confidence in the large commercial banks is a matter, I think, of fundamental importance to the country as a whole. It is the means through which the great bulk of debt is settled, and any shaking of confidence, in our opinion, would be a very serious thing.

Sir Oliver Franks: Could I add to that? I would like to begin by saying that I do not think that the question of exemption of the Clearing Banks is a matter of principle. I do not think that we can bring any principle before you to justify it. I think it is a question of expediency. I imagine that what I am about to say is in fact very familiar to the Committee, but I find in my own mind that one of the difficulties is to draw a clear distinction between, shall we say, the position of an industrial company and that of a bank. I think it is obvious that the position is different in the sense that one looks to creditors, to shareholders and to the staff

* See supplementary note to Appendix XXXVI, page 650.

in an industrial company, but in the case of the bank you have also to look to the depositors and first to the depositors. But the difference seems to be in a way this, that when you look at the industrial company, its stock-in-trade is, so to speak, a certain number of physical assets, maybe raw materials, maybe semi-processed products, maybe finished goods. But when you look at the bank, its stock-in-trade is money, and money is different from these relatively fixed physical assets which an industrial company has. It is different because the stock-in-trade of the bank—money—can be more immediately and more pervasively affected by a change in confidence than can a change in the physical assets of an industrial company. When you look at the actual experience of banks, it is of course the case that the movements which can take place either in the value of investments or the losses which can take place in relation to lending can be out of all proportion to the profits of a single year. I think it may interest the Committee to know that in relation to three of the Clearing Banks within a period of 12 months—I am taking September, 1954, to September, 1955, the swing in the market value of gilt-edged portfolios was in one case £44 million; in the second case, £47 million; and in the third case, £33 million. Now, it is quite obvious that the extent to which swings like that eat into the reserves of the banks, let alone their relation to profit in any year, is very considerable. Then when you take not the investments side but the lending side, it is of course a fact nowadays that very large demands are made on us by a very small number of very large companies. You will be familiar with the fact that if you take the people who borrow from the Clearing Banks sums up to £10,000, that is 98 per cent. of our borrowers; if you take the people who borrow a million or more, it is 0.015 per cent. of our borrowers. But the 98 per cent. take one-third of the money we lend; the 0.015 per cent. take over 20 per cent. of the money we lend. We are dealing therefore with lendings which may be of £10 million or £15 million, and you will see at once that if one of these goes bad on a bank, again the amount for which reserves and provisions have to be made or eventually the loss which will be sustained is out of

all relation to the profits of the year, or alternatively it makes a very considerable hole in the contingency account. I think that the point which the Committee has to weigh is what the effect of the disclosure of movements like this would be on confidence. It would normally not be possible for a bank to reveal who the customer was who was in difficulties. Therefore this large unexplained provision or reserve would have to be made and nothing said in the one case, where lending is in difficulty. In the other case, admittedly more could be said: it could be said, "This is a swing in investments". But what I think one has to ask oneself is what the effect of either a very large inroad into the reserves of banks or alternatively the relation which so large a movement or loss would have to the profit for the year, would have on the depositor and the general public; and, in a way, taking all the banks together, the depositors and the general public are nowadays not so far removed one from another. I do not think that in trying to judge this issue the question is what a reasonable and well-informed man would think to be the case; the problem here is not that. It is rather, what can be done to confidence by a rumour once it gets moving? And I think that it would take us, to estimate this, really into what happens in group psychology. I think we all saw in the last month or two what happens, not in the banking world directly, but in the foreign exchange world, when a rumour begins to move there, and it affects gold. This is the sort of problem which, I think, the Committee has to weigh in the judgment of expediency, not of principle, in relation to the Clearing Banks. There is, I think, no question about the size of these relatively sudden movements which can happen to us from time to time. What has to be weighed is what the effect of their disclosure is likely to be, given that they are out of proportion to the annual profitability of the banks. It is fashionable to say nowadays that of course there could not be a run on the banks. If it were really true that there could not be a run on the banks, then what I am saying about the power of rumours or the effect of group psychology do not apply. But I think the Committee will have to be sure that a run on the

banks could not happen; and I suppose that it might be rash to say that because it had not happened for a long while therefore it could not happen. This seems to me to be the crux of the issue on this very difficult subject. I could go on to talk about one other aspect of it which has relevance, which is that banking years tend to go in cycles. For some years we are apt to have quite poor profits and then for some years we have quite good profits. These really flow from what the decisions of the Authorities may be about the level of interest rates and so forth; when interest rates are very low, things are harder; when interest rates are high, things are easier. But I do not want to lay great stress on that because I think that could be explained either to the shareholders or to the public by giving them a reasonable account of what the situation was. The problem is whether, even though the facts were laid out perfectly clearly before the shareholders, the depositors and the general public, you could rely on the fact that these very large movements which take place or the occasional very large loss suffered on lending, would not make people's minds leap in imagination instead of staying, as it were, quietly with a reflective assessment of the position. I think it is only if one is sure that the imagination will not take wing and rumour proceed through the City in the way that Virgil described it, that one can resolve this question of the propriety of the exemption of the banks.

3083. I am much obliged. You say that a run on the banks could not be regarded as an absolute impossibility today, but it would be very, very exceptional today under modern conditions?—I at once say that I do not contemplate a run on any Clearing Bank as a matter of probability. It is not something which I take into account in my normal thoughts about my bank. But it seems to me another matter to say that one knows that it could not happen. I think the hypothesis here is that in a year the results of a particular bank could look singularly unfavourable, and you could see the loss on investments eating up a great part of the contingency reserves, out of all proportion to the profit, and then you have to ask yourself whether it is certain that the

depositors, the public, the overseas interests, would not become the victims of their imaginations and liable to spread the rumour, so to speak. I think that certainly is difficult to believe because there are times—there were times 30 years ago—when in banking or in the foreign exchanges this power of imagination has been demonstrated; not in this country, but it was demonstrated just the same.

3084. Then the converse case of the bank doing exceptionally well: is there anything in the point that shareholders will then come and ask for a higher dividend? That is the converse of the case where there might be a run.—If I may, I am going to assume for the purposes of this answer that what the banks in fact do in relation to their dividends is sensible and defensible. I think it is perfectly true that in relation to a good year the amount of dividend that might be paid would appear to be rather small and I would expect in the case of my own bank to be cross-questioned about it by the shareholders on why more was not being done for them, and it would be my business to try to explain that the view which the bank had to take was not exhausted in the results of 12 months, that it had to look before and after: before in relation to the commitments that it had undertaken and after in relation to the run of the years on average. It might or might not be difficult to convince the pertinacious shareholder, but I do not think that I would want to stand on that difficulty very heavily as a major reason for the consideration of the preservation of hidden reserves. If I had to cope with that one, I would. It might be not altogether easy, but it would have to be done.

3085. Now might I give you a summary of various points that have been raised against your view so that you can make your comments on them? The main criticisms would appear to be, first, that the investor cannot tell if he is getting a reasonable return on his share of the company's assets, and that the power to conceal reserves and profits might be used to conceal inefficiency in the use of the company's assets.—If I treat that for one moment as simply a logical proposition, it follows from the fact that these exemptions are granted to the banks and

is tautologous. But I think that more must be intended by the criticism than tautology, and I think that what I would reply is this, that in fact as my colleagues and I know very well, the banks are in fairly violent competition with each other and if a particular bank was not making reasonably efficient use of its assets, I think that this would fairly soon over the years be disclosed in the performance of one bank in relation to the others; and that the shareholder has a pretty considerable safeguard either in relation to inefficiency or in relation to the level of dividend in the fact that we are always looking over our shoulders at each other; in other words, that competition is real. But I must admit at once the first point that I made, that if he does not know the full position of the banking company, then he has not got all the material for making his judgment which he would have if he had that full material.

3086. But you say it does not follow that he ought to have the full material?—No, Sir, I do not quite say that. I think that I would say instead that if you will the end you must will the means. The question here is whether the arguments which lead to the view that the exemptions granted to the banks should continue are sound. If the answer to that is "Yes", then I think these consequences, so to speak, follow and have to be accepted. They are not really separate points. All I am saying now is that the Clearing Bankers do put forward, I think, the argument which I have tried to state and that therefore, while they accept that the shareholder is not in the same position as other shareholders, they think it follows from the exemptions. I merely added by way of clarification of the existing position that it is not the case that the shareholder is helpless. The fact of competition between the banks does, I think, as a matter of fact give him quite a considerable check, either on payment of dividends or use of the assets of the banks and so forth.

3087. Then the next one is that if the shareholders are not given sufficient information to exercise intelligent control over the banks' directors, the latter are really responsible to no one but themselves.—I think that I should not accept

that statement in the form in which it is. The fact that the shareholders have not got full information, which I have to admit at once, does not mean, I think, that they are in possession of no information or no valuable information, and are therefore in no position to exercise control. In fact, of course, they are in a position to exercise control. The question is how intelligent that control is. I think that they have quite a good deal to go on. For example, I think that in every Clearing Bank, the convention which is never broken is that the trend of profit is shown in the published profit; that is to say, if the real profit in the bank is up, then the published profit for the year is up on the previous year; if it is down, the published profit for the year is down. This in itself—I merely give this as a particular instance—is a piece of important information which shareholders possess and which tends over the years to enable them to make a judgment. But I have to admit that in proportion as the shareholder has not got full information, the fully intelligent control, which no doubt in the case of other companies he exercises, cannot be exercised in the case of a bank, and that therefore the responsibility on the board of directors is by that the greater.

3088. Thank you. Then the next one, should there be a take-over bid for one of the banks, it is suggested that there the shareholder would be at the mercy of the speculative bidder because he would not know the value of his shares.—I suppose for the purposes of answering the question I am to assume that that knowledge is present in simple and accurate form in all other cases where these exemptions are not granted. It is true, of course, that in regard to the banks, just because of these exemptions, the picture which is given in the case of other companies is not fully given in the case of banks. But I do not in this hypothetical case think that the shareholder is wholly without any means of judgment. I think that the banks do in fact, for obvious and prudential reasons, try to see that the prices of their shares bear a reasonable relation to what they should, but I think I have to give really the same answer as before: the shareholder has quite a good deal of information on which to base his judgment,

though he has not as much as in the case of other companies; the reason why he has not is because of the exemptions and it is on the basis of the exemptions that this case, like the others, stands or falls.

3089. The next one is from the point of view of the employee: it is suggested that the employee is put at a disadvantage because he cannot bargain effectively inasmuch as he does not know how much the bank can afford to pay him.—I think this point is as fair as the other ones, because he does not know all that is disclosed in the case of companies which are not exempted, and he therefore has some grounds of argument not available to him and this position flows from the basic exemptions. But equally it would not be true to suppose that therefore the member of the bank's staff is weaponless. A great deal of negotiation about salaries and wages is in fact conducted in terms of what related companies or branches of industry or commerce pay. These figures are known and the arguments are made in fact in those terms: whether we, in relation to, shall we say, insurance companies, or whatever it may be, are paying what we should. Secondly, there is the competitive position between the banks themselves and while all salaries paid in the banks are more or less confidential, equally they are relatively well known to the various Staff Associations or to the National Union of Bank Employees, and these afford a perfectly good method of engaging in argument with the bank on the subject of salaries. The only point really which is inaccessible is how the bank is doing at the moment, because insofar as that is behind the curtain, it cannot be used in argument. I would merely like to add that it is a very great handicap to the chairman of the bank also because very often he encounters the view that the hidden reserves of the bank are very large indeed and therefore the bank can do anything that it is asked: in fact those reserves are not in the least unlimited, and if I could disclose them I would be better placed in argument with my staff.

Mr. Thornton: I just wanted to add to what has been said, that for the reasons which have just been given I think it is true to say that the hoards of the banks never advance inability to pay as a reason

for withstanding wage and salary claims. I am not aware that they do. In other words, I do not think the salary demands are ever turned down on grounds of profitability.

3090. I see. The last one is that the customer cannot tell if he has been charged too much for the service he receives.—*Sir Oliver Franks:* In part that is like the other questions: he cannot tell what the true profitability of the bank in the year is. On the other hand, I do not concede that point has even the strength of the others, because he has that facility which we know among ourselves as the facility of crossing the street. He can always go and see what the charges are in the next bank, and the fact of competition between us means that we are under discipline about our charges in the way which we know to be perfectly real. He is not very likely to be done down.

3091. If bank X charges me too much for making out my income tax return, I can go to bank Y and say, "What will you do it for?"—*Certainly.*

Chairman: Those are all the questions I have in mind to ask you, but I expect some of my colleagues may have some further questions.

3092. *Mr. Watson:* In the case of pension funds set up in a big public company and administered separately within it, perhaps under trustees, do you think it is wise that these pension funds should invest in the shares of the company which it is connected to?—*Mr. Thornton:* I think the majority of general managers of the banks would probably take the view that it is not wise to invest in the shares of their own company. You might think it wise to invest in the shares of other similar companies. I have no actual experience of any pension trust funds, either within the banks or outside them really, but we do not do it.

3093. I was going to ask that question, whether it had come within your knowledge?—*Sir Oliver Franks:* I think we would say, to the best of our belief, and we think this is the case, that Clearing Banks do not do it; that is to say, a bank's pension funds do not invest in the shares of that bank.

3094. My question was really related to your customers. Perhaps your nominee companies are the holders of investments on behalf of a pension fund. Has it come within your knowledge that in certain cases these investments were the shares of the company which had established the pension fund?—My knowledge does not enable me to answer that one.

Mr. Thornton: I should have to have notice to find out.

3095. My question is related really to the voting power of those shares, which I suppose if you were in this position you would have to exercise in a manner directed by the pension fund trustees. There is another point arising out of your memorandum in paragraph (4) of the summary of your case for exemption, you say: "But the earnings of the banks are subject to wide fluctuations from year to year since the results may be much affected by changes in the value of their investment holdings . . .". Is that quite what you mean? Do changes in the value of investment holdings really affect earnings of the banks? It is losses that arise from the sale of them that you are thinking of?—Yes.

3096. Then there was a further point in your memorandum where you are referring to the depreciation in value of investments which the banks had to disclose in their balance sheets. You say: "Fortunately the appearance of notes in balance sheets had no disturbing effect here although they did not pass unnoticed abroad." I gather that one of the main planks that you had in requesting a continuance of non-disclosure is the possibility of the loss of foreign business. Does this comment really mean that the disclosure of depreciation had in fact some detrimental effect on foreign business of the banks?—*Sir Oliver Franks:* I should not be prepared to say "Yes" in answer to that question. What I think is true is that—Lloyds Bank was one of the banks which did this—I became aware that some foreigners raised eyebrows when I had not expected them in fact to do so. They took a view and they wondered. But it would not, I think, be true to say that we traced any physical loss of business to that reason.

3097. And perhaps the fact that it would be widely appreciated that other reserves

existed within the banks which were hidden and undisclosed, meant that the position was sound, irrespective of this disclosed depreciation?—I really do not know. I think it depends on the view that you took of the fact that the banks did disclose depreciation. If you thought that they were doing that because they had not got the reserves to cover it, then you would be following one line of thought. If you supposed that they were doing that because they were getting ready just in case the bank rate ever went to 12 per cent. when they might really have to, that would be another thought. Now, which reflection animated the minds of the foreigners, I do not know; but so far as my particular bank was concerned, we were doing an exercise which we thought worth doing in case the bank rate ever moved to unprecedented heights with a corresponding depreciation of our investments. We were not doing it because we had to.

3098. One further question, you say: "In the event of confidence being undermined the financing of world trade might pass in part to other foreign banking institutions, the growth of whose capital and reserves has not been hindered to the extent that the British banks has been as the result of restrictions and severe taxation, the legacy of two world wars." Would it be fair to say that you had in view continental bankers in that reference? And would it also be true to say that continental bankers are in the position also of not having to disclose their hidden reserves?—I cannot answer the last part of your question because I do not know the answer. What I am aware of is that I think in the Commonwealth generally the practice is the same as ours, though it is different in the U.S.A. I do not know what the normal position is, for example, in Germany and France.

Mr. Thornton: In the main I think it is the same as here.

3099. So that they would be put at an advantage if they were left with non-disclosure and the right of non-disclosure were taken away from the Clearing Banks?—*Sir Oliver Franks:* Yes.

3100. *Mr. W. H. Lawson:* Could I ask one or two questions of detail regarding

the exemptions which you may care to answer now or you might perhaps care to deal with in the supplementary memorandum which you were good enough to say you would send in. The first question is in relation to the market value of quoted investments. When the market value is below the book value or balance sheet value, it is I believe the invariable practice of the Clearing Banks to give the market value. But of course you are in fact exempt from that under the present exemptions; it may be therefore that that is an exemption which you may feel you no longer require.—May I answer that by saying that as we are here today we do not feel in a position to say that we will be prepared to see our custom transformed into a rule, but we would be very willing to look into it, as you suggest, and see what written answer we can make.

3101. Then the counterpart of that: from what you are saying, would there really be any great harm if the exemptions were withdrawn so that you also had to show the market value where that market value was above the balance sheet value? Could you in fact be harmed thereby? —*Mr. Thornton:* There is a difficulty here, which is that some of the banks are not satisfied that market value for thousands of millions of investments is necessarily a proper basis of valuation. When one talks of market prices of British Government stocks, one may be thinking in terms of £100 or £5,000. How can anyone really say that the market price that one reads in the Press every morning has any relation whatever to the disposal of £10 million or £20 million of stocks? You are seeking, Sir, with respect, to tie us to a basis of valuation which some of the banks have for good reasons departed from—good reasons to them. I think it would present us with this difficulty that having gone away from that and moved, as we believe, into a more realistic method of valuation which is at or under cost and below redemption value with such reserves as each bank may think to be proper, you will understand the reluctance on our part to be brought back to market values.

3102. Perhaps you would be good enough to deal with that point in your memorandum?—Certainly.

Sir Oliver Franks: May I add one point? I think the Committee will be already aware that a bank would be quite apt, if it is dealing with investments, to sell £5 million or £10 million at a time and this is where we are all dealing with the Government broker; we are not dealing with the market, the market cannot do it, and therefore the price is what he and we will make it. From this point of view, the market price of the day is not directly relevant. How far one can or should extrapolate that fact to a general view about market valuation, again, is a matter of opinion but I think that this is at the root of what Mr. Thornton is saying.

3103. Yes, I think I see that; my question was really directed to seeing how harmful it would be to a bank if it had to make that disclosure, thinking in terms of whether we could reduce these exemptions to the ones which really were essential. How essential that particular one is, is a matter which perhaps you would think over and deal with in your memorandum. —We should certainly be very glad to.

3104. The next point emerges from your remark that you would never in fact show an upward trend of profits if the hidden figure was downwards. The present position is that it is a convention or policy which you very properly adopt. But we have nothing in the requirements of the Eighth Schedule to make that essential. The exemptions which you have in the Eighth Schedule would, I imagine, in theory make it possible for you in a bad year to use some of your secret reserves to cover some of your banking expenses so that in fact you would be showing a better profit or an upward trend of profit in a year which might be down. That seems to me to be the technical position as at present. I wonder if you would look at that one?—May I be clear what the point is? Is it, would the banks be prepared to undertake that when their profits in year 2 were less than their profits in year 1—their real profits in each case—that they would not try to show in their published profits of year 2 a larger figure than in year 1 merely by drawing on hidden reserves?

3105. Yes, I do not think I would put it quite that way. I think it really, in practice, comes down to a definition of the

purposes for which you might use your hidden reserves. If one accepts the proposition that you need large hidden reserves for the purposes which you have mentioned this afternoon, then it might be possible to define those purposes in such a way that the banks would be *required* to follow their present practice in regard to annual profits. Do you see what I mean?—Yes, I do see. But I do not want to find myself admitting by accident that we would willingly forego the right to draw on our hidden reserves if necessary in relation to the published profit figure of a year. That seems to me a different question from whether, drawing on them, we will ever move against the trend. I sharply distinguish it. I do not know at all what the experience of the banks was nearly 30 years ago, but I should not be in the least surprised to find that the profits published were not wholly earned in some of the years 1931, 1932, 1933, and that therefore in fact the hidden reserves were drawn upon. But at the same time, I think that that is irrelevant to the question of whether the trend is faithfully shown or not.

3106. I am very grateful to you for pointing out there are two points and not one. I think the point is also relevant in this way. I think at some point in your memorandum you say that the depositors cannot be harmed by your exemptions because you always understate rather than overstate. Of course, if in a year you were to use your secret reserves so as to cover up an actual banking loss, as apart from bad debts and loss on investments, and if you were to do that for more than one year, you would be showing a position which was rosier than it was in fact. I think it is unthinkable anyone would do that, but I think under the present provisions of the Eighth Schedule that might be possible. It is that point I was after.—We would certainly be glad to include that in the memorandum.

3107. This afternoon you have been giving us extremely strong reasons, if I may say so, as to why it is necessary for a bank to have large secret reserves, and to be free to use those reserves without disclosure to meet exceptional losses such as you have described, on bad debts and on investments. I did not gather from

what you were saying anything like as strong arguments, or indeed any case as to why you should not disclose the amounts which you put into those reserves, which would depend admittedly on the amount of profit that you make; presumably in a good year you put more in and in a bad year less. That is something which could be explained and I am not quite sure you have this afternoon said very much on that subject.—I think that I should have to relate your second point to what I said earlier about the size of the hole in the reserves which particular misfortunes can bring, because there are people who would from year to year add up what was transferred to hidden reserves and thereby try to arrive at a figure of what in fact the hidden reserves consisted of and so forth. I think then they would do sums on what the depreciation on investments might have been and so forth and you would find you were back again in the central position. I do not think this one cuts loose from it.

3108. Except that one wonders how much that would matter. It would be at a much later date that they would do that sum. Still, I see your point. The two in some measure go together. My final question is whether you have in mind anything by way of limiting the amount of these reserves. What happens when you get up to the limit? You have, I think, and perhaps other banks have, from time to time pulled out from secret reserves certain amounts and put them into published reserves. I do not quite know what influences that. Does the moment come when you say, "We have more than we need", or how does that arise?—I think the answer to that question is that we should very much like to be in the position in which we had to answer it. The story very briefly is this. As you will know, deposits of the banks are roughly three times up from before the war, perhaps a bit more, because of what has happened to the currency. At the end of the war published capital, published reserves and hidden reserves were related to the pre-war quantum of deposits and the whole history of the last 15 years has been an effort to get the shareholders' money in the business into a proper

trading relationship to the deposits. Therefore, the question of whether or not there was enough and what you do if you have too much unfortunately never arises. I think the reason why from time to time transfers have been made from hidden reserves to published reserves (so as to enable, for example, an increase in the published capital) has been simply that as the situation has gradually improved, we have been very anxious when and as we could to make our published capital and published reserves stand in an improved relation to our deposits.

3109. *Sir George Erskine*: I should like to ask a question in relation to the exemptions to the banks. I think we all accept the position, as our Chairman says, that confidence in the banking system is a great national asset and we all accept the position that the great banks do an essential public service. Can you say why, on the question of confidence, the Clearing Banks should be responsible to no one but themselves? Certain other industries, for instance the insurance industry, are required to make returns to the Board of Trade. I think it would be helpful to this Committee—I am not asking this on my account—if you would tell us whether you in fact do disclose these secret provisions you make to anyone at all.—The answer is that we do not disclose them to anyone who might be said to be in control of us. We do disclose them wholly to two sets of persons. Those two sets of persons are our auditors in the first place, and the Inland Revenue in the second place; for the purposes of the audit of the books; for the purposes of the assessment of tax, everything is known to those two sets of persons.

3110. *Mr. Bingen*: As we all know, the supervision of companies rests with the Board of Trade to see that they are properly administered in accordance with the Companies Act, etc. In the second place you have got the Stock Exchange which has some control over issues which are quoted. Then you, Sir, made a passing reference to the Securities and Exchange Commission and obviously, in another capacity, you must be very well versed in U.S.A. affairs. I wonder whether you or your colleagues have any view as to whether there is a need in this country for

a state institution responsible for general supervision of the control of companies, whether their shares are quoted or otherwise; in other words, are the banks generally satisfied with the Board of Trade and the Stock Exchange as the two bodies, or do you think with the modern complexity of companies and modern conditions that anything more is required?—This is not a question to which I have an answer, so to speak, already given to me by the Committee of Clearing Bankers, so that I am just thinking about what I can say not merely truthfully but also which they would support. I think that they would relate the question that you have asked to what we say in the earlier part of our paper, which is that generally speaking we think that the existing system of things and methods of control work and work well. But I think I could add this, that the major premise or basic attitude which we have tried to express in our written evidence is that the great majority of companies are in fact honourably and reasonably conducted, and that we rather hope that they will not be unduly burdened by statutory regulation which is designed to deal not with them but with the few. And while this takes me outside the field of my knowledge, we would rather the few were caught up by legislation which deals with fraud or something of that sort, rather than by fresh regulations, resulting no doubt, in the end in forms and written work in great quantity which all have to do just in case the few sin. This is really why we comment at various stages of our written submission on the problem which is always present, that having a man who tends to sin, the ways of evasion are relatively easy if he is determined. So that these are really the grounds I think why we would prefer something like the existing system which I think works well, and look for protection in picking up people through the laws dealing with fraud.

3111. *Mr. Althaus*: You stated that all your transactions in gilt-edged securities were in effect done by the Government broker.—I did not say that quite. I said that very often what the banks found themselves doing was dealing in sums of £5 million to £10 million, and that when

that was so we were more likely to be dealing with the Government broker. But I would not wish to be understood as saying that if, for example, somebody came along to us and said, "Can you sell us half a million or a million?", that we did not deal in the market. In that case, we would be dealing in the market with somebody who wants to buy.

3112. I was really going to take it further than that. In fact, no one doubts the policy and day-to-day actions of Government Departments are of prime importance, but there are in fact many other dealers, insurance companies, large industrial companies, pension funds and funds of that kind, exchanging or buying or selling very large amounts of stock from day to day; and although it is probable that all those transactions will still be a matter of great interest in official quarters, it is also equally likely, and I think it would be the experience of some of your colleagues, that the great bulk of it is in fact effected through the ordinary course of supply and demand in the market in which the market itself takes its element of risk. You did not stress it and it is not really material to the argument, but I think you might be doing a little bit less than justice to the market machinery.—If I was, then I apologise. It is of course perfectly true that a great volume of transactions is going on through the market all the time. What I had in mind was when we really wanted to sell we usually wanted to sell quite a lot quite quickly, and then the situation which I have described is in fact the one which is much more often than not likely to arise,

because I think the digestive organs of the market are not always equal to it. This may of course be partly due to the fact that when bank A is selling, bank B is selling too. I did not wish to infer there was not a market, but I think there is a limit to how much it can take on board.

3113. I have one question for Mr. Thornton. This arises out of section 50 (5). I am not quite sure whether it comes within our province of inquiry but I think it is an important point to make and to go on the record. You wish the period of irrevocability of applications to be extended and therefore I take it you regard this as an essential part of the machinery of issues. There are many issues, big ones, which are made not under the Companies Act but under the provision, among others, of the Local Government Act, 1933, I think, in which applications can be withdrawn at any time up to the posting of the allotment letters. Has that been your experience or are you aware of such a situation?—*Mr. Thornton*: I am afraid we are not.

3114. But if it were so, you would welcome, if it were possible, the bringing of all issues on the same footing?—We certainly would like to see them all in line with the Companies Act.

Chairman: Those are all the questions anyone wants to ask you and it only remains for me to say how very grateful we are to you for the valuable help you have given us this afternoon. Thank you very much indeed.—*Sir Oliver Franks*: Thank you, Sir, for the courtesy with which you have listened to us.

(The witnesses withdrew)

MR. J. H. GUNLAKE, MR. F. M. REDINGTON, and MR. R. E. BEARD,
called and examined

3115. *Chairman*: Good evening, gentlemen. We are very much obliged to you for your memorandum of evidence and for coming to help us this evening. For the purposes of our record, if I might get your names, and so on, right: you, I understand, Mr. Gunlake, are the President of the Institute of Actuaries; you Mr. Redington, are the immediate Past

President; and you, Mr. Beard, are an Honorary Secretary of the Institute. That is right, is it?—*Mr. Gunlake*: Yes, Sir.

Chairman: As the field in which we shall ask you questions is very largely one of accountancy, I will ask Mr. Lawson to put the questions on behalf of the Committee.

3116. *Mr. Lawson*: Your memorandum is headed "Disclosure of Reserves of Life Assurance Offices" and seems throughout to deal with that subject. My first question is whether you have any views to give us about the exemption provisions as they relate to other types of insurance business?—No, Sir, I think not. This gives me the opportunity of saying something that should be said. As the Committee knows, shipping companies, banks and discount houses are bracketed with insurance companies in the matter of exemptions. It is not for us to say anything at all about the case of those other classes of company. That is not to say that we do not think they have a good case. We just do not know. As far as insurance itself is concerned, we are professionally concerned only with life assurance. It is the case that a number of members of our profession hold general managerships, secretariats, and so on, and in that capacity they are concerned with non-life business. But that is in their administrative capacity, not their professional capacity, and it is not for us to say anything in that field.

3117. I see. So we must take it that your evidence relates only to life offices?—Yes.

3118. The provisions regarding exemption are, as you know, rather complicated. The wording of the Eighth Schedule is complicated. Am I right in thinking that the main exemptions—I will list them and see whether I have got them right—are, first, from the requirement to show reserves, provisions and liabilities separately?—Yes. As you say, these exemptions are rather intricate. Our memorandum deals more particularly with the question of market value of assets, but there are, as you say, other exemptions involved.

3119. I could, perhaps, short-circuit it. I realise that you deal almost entirely with the exemption as regards value of investments. Am I to take it that as far as life offices are concerned, you do not see any need for any of the other exemptions, such as they may be?—I think we would be willing to answer questions on the other exemptions if that would be your wish.

3120. The first exemption, which I have just described, does not affect the market value of investments. I do not know whether any of the life offices have provisions against the value of investments which are included in the liabilities without disclosure, whether anything of that sort arises or not?—May I just mention that I am myself in private consulting practice and I am not connected with the life business at all. I understand the principles involved, but I am not so well versed in details as my two colleagues. May they take some of the questions?

Chairman: By all means.—*Mr. Redington*: The exact nature of any particular reserve, or where it is, is difficult to answer. For example, as the market rate of interest changes, the values of the liabilities may be strong one day and, possibly, weak the next day. *Vice versa*, the value of the assets may be strong one day and weak the next.

3121. *Mr. Lawson*: I see that. One realises the difficulty of assessing the present value of the liabilities of a life office. That is an actuarial calculation which the actuary does, taking, I understand, whatever rate of interest seems appropriate at the time. He makes the calculation after allowing for other factors and he arrives at a figure which is the value of the liabilities, in his assessment, at that particular moment of time. If he does that to the best of his ability in a fair way and puts that figure in a balance sheet, I suppose that that would be the true and fair view of the situation and that you do not need any exemption as regards that. The only exemption that arises is that having arrived at what might be regarded as the present fair value, he then adds something on, either to be over-cautious or to have some particular reserve for some purpose up his sleeve. Is that done or not? Is it necessary to do that?—In the valuation of the liabilities, the actuary states the basis he has used. That may contain a reserve. It may be a strong basis. The other point I would make is that it may be strong one day and weak the next.

Mr. Gunlake: May I take one point which you mentioned? You referred to the calculation of the liabilities and entering them in the balance sheet. That,

of course, does not happen at all. The balance sheet of the life office is, I should have thought, unique in this respect. On the right-hand side there are assets, as there always are. On the left-hand side there may be one or two specific liabilities—sundry creditors, and so on—but the main item on the left-hand side is the amount of the life assurance fund as shown in the revenue account. That of itself tells you absolutely nothing whatever about the assessment of the liabilities of the office in the actuarial sense. That is a completely separate exercise which is done under the provisions of the special legislation affecting life offices and the results of which are set out in very great detail in the returns which are made to the Board of Trade under the special life assurance companies' Acts.

3122. I appreciate that, and that is set out in the annual accounts of most insurance companies. Assuming that it is accurately set out, that, one would imagine, would be in accordance with the provisions of the Companies Act, even if there was no particular exemption for insurance companies?—*Mr. Redington*: I think you are asking whether there are any unspecified hidden reserves in the liabilities. I would say that most offices do not have much. They state the valuation basis, and every fifth year they produce all the data and you can reproduce the valuation of the liabilities fairly well. There may be minor amounts within those reserves which the actuary may use to avoid minor disturbances which, he may feel, would improperly disturb the surplus. The valuation of the liabilities of life offices is a very complicated business. Suppose that the actuary changes the mortality basis for a minor table. It may involve a strain of, say, £50,000. He may say, "That is not a figure for this year's surplus." He may take that small amount out of an inner reserve to avoid an unnatural disturbance of the surplus. By and large, however, there is not much on the liabilities side. The statement by the actuary of what he has done is fairly well the whole of the story for most offices. Does that answer your question?

3123. Yes, I think that answers my question. It was what I was hoping you would say. On that answer, it seems that

as far as this first point I have put to you is concerned, no great harm would be done to insurance companies if that particular exemption was withdrawn: that is to say, the exemption which enables you not to distinguish between liabilities, reserves and provisions.—*Mr. Gunlake*: It is not general to make an annual valuation. You mentioned that you thought it was customary for a summary of the actuary's valuation to appear in the balance sheet. I should have thought that it was not so.

3124. It is done every five years?—Every five years is the common practice, yes. May I draw your attention to the Fourth Schedule of the regulations prescribed by the Insurance Companies Act, 1958, under which the actuary broadly must do three things. He has to give a mass of detail about the contracts which he is valuing. He then also has to state in considerable detail the basis upon which he has effected the valuation: that is to say, the mortality table he has assumed, the rate of interest he has assumed, and so on. Then, he has to give all the results of his calculations in the form of a schedule, which is given in the regulations. In that schedule, there is an item right at the end which says "Adjustments, if any, to be separately specified." So that if, when the actuary has made his calculations on a specific mortality and interest basis, there are then any adjustments to be made, the words here require them to be separately specified in the Board of Trade returns; so that if there are special reserves, that is where they would normally appear.

3125. They are publicised in any case, because the returns to the Board of Trade are open to inspection, are they not, so that these facts become known? The point I am after is whether there really is any advantage to the insurance companies in having this particular exemption, namely, that they need not distinguish between reserves, provisions and liabilities. What both of you have told me leads me to think that there is no particular advantage in it because of the fact that they are disclosed in the Board of Trade return and in the company's accounts, if not every year, at least at the three-year or five-year actuarial valuations?—I recall

a case of a life office to which I am consultant where, at a recent valuation, I included a special reserve for fluctuation of claims for a particular technical reason. That was shown in the Board of Trade returns, but the valuation is not made every year. Had you in mind that the balance sheet might include a footnote saying, "At his last valuation, made on such and such a date, the actuary included an additional reserve, say, for claims fluctuation"?

3126. I have not thought it out. I suppose that if you did it at the time, in the year in which he made the valuation, that would suffice?—The point I am making is that the exemption to which you are referring relates to annual accounts, whereas the normal actuarial valuation is not annual.

3127. I see that point, but I think that that could be overcome.—*Mr. Redington*: Rather than say that this was not necessary, I would agree that it is not a major issue. A full description of an actuarial valuation might take 20 or 30 pages, and most people would not be interested in it. There are a lot of technical problems. There are a number of contracts with an option. How does one value an option? The actuary, knowing these things and the intimate details of thousands—even millions—of policies, must allow for all these little things. He cannot explain them all. The general position we are in at the moment is very convenient and I do not think there is a major issue in this part of the problem, either on your side or on ours.

3128. I see. Thank you very much. The next one is the exemption, which follows on the previous one, from the requirement to show the amounts transferred from profits to provisions and reserves. There again, you do not indicate in your memorandum that there is any need to retain that exemption. I imagine that it is not the custom of an insurance company, is it, to make substantial transfers out of its income to secret reserves?—I think not. There is the minor point which I have already made about a minor value change. You are not including here the position in relation to profits on realisations of investments, are you?

3129. I am coming to that under the investment problem, I will clear the other points first, if I may. The next one is the exemption from the requirement to show the cost or valuation, and depreciation of fixed assets. I do not know whether any life offices take advantage of that exemption or not, but there cannot be much in that point, can there?—No.

3130. Then, there is the question of taxation. That is a little complicated with insurance companies, but do they, in fact, show the amount that they have provided for taxation in the same way as other companies?—I think the practice differs. They put something in, yes.

3131. The ordinary provision of the Companies Act is that you should show the amount you have set aside for Income Tax, Profits Tax, and so on. Is there any need for insurance companies to be exempted from that requirement?—Again, it is a fairly minor issue. The practice of the offices differs. Whether the differences are wise, I would rather not comment; it is really a life office question and not a professional one. It is small compared with the big professional issue, but it is part of the problem.

3132. I come, then, to the main point of your memorandum and one which we have also discussed this morning with the British Insurance Association; that is, the question of the valuation of the assets, in particular the valuation of investments. The exemption which, I understand, the life offices wish to continue to have is exemption from the provision which requires a company to state the market value of its investments—that is the first point—and, secondly, from the requirement that amounts transferred from reserves to write down the value of investments should be disclosed. It is the point you were on just now. If they make a realised profit on investment, I understand that the insurance companies want to be able to write down other investments by the amount of that profit so as to create a situation which would cover any decline in the market value of investments. That is really your view too, is it not?—Yes.

3133. Let us pursue that a little further. In reading your memorandum, I was

impressed with the views which you have put forward about the non-disclosure of the market value of redeemable securities, because one can understand that the actuary takes the rate of interest into account in assessing the amount of liabilities and he takes into account the earnings which are likely to be derived from the investment; and provided the investments are redeemable at dates which fit in fairly well with the obligations under the company's policies, the present market value is of very little consequence. I see that. But you go rather far. You say that it would be harmful and misleading. I am wondering whether that is not over-stating it. Would it be positively misleading, do you think, to give the figure of present market value?—*Mr. Gunlake*: You are speaking of redeemable securities, are you?

3134. Yes, I am at the moment.—I think our view is that it would be. We cannot separate assets and liabilities. They are all part of the picture we are trying to see. Moreover, we cannot isolate a particular valuation. It is one of a long series of planned exercises. That is the way we would look at it.

3135. But, of course, pension funds do as a rule give the market value, do they not?—Yes. This is something I have had a great deal to do with in my practice. It is very common form for them to state the market values. One wonders, of course, what kind of pressure might conceivably arise as a result of that.

3136. Have you any experience of pressures of one kind or another arising, or disquiet or disturbance caused in any way as a result of that practice?—No disturbances have reached my desk, but I have heard of claims from staffs. At least, comments have been made and questions have been asked as to whether benefits could not be increased, perhaps substantially, because of this ephemeral market position.

3137. Yes, where the market value is higher; if the market value were lower, would it cause any uneasiness?—Nobody seems to think about the possibility of depreciation nowadays.

3138. *Mr. Bingen*: I do not agree for one moment. Surely, when you are

dealing with pension funds, do you not normally find that intended beneficiaries are prepared to wait for the next quinquennial valuation?—This is an inflationary period, and some pensioners are suffering considerably. I would say that there is a good deal of eagerness for increased pensions in present conditions.

3139. Surely, it must depend on whether you can afford to pay them from the solvency of the fund and the actuarial valuation of the fund quite independently of the market value?—Yes; but the publication of a market value figure in between two valuation times, if it is very much above the book value, can cause questions to be asked. People are not always willing to wait until the next valuation comes round.

3140. *Mr. Lawson*: They could always be given the answer that they had to wait for the next quinquennial valuation. No trustee pension fund could agree to a change in benefits before a quinquennial valuation.—Normally, change is expressly prohibited without the actuary's agreement.

Mr. Redington: I would think that the parallel of the pension fund is not all that close. The early history of life assurance and the history in many other countries is full of the wrecks of companies which have anticipated the future. The pressure—I will not say from any particular quarter—to benefit the present at the expense of the future is always present. The core of the actuary's professional job is to protect the future against the claims of the present. With premiums paid in advance and benefits payable 20 or 30 years ahead, including provision for proper emergence of bonus, it is so easy to capitalise future events into a present figure which can be spent now, on bonus or dividend. The actuary's job is to protect against that, letting the income and outgoings move slowly in parallel. Any figure which capitalises, such as the market value of the assets, is running in a way counter to the essential professional job.

3141. I think I see that. I see the reason. I am not trying to put this higher than to ask whether there would really be any harm in its disclosure. What harm would it do? I am not suggesting that it

would be any great advantage either to policyholders or to shareholders, but would it do harm if insurance companies in this respect were brought on the same basis as other companies. I think you feel that it would be harmful because of these pressures which build up?—Yes.

Mr. Gunlake: I have no doubt of it. The financial journals would make un-inspired comments on this. The only way they could properly comment on it would be to examine simultaneously the Board of Trade returns containing the actuary's valuation. In all my experience, I have never known a financial journalist to do that.

Mr. Redington: It is significant that in all the suggestions for the publication of the market value of assets, you can hardly find a word about liabilities, whereas the two are indistinguishable. The two have to be taken together. I have no doubt that the public would take the market value of the assets as a relevant important fact. In all the articles I have read saying that we should publish, the intention is to judge the company by the market value of the assets. Even we as actuaries cannot do that.

Mr. Gunlake: May I give an illustration which is well within my memory and, I have no doubt, well within the memory of members of the Committee. Many years ago the position of a large Dominion insurance company was called into question. This was at a time of depreciation. I am old enough to remember such times. This created so much disturbance that it went right up to the political level. Indeed, the Prime Minister himself intervened. I remember the judgment he gave on that occasion: that in his view, the company was as solvent as such a company needed to be. That was a masterpiece of drafting. But it was all complete nonsense. There was no real doubt about the solvency of the company. Today, it is flourishing as well as its fellows are. That is the sort of thing that can arise and causes us concern. It was unnecessary and created a complete storm in a teacup, and a grave storm it was.

3142. *Mr. Watson:* It led to legislation to restrict the amount of ordinary shares that insurance companies might hold.—

But was that in the interest of policyholders?

3143. *Mr. Lawson:* May we follow on to the question of ordinary shares? I fully understand your argument about redeemable Government securities in that that is a matter of a rate of interest and the rate of interest is linked to the rate of interest which the actuary takes in assessing the liabilities. I think I am clear about that. But we have the position, have we not, that the managers of an insurance company or a life fund have a free choice. They can invest in redeemable Government securities, they can invest in irredeemable Government securities or in first-class preference shares or something of that kind, or they can invest in ordinary shares. As far as those last two categories are concerned, it is not a question of matching dates and of seeing at what date you need your money in the future. The question is there, is it not, whether the income that you will get over a period of years will be higher by investing in one type of security rather than another. I wonder whether, in those cases, the market value is not of some interest to shareholders in assessing whether the management have exercised their discretion wisely or whether they have chosen a good moment to go into equities or not. Is not that the type of information that a shareholder is entitled to have?—I think it would hardly help shareholders since, as I am sure you know, the shareholders' interest in the life fund as a rule is a small percentage, if it is anything. There are some mutual offices which have no shareholders. In the majority of offices, the shareholders are interested in the surplus only to the extent of one-tenth; that is a common arrangement.

3144. Is it not also of interest to policyholders in so far as they participate in profits? Surely, if you invest in, say, equities and you are lucky in your choice of securities and of timing of investment so that they double or treble in value and double their dividends, is not that a point of interest to the participating policyholders as well as to shareholders?—It is not the capital position which should matter. It is the income which matters. If the market value of an equity doubles, that may be due only in part to an

increased dividend which you have already had as compared with the situation when it was bought. That will, in fact, have emerged to the benefit of policyholders in the form of part of the surplus disclosed by the valuation. A substantial part of the appreciation of equities is an expectation on the part of the jobbers of future favours to come, of further increases of dividend. If that happens, well and good; they will flow in in the form of increased dividends for the benefit of the policyholders, and shareholders to the extent to which they are entitled to benefit.

3145. Your answer is that the policyholder is interested in income and that sooner or later this higher value is reflected in income, and that that is the only thing in which he really should be interested, so that he should judge the effectiveness of the management by the increases in the income?—I cannot put it any better than Mr. Redington put it. The enhanced value might well be no more than a capitalisation of future profits. To throw it all away in one go would be something that we have spent 100 years of professional life to try to avoid doing.

3146. I do not suppose that your shareholders would throw it away all in one go even if it were disclosed. I am directing my question to whether the fact should be stated rather than to whether they should have much say in it.—*Mr. Redington:* Towards the end of the memorandum, we have said that perhaps more information under the insurance companies legislation might be appropriate.

3147. Could you amplify that? What sort of points have you in mind?—In essence, we fight against capitalisation, but information about income and outgoings is more proper and more restrained and more useful. In drafting that, the Council had in mind that the information about the assets is rather thin. When we examine each other's affairs, which we do out of curiosity and without any inside information, we get on very well without the market values. But there is a weak spot. We do not know the length of term of the assets. In the fifth schedule of the return to the Board of Trade, an office sets out its liabilities in detail. They may be very long-dated. We cannot know

whether its assets are very short-dated. A serious unmatched position could be a danger or vice versa. Some spread of the assets according to term would be a useful piece of information. It would be a matter for discussion what was shown on each line of the schedule in terms of future years—five-year stocks, ten- and fifteen-year stocks, what information was shown on each line, book value, income, current income, and so on. Information about the income and its length of term is relevant. Capitalisation of it is dangerous.

Mr. Gunlake: I am glad the point has been raised. We are anxious that the Committee should not feel that the burden of our evidence is to pursue obscurantism for its own sake. On the contrary, for 90 years, since 1870, we as a profession have been giving a vast amount of information about our main professional work, which is the valuation of liabilities, to an extent which is not matched in any other profession. There is only the reverse of obscurantism on that side. Our submission is that if further information is desirable on the assets side, it would be far better if it were done through the special legislation affecting insurance companies rather than through the general provisions of the Companies Acts.

3148. What I am trying to get at is this. If you are going to put additional information into these returns to the Board of Trade, which are published, it leads to the question as to whether you need refrain or be exempt from giving similar information under the Companies Act insofar as it is the type of information which is given by companies generally. Companies are not required to go into a vast amount of detail—nothing like the amount of detail that insurance companies have to go into in their return to the Board of Trade. If you are putting forward that type of information in those statements to the Board of Trade, there would be no need for you to have exemption as regards that type of information in the Companies Act?—I do not think I quite accept that. If the supplementary information about the assets were included in the Board of Trade returns, that would be read side by side with all the information about the liabilities. What you are suggesting is that for the purposes of the

balance sheet, which appears once a year whereas the Board of Trade return is made normally once every fifth year, something selective should be stated about something which falls within the actuary's province; something should be said about half the story. This is something over which any professional man would be worried.

3149. Would you have any objection to showing the market value of investments in your Board of Trade return? You have come rather close to accepting that in saying that you would give the dates, and so on. If you have, say, Government securities due at such and such a date, anybody can calculate their market value?—*Mr. Redington*: In a way, we are close to it already, because the yield on the funds gives a fair clue. My own company produces 50 or 100 pages of information about the company every five years, in which the public shows the most profound disinterest. If we put in the one figure about the market value of investments, the whole world would know next day and it would be all over the place. All the 50 pages about liabilities are equally relevant to the picture.

3150. Would you answer the specific question: Would you object if you were required to put the market value of investments in the Board of Trade return?—*I think it would be just as objectionable as in the balance sheet.*

3151. Because people would fix on that one figure?—*Yes. There is a certain curiosity about that particular piece of information.*

3152. There is only one more question which I should like to ask you and it can be summarised in this way. As I understand your case, it is that this information about market value of investments would be misleading and harmful to shareholders. You are not really claiming exemption on the ground of any special privilege for insurance companies, but you are saying "The way we would like to make our accounts is the proper and best way of making the accounts in the case of an insurance company and the best way of showing the true and fair view, and if you force us to do what other companies do you are merely forcing us to do something

which is misleading and harmful"?—*Mr. Gunlake*: Yes. We feel that life assurance is so specialised and different from any other kind of commercial or financial organisation; that is the reason why we take this view. It is completely unlike a trading company.

Mr. Redington: We are concerned with income and outgoings over 50 years ahead. To capitalise that into present value is rather comparable to asking an industrial company to show against the value of its factory the profit which they expect to make from that factory. It is not an exact parallel, but to our way of feeling the consequences of it are comparable with that.

Mr. Lawson: Thank you very much.

3153. *Mr. Althaus*: In effect, if you were asked to isolate and put a market value on the assets of an insurance company, you would be not only contravening all the principles of true actuarial practice, but you would be doing violence to your professional conscience. Is that an excessive statement?—*Mr. Gunlake*: It is putting it a little high.

Mr. Redington: The germ of that point is that we might be forced in certain circumstances to do a great deal of work—work which could only be approximate at the best—to correct that misapprehension.

3154. *Mr. Bingen*: I have only one question. We know that you are valuing the future assets to meet future liabilities, income versus outgoings. You then go on to say that it would be highly misleading and prejudicial if people who recover under the policies at some later date, or their executors under life policies, or pensioners, know what the market value of the assets is. If you showed an enormous surplus, there would be a demand for reversionary bonuses, higher pensions, and so on. Is it not possible to educate people in course of time so that they understand what you are trying to achieve as actuaries and, at the same time, to show the present value of the assets just as other companies do? You say that it would be misleading and harmful. Will that necessarily be the position as and when you educate people to understand

the nature of your black art?—*Mr. Gunlake*: I agree with you, frankly. As a consultant, I am engaged daily in explaining to my clients what I am doing. I am most eager to do that, and I take no pleasure in practising a black art.

3155. But that time has not come yet? —I do not think so.

Mr. Redington: It is more difficult perhaps than you appreciate. I know that some actuaries have had difficulty in the past in persuading their board of directors that because the market values were high, they were in fact in a worse position than they had been the year before. The rate of interest had dropped and the threat of the rate of interest was worrying them. It is not infrequent for an actuary to have difficulty with his own board of directors. Indeed, it is probably why you call it a black art, because in the past the actuary had to keep quiet about a lot of what went on. As an individual, I could not agree more that that is the right answer—publish the thing and explain it; but it is not so easy.

3156. In the company with which I am concerned, we had demands for higher pensions and some of our employees took the view that there was a tremendous actuarial surplus, as, indeed, there may well have been. We therefore arranged for an actuary to give an address to the workmen explaining the whole scheme. As a result of that, they understood it very much more. I am merely saying that if you try to disclose properly, there is no reason simply to cut out one item, which is the market value of your investments?

—*Mr. Gunlake*: I hope it will not be unfair comment to say that it is easier to explain these things to the trustees of a pension fund, and even to a meeting of some of the members, than it would be to explain them to the holders of 100 million policies. The area is enormously wide. I am thinking of industrial assurances as well as the ordinary branch assurances.

3157. The trustees in that case thought it appropriate to have the actuary explain matters to representatives of the workers. —I am delighted to think that he was successful.

Mr. Redington: You will appreciate that the actuary is under great pressure in

many companies to put up the bonus. The whole of his field organisation wants better competitive terms. The actuary has an unhappy life sometimes. The pressure can be severe. I do not want to overstate this, but it is real. I could quote some hair-raising cases, though perhaps not in this country in recent times, of pressure leading to insolvency and great distress.

3158. *Mr. Brown*: You used the phrase "the fact of market value". Our last witness commented on that phrase in respect of the short-term gilt-edged investments of the banks. Would it not be much more true for a life assurance fund to say that the market value represented by the middle price on the Stock Exchange is very far removed from anything like a realisable value of those assets?—Yes, certainly.

3159. *Sir George Erskine*: If you object to giving the market values of the whole of the portfolio, would there be any objection to showing, based on market values, the percentages of the fund invested in various categories—in, say, equities, Government stocks, and so on? —One would like to say "Yes" to that, but you would have to be careful if you had one set of figures given on book values and another set given on percentages on a different value. I can see all sorts of complexities. I think that the line we are suggesting—the income spread according to term—is the healthiest form of information.

3160. On the figures you show, it might happen that your book value of equities might be quite a small figure; but you would give a more realistic presentation if you showed on the basis of market value what the percentages were?—I can see the attractiveness of that thought but it is subject to the violent fluctuations of the market from time to time. I think there is a clash in trying to show book values in one place and market value percentages in another place.

Mr. Gunlake: Yes. This is quite a new thought to me.

Mr. Beard: I should have thought it equivalent in many cases to giving the market values. In other words, there would be sufficient information from the

two percentage splits to be able to reconstruct the market valuation. Although, on the face of it, it appears to conceal the information, it would probably enable a good analyst to produce the answer.

3161. *Mrs. Naylor*: When Mr. Redington was suggesting that income might be sub-divided according to term, did he intend that ordinary share income should be shown separately from income from redeemables?—*Mr. Redington*: We are not making any specific proposals. We would think in appropriate sub-divisions, of which equities would be one, and the redeemable securities would be sub-divided according to term.

3162. Do all life offices in the United Kingdom claim these exemptions?—*Yes*. There is one office that follows a different system from the rest of us. It is a small one. Generally speaking, however, the answer is "Yes".

3163. You think there is one exception?—*Yes*.

3164. Have you any experience of the position abroad—say, in Switzerland or America?—There is tight legislation in most of Europe. They have a fixed basis for doing everything. I would not like to speak in detail, but in America they publish market values. It would be unfair to say that it is partly as a consequence, but the fact is that the American companies invest hardly anything in equities. They are mostly in fixed interest and short term. I do not think that that is in the interests of the policyholders. It is a different structure. The British companies, under the freedom that they have, have done very well for their policyholders—I believe, better than any other country.

3165. *Mr. Bingen*: Is it true that American life offices invest in Government stocks in the United States rather than equities because of the yield? The equities yield has been very low in the United States in recent years?—They are prohibited by legislation. There are many reasons, including bad history in the early 1900s. They give high guaranteed surrender values and they have short-term fixed-interest securities. I think that the British pattern of life assurance is more profitable for the policyholder.

3166. *Mr. Brown*: Is there a corollary that if the practice in this country had been of annual publication of market values of assets, it is likely that investment policy would have been much more restricted?—I am quite sure it would.

3167. To the disadvantage of the country as well as of the policyholder?—*Yes*.

3168. They would have wished to restrict the violent fluctuations which occur in the market values of some securities?—*Yes*. They would perhaps have tended to invest in short fixed-interest securities instead of long, and in fixed interest instead of equities; they would also have invested in mortgages.

3169. *Mrs. Naylor*: That would be so if there was public criticism of the fluctuations, but that is something we do not know.—*Mr. Beard*: If the American pattern were followed, there would be. We are right at the core of this very problem. Mr. Redington has told us that the assets and the liabilities are both part of the same picture. The actuary, in determining his liabilities, has regard to the assets and the structure of the assets relative to the liabilities. If the law, as in America, were to lay down the principles, there would be little room for the actuary's judgment. He is concerned because he wants to see what the difference is between the assets, on the one side, and the liabilities, on the other side. That is the key figure used by the American journalists in looking at the companies, life or non-life. In the last 30 or 40 years, it is interesting to see how this surplus in well-known companies has decreased and, merely because market values have gone down temporarily, they have been forced to contract their business, even to the extent that some of them have been wound up or absorbed. In 1929 when the market was down, the authorities intervened and said "We will have conventional values for your assets, because we recognise that market values are a poor guide at this point of time." When market values go up, however, the companies can usually expand and take advantage of it. Nevertheless, it makes the situation very volatile and very difficult at times for the companies. The actuary must look at both

sides of the balance sheet. To publish differently based figures on each side can be completely misleading to the world at large.

3170. *Mr. Watson*: I imagine that one of the difficulties or embarrassments that might be thrown up, in deciding what bonus to offer to with-profit policyholders, would be the extent of the capital appreciation. Would I be right there, if it were disclosed? I am thinking of the policyholder of long standing, who might consider that he is responsible in some measure, along with his fellow long-term policyholders, for assisting the building-up of the company and that he might expect that his special position should receive recognition by some special bonus.—*Mr. Gunlake*: This is a problem which is another of our professional worries—the equitable distribution of the surplus, quite apart from its amount; who should get it and in what proportions. A great many offices in this country distribute what is called a compound bonus, which has the effect that the older policyholder gets a great deal more at each distribution than the younger one.

3171. So you think that that embarrassment is being overcome?—There are ways of overcoming it, I think.

3172. In other words, the knowledge that a large appreciation exists on the investment portfolio of a company leads that company to take measures in the distribution of its bonus to recognise the greater claims of the older policyholders?—*Mr. Redington*: There is a very healthy difference of opinion within the actuarial profession. We had a public meeting a year ago on this very important question. The pros and cons, the difficulties of departing from tradition, the possibilities of misrepresentation and the need to do something are being healthily discussed. I think that the actual publication of the figure for market values would not do any good to the situation. But the public knows that it exists; and the right discussions are going on in the right place.

3173. I was wondering whether there was any real objection to the publication of the asset value at the date of an

actuarial investigation, whether triennially, quinquennially or even annually. The purpose would be to disclose to the policyholders, and possibly to the shareholders, some degree of the expectation of the income of the company over the next period, arguing from the point of view that asset value is some indication of future income, which I think is common to everyone. If that situation were disclosed and if you could assume that public education, knowledge and sophistication had advanced sufficiently to realise why it was disclosed, would it not bring to light the relative attractions of one company compared with another?—*Mr. Gunlake*: In theory, it might. I am just asking myself the question how far I could interpret figures of that kind if I were faced with information about two companies and something was stated about the market appreciation of the equities. It still does not tell you what the bonus will be five years hence, because the actuary is concerned not only with the present valuation, not only with the next valuation, but with valuations for 50 years ahead. Even though you might be able to detect from the kind of information to which you are referring that Company A appeared to be in a stronger profit-earning position than Company B, it still would not follow that the bonus five years hence of Company A would be declared at a higher level than that of Company B.

Mr. Redington: The public would think they knew more than they did. To give one example, a margin of 10 per cent. for a company doing almost entirely non-profit business might be much better than 20 per cent. for a company doing pretty well all with-profit business. There are a lot of other things that must come into the judgment. One of our main points might have been that the danger of publishing market values is that the public would think they knew something that, in fact, they did not. To give another example, the proportion of long-term group pension business, the nature of the premium guarantees, the age of the company, whether it does a lot of annuity business or short-term life cover—all these are relevant facts and a given percentage for one company may be very different from a given percentage for another.

3174. *Mr. Watson*: I can see that that inevitably must be the case when you start publishing such information, if you ever start it, but when it had been going for about 15 or 20 years would an understanding not have developed?

3175. *Mrs. Naylor*: Can you not educate the financial journalists?—*Mr. Gunlake*: This would be most valuable information for practitioners of black arts, but not for anybody else.

Mr. Redington: I think the process of education is going on.

3176. *Mr. Hilary Scott*: Is it possible that the public education would be retarded by showing the market values of investments rather than advanced?—*Yes*, I think it would be.

3177. *Mr. Watson's* question suggested that people might get an idea of the future income which could be expected if they saw the market value of the underlying investments in the company's accounts. As I understand it, you do not think that that is a conclusion that people ought to be able to draw. Is that right?—*Absolutely*. To think that the excess of market over book values is distributable is severely dangerous.

3178. Your point would be, would it, that the publication of the market values is not a guide to what income might be expected and, therefore, as to what the policyholders might expect to receive by way of bonus in the future?—*Mr. Gunlake*: Yes.

3179. *Mr. Watson*: No doubt, you base that on the variation of the rate of interest more than anything else?—*Mr. Redington*: Yes. As regards changes of interest our case is very strong. It is a provable case. It is not an opinion. It is a fact.

3180. For my benefit, can you say how an actuary makes an actuarial investigation? He assesses all the liabilities of the company. Then, he looks round at the book value of the assets. If there is a difference, he says "That is the surplus". Is that right?—*I would not want to*

bore the Committee, but that is a deep question.

3181. But he does not take account of the present market value in declaring what is distributable in the form of bonus to policyholders or for the benefit of shareholders?—*Mr. Gunlake*: No.

3182. Thank you. I wanted to get that clear.—*Mr. Beard*: "Present" means the value on a specific date at a particular moment. To say he does not take account of it is not strictly accurate since market values depend to some extent on conditions to which the actuary would have regard. What we are concerned about is that drawing a picture at a specific point of time may have little significance. At 31st December, the market may be up; at 1st January, it may be down. The company's real position may be no different between the two dates, yet if you take the 31st December figures you get one answer and on the 1st January figures you get another. It has nothing to do with the stability of the company at those two moments.

3183. Does the same position exist in Canada? Is the market value of the assets of Canadian insurance companies disclosed?—*Mr. Redington*: Yes, but their pattern is very similar to the American one.

3184. Thanks again to legislation?—*Yes*. It is a bit more liberal. They can invest in equities, but it is still very restrictive.

Mr. Gunlake: I do not know whether it would throw any light on the question if I mention a little insurance company to which I am a consultant and which is established under a private Act of Parliament. It is for the benefit of one of the branches of the Civil Service. The provisions of the Act say that at the valuation date, the assets should be valued by the directors and the liabilities should be valued by the actuary and the difference shall be deemed to be surplus. On one occasion, I was asked by the directors what would be my attitude if I felt that the value that the directors placed on the assets was an improper one from my

point of view. I said that I should resign and, if I thought fit, I should do so in suitably public circumstances so that everyone should know what the cause of my action was. This may throw a little light on this problem.

Chairman: Well, gentlemen, those are all the questions we wanted to ask you. It only remains once more to thank you very much indeed for coming to help us. It has been most useful.—Thank you, Sir, for a very patient hearing.

(The witnesses withdrew)

APPENDIX XXV

Memorandum by the British Insurance Association

In response to the invitation contained in the letter dated 15th January, 1960, from the Committee, the British Insurance Association has pleasure in submitting the following memorandum.

The British Insurance Association is the association of the British insurance companies and of those British Commonwealth companies which operate in the United Kingdom.

The views put forward in this memorandum are those of insurance offices both as companies with business connections in all parts of the world and also as investors of policyholders' funds. It has been basic to our thinking that the objective should be an Act which would give the authorities adequate safeguarding powers in preference to one which would legislate against every conceivable abuse. Companies' experience in the twin fields of our complementary activities leads us to contend that if too many hard and fast rules are created they will produce a stultifying effect, in particular being harsh upon companies operating legitimately.

We feel that on the whole the existing Company Law has worked well, and that the general standard of commercial ethics in the world of finance and investment is high. But experience has shown that, on the investment side, in some respects there is need for additional safeguards for investors. Except where otherwise stated, our comments should not be construed as relating to private transactions (either in shares or debentures) where institutional investors, such as our own members, can be assumed to be able to make their own enquiries and to protect their own interests. The views expressed are intended to apply in the field of capital issues dealt in or to be dealt in on a public Stock Exchange.

Throughout this memorandum "the Act" means the Companies Act, 1948, and "the Stock Exchange" should be read as including the various stock exchanges operating in the United Kingdom.

Our comments are numbered to coincide with the numbering in the Committee's questionnaire.

1. Incorporation of Companies—Memoranda of Association

(b) Limitation of Objects, etc.

(1) In considering the possibility of a more effective participation by investors in the affairs of their companies, it has to be borne in mind that the current practice is for memoranda of association to contain wide objects clauses. There has also been a growth in the number of companies with diversified interests. We have come to the conclusion that it would be difficult to restrict the limits within which the directors were empowered to act and that it would not be to the advantage of shareholders generally if the authority of the directors were to be too severely restricted. At the same time the principles of the *ultra vires* rule should remain.

(2) Doubts have been expressed to us as to whether it is competent for a company's regulations to provide that the objects clause of its memorandum shall not be altered without the consent of a class or classes of the company's share capital. In our view legislation should make it clear that a company's articles may so provide.

(d) Shares of no par value

Evidence was submitted to the Gedge Committee on behalf of the insurance companies and we agree with the conclusions and recommendations made in the Majority Report both as to the advantages of shares of no par value and the safeguards required

if they are permitted by legislation. We recommend that the changes suggested by the Committee should be implemented although the demand for them has to some extent diminished since the Report was published.

4. Donations by Companies for Charitable and Political Purposes

We see no reason why companies should be prohibited by statute, either absolutely or with limitations, from making donations which the directors of the company feel to be appropriate in view of the nature of their company's business.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) *Fundamental changes in company's activities*

In our opinion it is desirable that directors should maintain closer contact with the debenture holders and shareholders of their companies than is sometimes the practice at present. It would appear to be the intention of section 157 of the Act that such holders should be entitled to know the main activities of the companies in which they have invested so that any material change or addition should be specifically notified to them by the directors and not merely by an incidental reference in the chairman's speech or elsewhere. We also consider that in the case of a fundamental change the shareholders should be consulted in advance.

(c) *Issue of shares*

We are of the opinion that shareholders should retain some control of the issue, by the board, of capital already authorised where such issues would materially affect the control of the company or radically change the nature of its business. We recognise, however, that it may be difficult to legislate on this subject, particularly as the creation of such authorised capital must be the subject of a resolution at a general meeting of the company.

(d) *Borrowing money and charging property*

(1) There have been cases where large borrowings have been effected by a company about to be acquired, or where assets already subject to charges have been purchased in the knowledge that such borrowings or charges could not be made after acquisition owing to the limit imposed by the group borrowing powers of the acquiring company. We submit that such items should be treated as borrowings by the acquiring company for the purpose of the group limit.

(2) The Courts do not regard the issue of a debenture for consideration other than cash as coming under the definition of borrowing. We submit that the effect of this kind of issue on existing securities is the same as that of borrowing and that the Act should provide that all issues of debentures should therefore be deemed to be borrowing.

(3) Moreover a similar situation appears to exist when a company purchases a mortgaged property and assumes liability for the mortgage. We submit that, in such circumstances, the amount of the mortgage ought legally to be a borrowing of the company.

(4) Whilst acceptance credits specifically related to transactions for the purchase or sale of goods are self-liquidating and have no serious effect upon the normal longer term borrowings of a company, there are other types of acceptance credit which are not related to such transactions and constitute purely financial operations, the effect of which is similar to borrowing. We submit that debts of the latter type should be deemed to be borrowing.

(5) We further submit that borrowings of a company and any of its subsidiaries should be deemed to include—

- (i) the paid-up amount of any issued share capital (with any premium thereon); and
- (ii) the principal amount of any moneys (with any premium thereon) borrowed by any person or corporation (other than a subsidiary)

where the company or the subsidiary has guaranteed the repayment of such paid-up capital or principal amount. There should be an exclusion in respect of cases where the giving of such guarantees constitutes part of the ordinary business of a company.

(6) We submit that, whatever the limit of the borrowing powers of the group, this should not be related to the nominal amount of the *authorised* capital of the company, which may greatly exceed the capital employed in the business.

(7) We have considered the desirability of the disclosure in companies' balance sheets of the limit of the directors' borrowing powers and submit that the best course would be to make it obligatory on the company's directors to certify that the borrowings did not (or did) exceed the appropriate limit at the date of the balance sheet.

Note: We recommend that the submissions in each of the preceding seven sub-paragraphs should be given statutory force.

(8) We feel that it is desirable that the limit imposed on the borrowings of parent companies should apply to the total borrowings of the company and of its subsidiaries (excluding inter-company borrowings). There are, however, cases where it may be impracticable to place any limit on the borrowing powers of subsidiaries, e.g., those overseas, and we therefore suggest that it should not be a statutory requirement.

6. Directors' Duties

- (a) *Definition of duties*
- (b) *Fiduciary position and legal duties*
- (c) *Disclosure of interests*
- (d) *Bodies corporate as directors*
- (e) *Directors and officers dealing in their own companies' shares*

No comment, except where views are expressed elsewhere in this memorandum.

We recommend that, in cases where a subsidiary is substantially (say more than 75 per cent.) controlled by its parent company, there should be some relief from the existing provisions of the Act and that possibly some parts of sections 195 and 198 need not apply, in relation to dealings in the shares of the parent company, to directors of such a subsidiary, if they are also officers of the parent company.

7. Shares with Restricted or No Voting Rights

(1) Where the words "non-voting shares" are used in this part of the evidence, they should be construed as including equity shares with restricted voting rights.

(2) It is our view that the right of ordinary shareholders to vote is a fundamental principle and that non-voting ordinary shares can only be justified by exceptional circumstances. All those who share in the risk or equity capital of a company should have a proportionate voice in the conduct of its affairs. Furthermore, the existence of non-voting shares tends to lead to difficulties when alterations to the capital structure of companies are contemplated; for example, on the capitalisation of reserves. Nevertheless we feel that statutory enfranchisement of existing non-voting shares would lead to difficulties and we doubt the wisdom of legislation to this effect.

(3) In fact the whole question of legislation in relation to non-voting shares is a difficult one. If in the view of the Committee legislation is desirable we feel that it should follow the lines indicated in the next four sub-paragraphs.

(4) Companies should be prohibited from creating or issuing non-voting shares unless, at an appropriate date, they already have such shares in issue. A company

having such shares in issue at the appropriate date should be prohibited from issuing further non-voting shares except by way of free bonus shares to be allotted to existing holders of non-voting shares. There should be an exception for cases where the national interest is involved and for such it should be necessary to obtain a licence from the Board of Trade before the non-voting issue is created.

(5) Any scheme for the enfranchisement or further enfranchisement of a class of equity capital having no voting or restricted voting rights should have to be submitted to class meetings of both or all classes of equity capital.

(6) We consider that some degree of statutory protection should be given to the holders of existing non-voting shares. We recommend that this be done by enacting that, in companies where there are voting and non-voting equity shares, all equity shareholders must receive notices of all company meetings or meetings of equity holders (as recommended below in paragraph 26 as regards the holders of debentures and preference shares) and that the holders of the non-voting shares should be entitled to attend and speak at the meetings. Where appropriate, non-voting shareholders would then be able to seek the protection of an extended section 210 if the proposal in paragraph 8 below were accepted.

(7) A number of companies have taken power under their Articles of Association to disfranchise shares which are held by foreigners. We consider that this is not a matter which should be readily undertaken, and that in future any company which wishes to disfranchise foreigners should obtain not only such consents as are necessary under its Articles of Association, but also the consent of the Board of Trade.

8. The Protection of Minorities

(1) Section 210 of the Act is designed for the protection of aggrieved minority shareholders. We consider that its application should be made wider *inter alia* by the deletion of paragraph (b) from sub-section (2) so that the Court's aid could be sought by an oppressed minority although the case was not one necessarily involving any question of winding-up. A particular application of the section, if it should be amended as recommended above, is mentioned in paragraph 7 (6).

(2) We consider that holders of a class of capital of a subsidiary company should have a remedy if a resolution which they feel is not in their interests is carried at a class meeting by the power of the votes of the shares held by the parent company. We submit that this remedy should be afforded by the amendments proposed in sub-paragraph (1) above.

(3) The proposed amendment would involve consequential alterations, in particular a variation of the marginal heading of section 210 of the Act.

9. Protection of Special Classes of Shares

(1) Section 72 of the Act goes some way, though in our view not far enough, towards giving protection to classes of shareholders but it only operates if there is power in a company's Memorandum or Articles of Association for the authorisation, by the consent of a specified proportion of the holders of the issued shares of a class, of the variation of the rights of that class.

We recommend that the section should be amended so as to provide that, irrespective of any provision in the Memorandum or Articles, the rights attaching to a class of shares may *only* be modified, varied, extended or abrogated either by the Court or by an extraordinary resolution passed at meetings of the shareholders of the class or classes affected and confirmed by a special resolution of the company in general meeting.

(2) We recommend that the last sentence of Clause 4 of Table A be given the force of law so that the quorum at a class meeting must be at least one-third of the issued shares

of the class, represented personally or by proxy. It should also be provided that, in the event that no quorum be present, the meeting stand adjourned, as provided in Clause 54 of Table A in respect of general meetings, when the shareholders then present should constitute a quorum.

(3) We further suggest that the body of shareholders who should be entitled to apply to the Court should be the holders of 10 per cent. (instead of 15 per cent.) of the issued shares of the class, being persons who did not consent to or vote in favour of the resolution for the variation. The lower percentage would more readily permit applications by a body of shareholders who were aggrieved, whilst still being adequate to frustrate frivolous applications to the Court.

(4) The suggestion contained in sub-paragraph (1) would remove any doubts as to the interpretation of the word "may" in the third line of Clause 4 of Table A which requires revision.

(5) In our opinion there can be no doubt that the issue of further preference shares ranking *pari passu* with an existing class is a matter which vitally affects the interests of those shareholders, as their position in their company may be weakened thereby in times of adversity. We therefore submit that it should be enacted that the creation of further shares ranking *pari passu* with a class issued with preferred or other special rights shall be deemed to be a variation of the rights of that class unless otherwise expressly provided by the terms of the original issue or by the articles of the company.

(6) The treatment of preference shareholders is specifically referred to in the questionnaire under the heading "Getting rid of preference shares by winding-up or return of capital".

The problem is one of some difficulty. On the one hand if a company has excess assets which it cannot use it is reasonable that some capital should be returned. In such an event it is natural and proper for a return of preference capital to be made in priority to ordinary capital unless the preference shareholders agree otherwise.

The second aspect of the problem arises from the fact that preference shareholders are corporators in their company along with the ordinary shareholders, and therefore we submit ought not to be turned out without their consent when it suits the convenience of the ordinary shareholders. At a time of low interest rates it would be most disadvantageous to the holder of a high coupon preference share to be repaid at par (for he could not reinvest his money in a similar security on like terms) and this is what the Committee appears to have in mind in posing the question.

The ideal remedy would normally be that a proposal for a return of capital should be submitted to a class meeting of preference shareholders for the approval of the terms.

The Investment Protection Committee of this Association has for many years pressed for the acceptance of this principle for new issues of preference shares and also on those occasions when some reconstruction of a company's existing capital has involved conditions where such a principle could properly be introduced. In practice there has been a wide measure of acceptance of these principles as being reasonable.

With regard to winding-up, the protection of preference shareholders against being "got rid of" would have to be achieved by other methods (for example by introducing an "average market price" clause) if it is not possible to have a preference class meeting on a proposal to wind up the company.

In both these matters it is difficult to propose new universal legislation since it would affect relationships between existing issues of preference and ordinary shares. When these problems arise we would prefer to rely upon the acceptance of the principle that both classes of shareholder are corporators. In relation to new issues of preference shares, however, we would welcome legislation to protect what we consider to be the just rights of the holders of such shares.

10. Board of Trade Powers to Appoint Inspectors

The appointment of an Inspector to investigate the affairs of a company under sections 164 and 165 of the Act is largely at the discretion of the Board of Trade, and we feel that much valuable time may be lost while the Board are considering whether there are grounds for the appointment of an Inspector. It is therefore submitted that:—

(1) Section 164 should be made mandatory if application is made by not less than 200 members (whether preference or ordinary shareholders) or by members holding not less than one-quarter of the shares in issue or by one-quarter in number of the persons on the register; but it should be open to the Board to decline to make an appointment if they are of the opinion that the application is vexatious. The Board should, however, exercise discretion, as at present, if application is made by holders of less than one-quarter but not less than one-tenth of the total number of shares in issue.

(2) Section 165 (b) (i) and (ii) should be made mandatory as well as section 165 (a).

11. Disclosure of Ownership and Control

(a) *Nominee Shareholders and Debenture-Holders*

We are of the opinion that the machinery provided by nominee shareholdings serves a useful and, in the majority of cases, a desirable purpose. On the other hand we feel that its use must be controlled to prevent the abuses which sometimes arise from undisclosed ownership. A shareholder, prospective or actual, should have a proper opportunity of ascertaining who are the substantial shareholders in his company and the directors should have similar information at their disposal.

We therefore recommend that there should be better provision, if practicable, to ensure the disclosure of the real ownership of such substantial shareholdings.

We offer no comment upon the subject of the debenture holders, as they are unlikely to be involved in any question of the control of the company.

12. Share Transfer and Registration Procedure

It is our opinion that, in view of the increasing public interest in shareholdings and in the number of dealings taking place, it is essential to secure some simplifications in the existing transfer procedure, but at the same time we feel that they must be initiated by the Stock Exchange.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

We attach great importance to the protection of the interests of the many companies trading overseas afforded by the opportunities of carrying on business through associated and subsidiary companies without the obligations of full disclosure. If, therefore, any suggestion arises for the amendment of section 150 of the Act, and the existing terms of the Eighth Schedule, and if such alterations might seem to lead to a position where full disclosure of the names of such overseas subsidiary and associated companies and the full consolidation of their trading into group accounts is required (without the continuance of the existing reliefs available), we would wish to register objections and to contest the matter. It is our opinion that the interests of many types of company engaged in overseas trading would be hampered and, possibly, jeopardised by such widespread detailed disclosure.

15. Loan Capital

(a) *Debentures and Debenture Stock*

(1) We feel that it would be advantageous from the point of view of potential lenders and borrowers if a floating charge could be obtained in Scotland and it is recommended that, if possible, legislation should be introduced to permit it. (See also paragraph 28.)

(2) In view of the number of issues of loan capital which are constituted by an "Instrument" (e.g. unsecured loan stocks) we suggest that section 87 (3) of the Act should be amended to include not only trust deeds but any other instruments constituting stocks.

(3) We suggest for consideration that several of the safeguards for shareholders' voting rights which are contained in the Act should be made available to debenture holders.

We suggest that the Act should import into all regulations concerning meetings of holders of loan capital provisions to the following effect:—

- (i) At least 21 days' notice should be required for any meeting.
- (ii) Holders should have an unrestricted right to appoint a proxy who should have the power to demand, or join in demanding, a poll.
- (iii) The latest time for lodging proxies should not be more than 48 hours before the commencement of a meeting.
- (iv) Holders of loan capital should have power to requisition meetings.
- (v) There should be definitions of the majorities required for the passing of extraordinary resolutions.

(4) We also suggest that debenture holders should be given statutory rights governing the demanding of polls at meetings. Five stockholders or the holder(s) of one-tenth of the voting rights should be able to demand a poll and it should be mandatory upon a proxy holder to demand a poll if he holds proxies, representing at least 10 per cent. of the voting power, which are against the result of a show of hands.

(5) We consider that legislative provision should be made requiring the disclosure in a prospectus of all information material to the terms of issue of debenture and loan stocks upon which an investor is invited to subscribe.

(6) We submit that every prospectus in respect of a debenture issue should include the following information (in addition to the matters referred to in paragraph 17 below as regards prospectuses generally):—

- (i) The interest and redemption provisions of the stock, indicating the minimum percentage of stock which the sinking fund is calculated to redeem by the final date, and including a clear statement as to whether or not the borrowing company is retaining its common law right to purchase stock beyond its sinking fund requirements (and if so in what manner and up to what price), and whether stock so purchased is to be treated as alive for the purpose of drawings. It should also be made clear whether the company is retaining its right to reissue stock and if so, in what circumstances. There should also be a statement of the premium (if any) at which stock becomes repayable in the event of (a) voluntary liquidation or (b) the security otherwise becoming enforceable.
- (ii) What limitations, if any, are imposed by the trust deed on the borrowing powers of the company by a formula or otherwise, and on the powers of all or any of its subsidiaries to raise money outside the group either by the issue of shares or by borrowing and whether, and if so what, overall restrictions are imposed on the borrowing powers of the group. It should be stated whether or not the word "borrowing" includes such matters as issues of debentures otherwise than for cash, pre-acquisition borrowing of subsidiaries, mortgages existing on properties acquired, guarantees, acceptance credits, or borrowings from banks in the ordinary course of business, etc. (see paragraph 5 (d) above).
- (iii) A precise statement of the security offered, and of its effective scope, e.g. a floating charge in relation to assets abroad. In the case of a floating charge it should be stated whether, and if so what, prior or *pari passu* charges are permitted in relation to existing or after-acquired assets.

- (iv) What powers a company giving a floating charge has of disposing of its undertaking, property or assets with or without the consent of the trustee either to a subsidiary company or outside the group. Particular consideration should be given to the question as to whether or not a company can under the trust deed cease to carry out its main business or some substantial part of its business with or without the consent of the trustee.
- (v) A precise statement of any important discretionary powers accepted by the trustee under the trust deed including any right to waive or condone a breach of trust.

(b) Trust deeds—Duties of Trustees and Receivers

(1) The duties of a debenture trustee cannot be precisely defined and it is difficult to see how they can be laid down by legislation. But we consider that there should be a proper recognition of what his functions are considered to be, and the more important of these may be summarised as follows:—

- (i) To ensure that the prospectus or particulars of issue contains all material terms of issue including those mentioned above.
- (ii) To ensure that the trust deed gives effect correctly to the terms of the prospectus.
- (iii) To ensure that the trust deed is registered and that all necessary steps have been taken to constitute the security.
- (iv) To ensure that the proceeds of issue are applied as stated in the prospectus in cases where this has a direct effect on the status of the security under offer, e.g. repayment of a prior charge.
- (v) To ensure by obtaining appropriate information from the company's directors or auditors that the company carries out all its important covenants whether they are expressed positively, e.g. to apply a sinking fund or to insure and maintain its properties, or are expressed negatively, e.g. restrictions on borrowing and powers to charge assets.
- (vi) To take all necessary steps to see that a breach, which the trustee is not prepared to waive, is remedied, and if not remedied, then to discuss the matter generally with stockholders with a view to taking other more formal action, including in the extreme case the enforcement of the security and the appointment of a receiver.
- (vii) To accept discretionary powers in so far as necessary to give the borrowing company reasonable flexibility in carrying on its business. Such discretionary powers should always be expressed positively and should never be implied, and in appropriate cases guidance should be given as to the circumstances and manner in which the discretion may be exercised.
- (viii) In appropriate cases to give some lead to stockholders in the event of the company submitting a scheme or other proposals to them for their sanction by extraordinary resolution.

(2) There may be cases where, by reason of the private nature of the interests or the limited number of participants, it is properly not felt necessary for a particular issue of debenture or loan stock to have a trustee but, if a practicable formula could be found, we feel that it would be desirable to make such an appointment a legal necessity where the stock is held by more than a stated number of persons.

(3) The Cohen Committee, in paragraphs 62 and 63, reported on these matters and we endorse those views to this present Committee although comprehending the difficulties inherent in regularising these requirements by statute. Nevertheless, we feel that in any event a Stock Exchange regulation might be introduced requiring the appointment of an independent trustee, preferably a corporate trustee, for any quoted debenture or loan stock.

(4) Any provision requiring the disclosure of specific information in particulars of issue would assist the trustee in his duties, and it is suggested that in a case where a trust

deed has failed in some respect to put into effect the terms of issue as set out in a prospectus, some legal procedure should be made available to the company and/or the trustee to apply to the Court for rectification of the deed. Some such procedure might also be helpful to the trustee in obtaining clarification of the construction of a clause in a trust deed and possibly in respect of other matters.

16. Take-over Bids

(1) Although take-over bids have received a great deal of publicity in recent years it is, in our view, true to say that in the great majority of cases such acquisitions have been to the advantage of economic development.

The Association was one of the bodies which associated themselves with the publication, in October 1959, of "Notes on the Amalgamation of British Businesses" and would like now to endorse the contents of those notes in particular the principles on page 4 *et seq.*

(2) We submit that the number of cases where abuses have occurred is very small and we feel that it would be a mistake to introduce legislation which would have the effect of unduly restricting what is a perfectly normal process in a commercial community.

We submit, however, the following observations with regard to public, as distinct from private offers. The same general principles should apply whether the offeror is a corporation or an individual, and whether the consideration is cash or an exchange of shares.

(a) Procedure

(1) As a general rule it is desirable that the offer be made through the board of directors of the company, but it is not considered that there should be legislation to this effect. Where a bid is not made through the directors, it should be obligatory on the bidder to furnish the directors with particulars of the offer not later than the time at which it is posted to the shareholders.

(2) When an offer is made shareholders should be given adequate time for acceptance, but there should also be a maximum time during which the offer is to remain open and this maximum time should not be too long. It is suggested that this time should be laid down, possibly by regulation under the Prevention of Frauds (Investment) Act, as not less than three weeks nor more than, say, four or five weeks; further, that the bidder should be bound to declare whether or not the offer has become unconditional within seven days of the expiry of the time specified for acceptance in the terms of the offer. Whilst it is desirable that, when an offer has been declared unconditional, there should be a further period of, say, 14 days in which further acceptances will be received, it is thought that there should be no legislation to this effect because any such provision would, in our opinion, lead to practical difficulties.

(3) In the case of a partial offer (that is an offer for less than 100 per cent. of the securities of any class not already held by the bidder) this should be on a *pro rata* basis. The same time limits should apply, and where acceptances exceed the amount required, each acceptance should be proportionately reduced. We recommend that legislation be introduced to this effect.

(b) Securing disclosure of information on which shareholders can form an opinion

It is regarded as important that shareholders should be given all the requisite information upon which they can decide whether or not to accept a bid. We recommend that it should be obligatory:—

- (i) For the bidder to disclose (to the board if the offer is made through them and to the shareholders if it is not) the resources which are available to him for the purposes of his bid, and similarly to make a statement of his general intention as to the future conduct of the company.

- (ii) For the directors to give full information to the shareholders, to report on the availability of the bidder's resources if the offer is made through them, to express their opinion as to the merits of any offer made to shareholders, and to inform shareholders whenever a formal offer has been received, even if they have rejected it.

(c) *Functions of directors*

Our views on this point have been dealt with above.

(d) *Disclosure of identity of bidder*

We submit that it should be a statutory duty of a bidder to disclose his identity and that for this purpose he should not be entitled to rely on nominees' names. A shareholder may have to decide whether he will accept a cash offer or elect to remain as a possible minority holder. He is therefore entitled to know who the bidder is, so as to be able to form an opinion of the kind of treatment he is likely to receive as a minority holder.

(e) *The financing of such transactions*

Our views on this matter have been dealt with above.

(f) *Disclosure of directors' interests*

In our opinion present legislation provides adequately for the disclosures required in the case of directors who are not going to remain in office. There seems, however, to be no obligation upon directors who will remain in office to disclose any special inducements to recommend acceptance of a bid. It is suggested that it should be obligatory for them to disclose any such inducements.

(g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority*

(1) We suggest that where more than one class is bid for, the 10 per cent. which can be compulsorily acquired should be calculated by reference to individual classes and not overall as is understood to be the provision at present.

(2) It has recently become a fairly common practice for 100 per cent. acquisition to be achieved by extraordinary resolution. Where, for example, a company wishes to acquire the "outside" holdings of preference or other shares of one of its subsidiary companies, a scheme is submitted to such shareholders as a class, to agree to the sale or cancellation of their shares and the acceptance as compensation of shares of the parent company. Thus, approval is needed, not by 90 per cent. of the shares in respect of which the offer is made, but by 75 per cent. of those voting at the meeting.

In the opinion of the Association the offering company should be prohibited from voting in respect of the shares which it already holds or controls and for this purpose the quorum and the requisite majorities at the class meeting should be based on the remainder of the class, excluding the securities held or controlled by the bidder.

17. *Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders*

(1) We consider that the following information should be required by law to be shown in a prospectus:—

- (i) The borrowing powers (to which reference is made in paragraph 5 (d) above) of the issuing company and where there is not a group borrowing limit, the aggregate borrowing powers of its subsidiaries. If there is a group limit, but the borrowings of certain subsidiaries (e.g. overseas subsidiaries) are excluded therefrom, then the aggregate of their borrowing limits should be shown.
- (ii) The powers of a company or its subsidiaries to give guarantees of capital or borrowings in respect of other companies and (unless recommendation 5 (d) (5)

above is accepted and enacted) a statement of any such existing guarantees. There should be an exclusion in respect of cases where the giving of such guarantees constitutes part of the ordinary business of a company.

(iii) The control, if any, by preference shareholders or debenture-holders of the borrowing powers.

(iv) Changes in published reserves since the last annual report.

(2) The period of five years, over which financial information is required under paragraph 19 of the Fourth Schedule in a prospectus offering shares or debentures for subscription or for purchase by persons other than existing holders, should be extended where possible to ten years and, in addition, the following further information should be provided in the form in which it would be required under the Eighth Schedule of the Act (any necessary adjustments being made in order to show a true and comparable position year by year):—

(i) Amounts set aside for depreciation

(ii) Transfers to and from published reserves

(iii) The amount and basis of the charge for United Kingdom and other taxation

(iv) Net assets of the company.

If in any case the company has not been a public company subject to the Act throughout the ten year period, the above information should be stated on the basis which would have applied if the company had been subject to the Act during that period.

(3) We feel that the protection given by section 43 of the Act to persons who subscribe for shares in or debentures of a company should be extended to a subsequent holder, and any legal remedy open to an original subscriber should also be open to any subsequent holder.

20. Reduction of Capital and Purchase by a Company of its own Shares

Our views upon reduction of capital, as relating to preference shares, are set out above in paragraph 9 (6).

Under section 27 (3) of the Act a subsidiary which was a member of its holding company at the commencement of the Act did not need to divest itself of such shareholdings but was not permitted to exercise its voting powers. However in the case of mergers subsequent to 1948 we consider that there is doubt as to the appropriate course of action required of a company becoming a subsidiary of another in which it already has a shareholding. We accordingly recommend that section 27 of the Act requires reconsideration, and as a general principle we would be in favour of the sale of the shares.

21. Accounts

Taking the question in broad terms, we are of the opinion that, apart from the recommendations which we submit hereafter, companies generally already disclose sufficient information in their accounts (including where the company is a parent company, information regarding its subsidiaries) to enable members and other interested parties to obtain a fair and proper view of the financial position.

The accounting provisions in the Eighth Schedule to the Act have proved generally satisfactory, but we recommend the following additions:—

(1) Companies to which paragraph 8 (1) (a) of the Eighth Schedule applies should be required to show as separate items in their profit and loss accounts, dividends and interest received from (i) the company's trade investments, (ii) quoted investments other than trade investments and (iii) unquoted investments other than trade investments.

(2) Companies should be required to show, by way of note or otherwise:—

(a) the basis upon which the profits of particular activities are brought into account, when the period in which such profits were earned is longer than the accounting period

- (b) an estimated fair value of investments, showing separately the market value of quoted investments, the directors' valuation of unquoted investments, and their valuation of trade investments (not being subsidiaries), if the company is one to which paragraph 11 (8) of the Eighth Schedule of the Act applies.

(3) We welcome the present tendency for an increasing number of companies to issue estimated profit statements more frequently than once a year, but recognise that in certain industries, including the insurance industry, many companies would find this impracticable. In our view there would be serious difficulties in attempting to provide by legislation for the issuing of such profit statements and the matter could probably be best dealt with by the Stock Exchange.

(4) Section 148 of the Act provides that balance sheets laid before the company in general meeting shall be made up to a date not earlier than the date of the meeting by more than nine months, or, in the case of a company having overseas interests, by more than twelve months. We recommend that these periods should be reduced to six months and nine months respectively.

With regard to the Committee's specific enquiry as to whether all the existing accounting provisions are necessary and useful in present day conditions, our view is that in general terms they are still necessary and useful. On this point the exemptions from and provisos to certain requirements of the Act, subject to the safeguards laid down, are in our experience also of considerable value and should be maintained and continued. Two examples are particularly worthy of mention:—

- (i) In relation to subsidiary companies and the obligation to prepare group accounts of the company and its subsidiaries, sections 149, 150, 151 and 152 not only state what must be done but set out numerous and valuable options as to the manner in which group accounts may be prepared, the occasions when some of the requirements need not be followed and the right to omit some of the details in certain circumstances. These sections are drafted on liberal lines and the right to proceed by one method or another has proved most valuable to groups of companies. At the same time, by reason of the safeguards laid down, the protection afforded to the shareholders and to the public is not impaired.
- (ii) The exemptions granted to banks, assurance companies and others from some of the accounting provisions of the Act are of great importance and were granted in the national interest in order to protect the standing, credit and stability of the companies. They are mentioned in more detail under paragraph (f) below.

With regard to associated companies, which we interpret as meaning companies in which the parent company of the group holds a substantial interest and with which it works in close liaison and contact but where such interest is insufficient to make the company a subsidiary, we feel that it would be extremely unwise to require by law compulsory disclosure of the association existing between them, whether or not accompanied by additional information and a note of the extent of the shareholding. Our reasons for holding this view are that information in this connection might lead to a number of anomalous situations or misleading conclusions. Furthermore the disclosure might be detrimental to the interests of a group from a competitive or profit earning angle particularly if it traded overseas as do many insurance companies. Even the compulsory disclosure of the names of associated companies could be damaging and could lead to substantial loss of business.

The above are general notes. The following paragraphs relate specifically to points on which evidence is invited.

(b) Share premium account

Section 56 provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on these shares shall be transferred to an account to be called "the Share Premium Account", and the provisions of the Act relating to the share capital of a company shall,

with certain qualifications, apply as if the share premium account were paid-up share capital of the company. Until recently, it had generally been accepted that this provision required a company, when it issued shares to the shareholders of another company which it was acquiring, to give a value to those shares in excess of their nominal value and to credit such excess to a share premium account. It was thought that this followed from the decision in *Henry Head Limited v. Ropner Holdings Limited* (1952 Ch. 124).

This view has now been challenged. There is opinion in favour of the contention that in some cases no share premium need be created, and the shares acquired may be given a book value equal to the nominal value of the shares issued in exchange, plus any monetary consideration paid as a supplement to the shares issued, and such a procedure has been followed by several companies in recent mergers.

We therefore consider that the Act should be clarified to establish whether or not it is necessary to create a share premium account in such cases. We support the contention expressed in the previous paragraph.

We further recommend that share premium accounts, however created, should be available for the purpose of writing off all expenditure concerned with capital matters, including formation, reconstruction and the stamp duty payable on an increase in the authorised share capital, whether or not the whole of such increased capital is subsequently issued. Moreover, we are of the opinion that, if a share premium account needs to be created on shares issued to the shareholders on the purchase of a subsidiary, it should be available for the purpose of writing down the book value of the shares so purchased. This would enable any goodwill item, which might otherwise arise in the consolidated balance sheet, to be reduced or eliminated.

(c) *Use of pre-acquisition profits of subsidiaries*

When an acquired company is purchased with capital assets, e.g. cash, it is logical that its reserves should not be available for distribution as dividends to the parent company's shareholders. If the same principle is applied when an acquisition is made by the issue of shares, however, the result can be unreasonable in some cases. Where, for example, a merger is effected through an exchange of shares it would be irrational if reserves which were free before the merger were not subsequently available for distribution to the shareholders of either a newly formed holding company or the acquiring company except to the extent to which the share capital issued by the acquiring company exceeded the share capital of the company (or companies) acquired.

The Act gives no clear direction as to the use which may or should be made of pre-acquisition profits and present opinions are conflicting. We feel that the position should be clarified.

(d) *Description of Reserves*

In our opinion directors and managers of companies, professional accountants and other persons in legal and financial circles have now become fully accustomed to the description of reserves in the Eighth Schedule to the Act and the nature of the items which would be included under each heading and no amendment need be recommended.

(e) *Definition of Profits*

On this point we are fully in accord with the views expressed in the Report of the Cohen Committee to the effect that the trend of profits is the best indication of the prosperity or otherwise of a company and that it is preferable that the law should demand certain minimum requirements as to the contents of a profit and loss account or the manner in which the figure for profit is arrived at, provided that it shows overall and by its result a true and fair view of the profit or loss for the financial year and that these minimum requirements should be reviewed from time to time. Requirements on these lines are already laid down in section 149 of the Act and the auditors must, under the Ninth Schedule, certify that the profit and loss account gives that information.

A definition of profits which would be suitable for all cases would be extremely difficult to devise and might create more problems than it would solve.

(f) *Exemption of banks, assurance, and shipping companies from some of the accounting provisions of the Companies Act, 1948*

It is our firm opinion that the necessity for the exemptions granted to banking, discount and assurance companies was adequately set out in the Cohen Report on Company Law Amendment and although that Report was published in 1945 the reasons advanced are as valid today as at that time. The appropriate extracts from the Report are set out below:—

“PARA. 101. UNDISCLOSED RESERVES—

... It is also important in our opinion to ensure that there should be adequate disclosure and publication of the results of companies so as to create confidence in the financial management of industry and to dissipate any suggestion that hidden profits are being accumulated by industrial concerns to the detriment of consumers and those who work for industry. We have framed recommendations with which we think most companies should comply (pages 59–60). There are, however, three classes of companies where other considerations must be taken into account, namely banking companies, discount companies and assurance companies (we use the term “assurance companies” to cover both assurance and insurance companies). In the case of banking and assurance companies the interests of the depositors and the policy-holders respectively outweigh the interests of the shareholders and in the case of all three classes of companies considerations affecting the public interest must be taken into account. The reputation for stability of these companies is a national asset of the first importance to the community in general and it is not in the public interest to endanger their stability or the confidence they enjoy at home and abroad. From time to time the values of their assets and particularly their very large holdings of Government and other gilt-edged securities are adversely affected by political disturbances and economic conditions, national and international. In such circumstances it is desirable that their financial strength should be even greater than may appear. The history of the years after 1929 demonstrates the public advantage of their being able to present a reasonably stable position in a time of violent and sudden stress and for this reason it seems to us desirable that such companies should be permitted to retain a buffer of undisclosed reserves. In this country no one questions the stability of our banks, discount companies and assurance companies, but some countries are not so happily placed and countries abroad watch the evidence of stability very closely and react very quickly to any unusual symptoms. We consider, therefore, that banking and discount companies should be absolved from the obligation of showing separately reserves and provisions and transfers to and from such accounts, but that their balance sheets should indicate the existence of reserves and provisions and their profit and loss accounts should be appropriately worded so as to show whether any such transfers have been made during the period covered by the accounts. . . .”

“PARA. 102. ASSURANCE COMPANIES—

Parliament has enacted special legislation dealing with the affairs of assurance companies transacting most classes of assurance business and the Assurance Companies Act, 1909, prescribes forms of annual accounts to be deposited with the Board of Trade by such companies. Under section 110 of the Companies Act they may deliver these accounts for registration to the Registrar of Companies instead of accounts drawn up in accordance with the Companies Act: shareholders and policy-holders are entitled to obtain copies of the prescribed accounts and the annual accounts issued to the shareholders are often based on the accounts so prescribed. We do not consider it desirable to impose under the Companies Act any requirements for disclosure of reserves and provisions or transfers to and from such accounts beyond those contained in the prescribed forms. We suggest, however, that the Board of Trade should be empowered to alter the prescribed forms of the annual accounts so as to incorporate therein the requirements of the Companies Act including the amendments we suggest other than those relating to reserves and provisions (page 63, IV (1)).”

As a result, the Cohen Committee recommended that a number of the proposed accounting requirements, particularly with regard to the disclosure of reserves and provisions and to the transfers to and from such accounts, should not apply to banks, assurance companies, etc. It was made clear that the recommendation was based on the premise that the reputation for stability of these companies is a national asset of the first importance to the community in general and that it is not in the public interest to endanger the confidence they enjoy at home and abroad. Later, in the House of Lords (*Hansard* 25.3.47. Vol. 146/50/779), Viscount Swinton confirmed that there was "no question of giving a benefit to the company as a company, or to the company's shareholders as individual investors. That was never in the mind of any of us. There can be only one consideration, and that is what is in the national interest".

In the evidence before the Cohen Committee the point was made from two or three quarters that inner reserves were in the national interest. In particular the Committee of London Clearing Bankers in their Memorandum submitted that they were against the view that there should be statutory rigidity with regard to Balance Sheet valuations and to the methods of disclosing profits and losses, which rigidity might well do more harm than good whilst still leaving room for intentional misrepresentation.

This is equally true of insurance companies. The very nature of their business demands that their published accounts should show a position which creates and maintains confidence in their ability to meet their contracts—not only at home but also overseas, and not at a particular date but also taking a long-term view. Insurance contracts are based on good faith and the stability of the companies themselves as supported by the annual published accounts must continually demonstrate an assurance of reliability and trustworthiness.

It is therefore important that temporary financial disturbances or fluctuations in market values of their investments must not appear to disturb their financial strength more than need be. It must be apparent from their accounts that such factors have been withstood without affecting their stability and this is achieved by the companies having substantial undisclosed reserves, the published reserves being looked upon as minimum reserves and being maintained at a reasonably stable or increasing level.

Apart from the above considerations there are difficulties in practice. It would be impracticable for insurance companies and their auditors to draw a clear distinction between "reserves" and "provisions" if it ever became necessary to apply without some alleviation the definitions in the Companies Act, 1948. A typical illustration is in regard to marine business, where claims remain outstanding for many years after the policies have been written without any close indication of the amounts likely to be eventually involved. Consequently, it is impossible to estimate with any degree of accuracy the liabilities at the closing of each year's published accounts and to differentiate between the "reserve" and "provision" elements in marine funds.

Furthermore, the disclosure by insurance companies of the market values of investments, which could be liable to wide fluctuations, could be misleading. The aggregate market value at any particular date is of no special significance. The "liabilities" side of an insurance company's balance sheet, particularly if it is a life office, must look far into the future (and can never be other than an estimate), whereas a statement of assets at market value is a transient picture at a particular point of time.

The Insurance Companies Act, 1958, section 5, makes it quite clear that assessing the financial position of a life office and determining its surplus is the responsibility of an actuary. Thus, in practice, reliance must largely and inevitably be placed on the Actuary's Valuation Report, on the certificate which he appends to the accounts and on his knowledge of the nature of the assets. To present a fair and reasonable statement as to the financial position of a life office the valuation of both liabilities and assets must be considered in conjunction. To be obliged to supply some alternative and unrelated assessment of either the liabilities or the assets would confuse rather than clarify a proper interpretation of the position and might well lead to erroneous impressions being gained.

To insurance companies, particularly those engaged in life assurance, the importance of investments lies in their earning power rather than in their realisable value. In this respect they perform a similar function to that which the fixed assets perform for an industrial company. For this latter class of company, market value is not required to be stated because it is irrelevant to a fair assessment of the industrial company's earning power.

Admittedly, there is the possibility that a company engaged in fire or other general classes of insurance might have to realise assets to meet a catastrophe. In such an event, however, particularly if substantial blocks of stock have to be sold, the market would fall and the prices realised might bear little relationship to the market prices at the time of the last published accounts.

We repeat our view that a compulsory disclosure of the aggregate market value of investments would create false impressions of the position. Assume for example that this disclosure had been required of insurance companies during recent years. At the end of 1954 the public might have concluded that the position was one of strength; at the end of 1957 one of serious weakness; at the end of 1959 one of excessive strength. In fact, the strength of life assurance companies has not been subject to wide fluctuations over this period, but on the contrary has been steadily increasing, as is shown *inter alia* by the increasing scales of bonuses allotted to policyholders.

We are, therefore, convinced that from the national and public point of view and in the interests of both the policyholders and shareholders it is of the utmost importance that exemptions on accounting matters, particularly hidden reserves, already granted to insurance companies, should be continued.

22. Audit

- | | |
|---|--|
| (a) <i>Qualifications and appointments of auditors</i> | } No comment, except where views are expressed elsewhere in this memorandum. |
| (b) <i>Duties and responsibilities of auditors</i> | |
| (c) <i>Exemption of "exempt" private companies from section 161</i> | |

23. Provisions as to Returns

(a) *Annual Return*

(1) We feel that widespread economies could be achieved without limiting the amount of essential information available to shareholders if an annual return could be made giving the list of present individual shareholdings but without including particulars of shares transferred. It would seem desirable to leave companies with the freedom to submit a complete return once in every three years incorporating a return of shares transferred in the intervening years as at present, if this method was preferred.

(2) Additionally, we consider that, provided the existing requirements as to the frequency of an annual return were preserved, companies should be enabled, if they so desire, to select a date for the compilation of the annual return other than the day 14 days after the annual general meeting. The period between two consecutive returns should not exceed 15 months in the case of an annual return or three years and three months in the case of a triennial return.

We feel that no disadvantage to shareholders or others wishing to consult the annual return could arise if the date selected was a date when the annual return could be prepared, not as a separate process, but as a by-product of some other process such as the closing of the books for dividend distribution purposes.

(b) *Notification of changes of directors or secretary or in their particulars*

We consider that in this respect also economies might be achieved by easing the requirement for all changes to be notified immediately and permitting minor changes (e.g. honours, business occupation or other directorships) to be notified only at regular intervals, say as a complement to the annual return. The register of directors is a

document open for inspection, and it seems unnecessary that any minor change effected in the details in the register must at the same time be placed upon the central public files.

24. Company and Business Names

The wording of section 18 (2) of the Act, which provides a remedy in cases where a new company has taken a name which is too similar to an existing name, applies only where both are names of companies as defined in the Act. We suggest that the wording should be broadened to cover all corporate bodies under whatever Act they may have been registered, and also that a similar provision should be incorporated in the Registration of Business Names Act, which would include partnerships registered under that Act. There should therefore be provision for close liaison between the various registration officials in order to remove the risk of similarity of registrations being dangerously misleading to the public.

25. Foreign Companies

The larger insurance companies carry on business in a great many different countries and they have to comply in all cases with the requirements of local legislation. There is a steadily increasing tendency for countries overseas to multiply these requirements and to copy or adapt what is being done in other countries. It is therefore becoming more difficult for British insurance companies to comply with the requirements of such countries.

We recommend, therefore, that in drafting legislation affecting overseas companies trading in this country, the existing practice, which does not place upon them any more onerous legislative requirements than those applicable to United Kingdom companies, should be continued.

26. Internal Management and Administration

(a) Annual and other General Meetings

(1) We are of the opinion that the provisions of section 133 (1) (a) of the Act, as regards the summoning of annual general meetings, afford the minimum period of notice which permits full consideration of the matters laid before any meeting and we suggest that this period of 21 days be prescribed as the minimum notice for all meetings of shareholders or debenture-holders.

Moreover preference or other shareholders, who may not be entitled under the company's regulations to vote at a meeting, and debenture-holders may nevertheless be vitally interested in matters which are to be considered there. Accordingly we recommend that all shareholders in and debenture-holders of companies should be entitled to receive all notices issued to any class(es) of shareholders of the company, irrespective of whether they are entitled to attend or vote at the meeting, by the same post as they are sent to the class or classes which will be entitled to attend.

(2) Section 183 (1) provides for individual consideration of resolutions proposing the appointment of persons as directors of a company. It is suggested that similar provision could with advantage be enacted as regards all matters submitted to meetings of share or debenture-holders so that a number of independent items cannot be submitted under an "omnibus" resolution. It is desirable that individual holders should be enabled to exercise their votes separately in respect of each matter and not be led to vote against a proposal which is to their advantage by reason of the inclusion in the same resolution of a matter to which they take strong exception.

(3) It is possible for proxies to be suppressed or disallowed without the fact coming to the notice of the general body of shareholders. We recommend that proxies and polls should be under the control of independent scrutineers, such as the company's auditors. Many boards already invite the auditors to undertake such duties.

(4) Moreover there is no provision limiting the time within which the result of a poll must be declared and difficulty may be experienced in arranging for an application to the Court, under section 5, within the specified period of 21 days owing to delay in declaring the result of the poll. It is our view that the scrutineers should be charged with the duty of enabling the chairman to declare the result of the poll as soon as possible (including the number and value of proxies disallowed) and that the effect of the resolutions (if any) and the time limits prescribed by the Act should be operative as from the date of the declaration instead of as from the date of the meeting.

(5) It is our opinion that, notwithstanding any provisions in the articles of a company, it should be mandatory upon a proxyholder to demand a poll if he holds proxies representing at least 10 per cent. of the voting power which are against the result of a show of hands.

(b) Mode of passing extraordinary and special resolutions

It is our opinion that the existing three forms of resolution, viz. extraordinary, special and ordinary, are becoming outmoded, and we envisage no objection to the first two categories being merged. This would mean that resolutions would be of two types only, viz. special and ordinary, and simplification would be achieved without endangering the control of their company vested in the hands of shareholders.

(c) Securing proper disclosures of information

(1) We attach considerable importance to the disclosure of proper and complete information in circulars accompanying formal notices and seeking proxies, but as circumstances vary so extensively it is not possible to make a recommendation for legislation.

(2) We recommend that the requirement for proxy forms to be worded so that the proxy or proxies of a shareholder or debenture-holder may vote either for or against each resolution should be established by legislation. It is appreciated that this is a requirement of the London Stock Exchange but we feel that this control is not sufficient to cause the practice to be universally adopted.

(d) Exercise of voting rights in cases of interlocking shareholdings, etc.

(1) We are concerned at the position which arises when two companies have interlocking shareholdings in each other which confer effective voting control. The two boards of directors, which may well be identical or similar, can then maintain each other in office.

One particularly undesirable use of this situation arises when two companies exchange share holdings with a view to a limited merger of their interests. This may result, not only in effectively removing any real control by existing shareholders, but also in preventing any take-over bid by a third party. It is difficult to make a firm recommendation to prevent this kind of occurrence.

(2) We consider that it might be desirable to provide for the disclosure, when voting, of the interests of trustees in certain cases, e.g. where the trustee of a pension fund is a director or employee of the company.

Additional matters affecting management—

We recommend that the basic principles behind the clauses in Table A defining the rotation of directors, i.e. 89-91 and 95, should be given the force of law in order to ensure the regular annual retirement by rotation of an adequate fixed proportion of the directors and the earliest possible endorsement of the filing of a casual vacancy; also that it should be obligatory to give notice with the accounts of the names of the directors subject to these processes and whether they are seeking re-election.

We fully realise that for certain specialised functions a company's organisation may require a director to assume additional responsibilities as a manager and therefore be described as a managing director. On the other hand we have experience of cases where

by reason of a disproportionate number of such managing directors being exempt from retirement by rotation, the control of the company by shareholders has been impaired.

We therefore consider that the appointment of managing directors ought to be made by an independent majority of the board, i.e. by directors, constituting a majority of the board, who are not themselves managing directors. In the absence of such an independent majority, the appointments and the remuneration, other benefits and service agreements should be dealt with at a general meeting.

28. Problems of Administration and Enforcement of the Law

In paragraph 15 (a) (1) of this memorandum we refer to advantages which would accrue from the availability of a "floating charge on assets" in Scotland. Arising similarly from investment transactions it would be beneficial if the safeguards provided to lenders by the effect of "a notice in lieu of distringas" in England were obtainable in Scotland.

We realise that both these legal processes are derived from rules of law other than the Act itself although the effects of both are recognised therein.

29. Any other Matters within the Terms of Reference

Section 22 of the Act invalidates an alteration to the memorandum or articles which requires existing members to take up further shares, but it would appear that it is possible that this can in effect be accomplished by making a capitalization issue in the form of partly-paid shares.

We consider it undesirable that it should be possible for a company to impose a liability on any member (after the date on which he became a member) to contribute to the company's share capital or in any other way to be compelled to pay money to the company. A member is not obliged to take up any shares provisionally allotted to him under a "rights" issue but on a capitalization of reserves he has no option once the appropriate resolution has been passed. It is therefore submitted that the capitalization of reserves ought only to be applied in paying up uncalled capital of partly-paid shares or in the issue of fully-paid shares.

June, 1960.

Supplementary Memorandum by the British Insurance Association

1. This supplementary memorandum is submitted in response to the request extended to us when the Association gave oral evidence before the Committee on 16th December, 1960. We were then asked to express in writing "exactly what exemptions it is essential to retain . . . distinguishing between the Life offices and general insurance".

2. Since giving our oral evidence to the Committee we have reviewed the record of that evidence and the contents of the Association's written memorandum, particularly Item 21—Accounts, sub-section (f). After full consideration we confirm our belief that the recommendations of the Cohen Committee are still valid and that the exemptions granted to insurance companies by the Companies Act, 1948, are reasonable and proper.

3. It is a fact that insurance companies publish more detail in their accounts circulated to shareholders than the Companies Act, 1948, requires. Industrial undertakings rarely exhibit separate revenue accounts for each individual venture contributing to the enterprise. The Insurance Companies Act, 1958, however, calls for a statutory revenue account for each specified class of business (e.g. Life, Fire,

Marine, Motor, Personal Accident, etc.) and much of this extra information is commonly included in the accounts produced for shareholders.

4. Furthermore, the Board of Trade return required by the Insurance Companies Act, 1958, contains a comprehensive classification of investments which enables the reader to obtain a clear view of the constitution of his insurer's portfolio in the case of a policyholder or the underlying assets of his investment in the case of a shareholder.

5. We feel, therefore, that there is a strong case for the statutory control of the contents of the Profit and Loss Account and Balance Sheets of an insurance company being based on the requirements of the Insurance Companies Act, 1958, rather than on those of the Eighth Schedule to the Companies Act, 1948.

6. When we were giving our oral evidence the exemptions were described to us under four categories and these have been used, although not in the order in which they were given to us, as sub-headings in the following paragraphs 7 to 10.

7. *"The Company need not state the market value of its investments, but can simply describe them as at or under cost"*
(8th Schedule 11 (8)).

Our reasons for asking for the continuance of this exemption were fully set out in the original evidence. The information covered by the exemption would be of limited value to a shareholder wishing to assess the prospects of future profits, and of no real value to a policyholder who might wish to judge whether the company was properly run or was more or less efficient than its competitors. In fact, in the case of a Life office it would almost certainly lead to false conclusions by both types of interested party, seeing that the market value of the assets at any point of time is not a measure of a Life office's ability to meet its commitments, which stretch far into the future. It is our opinion that the statutory certifications required by the Insurance Companies Act, 1958 (e.g. note 3 of the 3rd schedule of Statutory Instrument, 1958, No. 1765) and the Companies Act, 1948, provide all the safeguards that the public interest requires. We would add that our world-wide reputation for strength and stability could be endangered by the publishing of inner reserves which would, in the ordinary course, fluctuate from year to year.

8. *"The Company is not obliged to distinguish between reserves and provisions or to disclose transfers to and from such accounts"*
(8th Schedule, 4 (1), 6, 7, 12 (1) (e), 12 (1) (f)).

(a) In the Life branch the need for the exemptions arises from the considerations referred to under paragraph 7. It is felt that to give details of transfers to and from capital reserves would be misleading if the exemption referred to in paragraph 7 (regarded by us as the most important exemption) is continued. The liabilities of a Life fund are largely estimated on the basis of averages and the distinction between liabilities, reserves and provisions is highly theoretical. The main sources of income of a life assurance fund are its premium income and investment income. That income, immediately it is received and after the payment of expenses, goes to swell the fund and assumes the nature of capital. The capital fund is held to make payments to policyholders and as a reserve against the future liability to policyholders. There is not here the normal concept of a trading account. The account has to show the fund brought forward, the income and outgo, and the resultant balance of the fund at the year's end. The estimate of the fund's liabilities may vary from time to time not only on account of the current operation of the business but because of an altered assessment by the Actuary of such features as future mortality and the terms on which future investments (of the premiums which the office is committed under existing contracts to receive and of the future investment income) can be made.

(b) On the non-life side it might be helpful to review the background to the item "Provision for unexpired risks" which is required to be set up under the Insurance Companies Act and which forms the bulk of the item "Insurance Funds" in the

Balance Sheet. This derives from the fundamental fact that an insurance company receives its premiums in advance and stands upon risk for the period of the policy. On the assumption that each policy is for one year and on the assumption also that, on average, premiums flow into the company regularly throughout the year, there will be one-half of the year's risks outstanding at the close of that year which, after allowing for assumed acquisition costs of 20 per cent., gives the figure of 40 per cent. of the premiums commonly used—and accepted by the Inland Revenue. Some companies, however, take a figure of 50 per cent. because the flow of premiums may not be even throughout the year, neither are risks always covered for one year only; in North America they are frequently for three, five or even seven years. It would be tedious and costly to measure precisely the degree of unearned premiums and even then, of course, the profit content or reserve could only be quantified after the expiry of the term of the risk. Any attempt to segregate under the headings required by these clauses would largely be a matter of guesswork.

(c) Another variation applies to Marine, Aviation and Transit insurance business and to the Statutory Revenue Account laid down by the Board of Trade for use in respect of such business. It is not customary in such an underwriting account to close a year's operations by the creation of a provision for unexpired risk. Instead the account is held open for a period, usually three years, and at the end of that period a balance is struck between the income, such as premiums, and the outgo, such as claims paid, expenses and other items. Here again it is not practicable to break down the fund into the categories required.

(d) The other main item on the liabilities side of an insurance company's Balance Sheet is "Claims admitted or intimated but not paid". Broadly there are three classes of claim outstanding. The first two would be those cases in which a claim has been notified and is either (a) assessed or (b) still awaiting assessment. The more complex problem occurs where an incident has been notified but it is not clear at the closing of the Revenue Account whether a claim will arise and certainly no formal assessment has yet been made. In these occasionally extreme cases where liability is doubtful it may require litigation before the position is established. Ordinary prudence will demand that while there is a possibility of a successful claim being sustained a sum must be set aside to meet it. Clearly such a sum could be partly reserve or perhaps all reserve; equally clearly it cannot be ignored. To attempt to distinguish, therefore, would be extremely difficult, if not impossible, and certainly not helpful to the reader.

9. "The Company is allowed to make reserves and provisions out of revenue before arriving at its published profit without describing the amounts so deducted"
(8th Schedule, 12 (1) (e), 12 (1) (f)).

Many of the considerations referred to in paragraphs 7 and 8 explain the need for these exemptions. We are ready to give the fullest information as regards our investment income and to disclose the full amounts received before transfers to reserves. The whole of the income from interest and dividends may not at present be disclosed in the revenue account, some minor part of that income having been applied by way of amortisation. We should not object in principle to a requirement that the whole gross income from interest and dividends must be disclosed in the revenue account and that, to the limited extent referred to, any application of a part of that income to reserve should also be shown.

10. "The company need not disclose the method adopted in the valuation of fixed assets or show separately any amount allowed for depreciation"
(8th Schedule, 5, 12 (1) (a), 14 (2)).

We feel it desirable to refer to the absence of any clear definition of fixed and current assets in the 1948 Act. As there is some difference of opinion on this matter we feel that it should be made quite clear that an insurance company's investments are not to be regarded as coming within either of these categories; otherwise a requirement to comply with, say, clause 5 (relating to fixed assets) or clause 11 (7) (relating to current assets) might negate the exemption referred to in paragraph 7. As to the rest, most

insurance companies do not include such items as motor cars, fixtures and fittings, and office machinery in their balance sheets, having charged them against income in the year of purchase. This item will, therefore, be for the most part "office premises" which do not represent a material part of an insurance company's assets.

11. To summarise our views on the four categories of exemption referred to in paragraph 6 above, we are of the opinion that:—

- (a) For the proper conduct of our business, continuance of the existing exemptions relating to the following sections of the 8th Schedule is essential:—
4 (1), 6, 7, 11 (8), 12 (1) (e), 12 (1) (f).
- (b) The difficulties of interpretation make exemption from the following sections desirable:—
5, 11 (7), 12 (1) (a), 14 (2).

12. Other material exemptions under the 8th Schedule on which we wish to comment are:—

- (a) 8 (1) (a), 8 (3) and 12 (1) (g).
These clauses require subdivision of the investments into categories of trade, unquoted and quoted investments. In view of the subdivision already required under the Insurance Companies Act, such a further subdivision would make the lay-out of the accounts very complicated, and it is doubtful whether the additional information would be particularly useful.
- (b) 11 (4) and 11 (5).
Much of the normal business of an insurance company consists in providing for the liabilities of other persons and for contingent liabilities. It would clearly be impossible for us to comply with the requirements of these clauses if they were held to cover our normal business.
- (c) 11 (10), 12 (1) (e) and 14 (3).
The basis of taxation of insurance companies is complicated and computation of provisions involves so much estimation that we doubt whether it is practicable to give any useful information under these headings.

British Insurance Association.

3rd February, 1961.

APPENDIX XXVI

Memorandum by the Committee of London Clearing Bankers

This Memorandum is tendered in response to the invitation contained in a letter from the Board of Trade dated 15th January and its accompanying questionnaire.

The general impression of the Committee of London Clearing Bankers over the period of 12 years of the working of the Companies Act, 1948, is that the Act has worked well and meets adequately the needs of commerce and industry whilst affording protection to the community. The Clearing Banks would, therefore, regret any wide extension of legislation. The general standard of integrity and financial probity is high and such exceptions as there have been are not numerous in relation to the great number of companies whose affairs are regularly and wisely conducted with due regard to the interests of all concerned. The publicity which any lapse attracts is capable of creating a false or misleading impression of the standards observed by the vast majority.

The Clearing Banks have accordingly limited their evidence to those sections of the questionnaire where they might be expected to have special knowledge or experience, or with which they are directly concerned. Many of the questions which the Company Law Committee will be considering are primarily for lawyers or accountants, and the Clearing Banks have, therefore, refrained from comment; other questions, such, for example, as the duties of directors, although involving problems of much interest are, in general, in the opinion of the Clearing Banks, hardly capable of definition and regulation by statute. But should the Committee wish to have their assistance in respect to any of these other questions, the Clearing Banks will be glad to co-operate to the best of their ability.

4. Donations by Companies for Charitable and Political Purposes

The Clearing Banks see no reason to advocate a change in the law; they regard it as natural and proper for any business, whether owned by a company or an individual, to make charitable donations judged to be in the interests of the business, using that term in its widest sense. As members of the community the banks feel they should be free to continue their practice of responding to charitable and similar appeals.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(d) Borrowing money and charging property

Clause 79 of Part I, Table A, as to the borrowing powers of directors exempts from the calculation of sums borrowed "temporary loans obtained from the company's bankers in the ordinary course of business". Difficulties arise over interpretation of the words "temporary" and "loans". To remove these difficulties the Clearing Banks suggest the exemption should at least be re-worded thus:—

"(apart from loans and/or overdrafts obtained from the company's bankers in the ordinary course of business)".

The words "in the ordinary course of business" on occasion also give rise to difficulties of interpretation and it would be helpful if they could be dispensed with.

6. Directors' Duties

*(c) Directors' and officers' dealings in their own companies' shares**As to directors:*

The Clearing Banks feel generally that the provisions of sections 195 and 198 providing for immediate disclosure to the Board by directors of transactions in their

own company's shares, coupled with a register of such transactions open to inspection by shareholders and debenture holders during the period of 14 days before and three days after the company's Annual General Meeting, and by the Board of Trade during that or any other period, are satisfactory.

Sometimes it is suggested that the register should be available for inspection either at all times or at more frequent intervals than the period around the Annual General Meeting. On the whole, however, the Clearing Banks' view is that the interest of shareholders generally would be more likely to be injured rather than benefited by an amendment of the law providing in effect for disclosure of dealings, other than to the Board of Directors, concurrently with those dealings taking place. Misinformed speculation as to the reason for such dealings, whether purchases or sales, might become rife and an explanation connected with the director's personal and private affairs, and as to his motives, would hardly be practicable and might even be disbelieved.

As to officers:

Whilst appreciating that certain employees may share with a company's directors confidential information as to a company's affairs, it must be remembered that it is not only senior employees who have to be trusted, but also, for example, clerks in the Secretary's or Registrar's Office engaged with the preparations for a dividend payment or a capital operation. The Clearing Banks do not consider it necessary to subject employees to the legislation which applies to directors; the latter are in a very different position. Discipline of a company's employees is a matter for its directors and if an employee has been guilty of improper, or even unethical, conduct it should be left to the directors to take any necessary action. Statutory requirements as to disclosure by all employees of their dealings in the company's shares would serve little purpose.

11. Disclosure of Ownership and Control

(a) Nominee shareholders and debenture holders (including nominee holding companies)

The Clearing Banks gave evidence on this subject in 1943. It then appeared to them that there were two grounds of criticism of the nominee system which had some validity:—

- (a) Concealment of the identity of shareholders where on grounds of public policy full disclosure of the controlling interests is desirable and even necessary.
- (b) Enablement of directors having a special knowledge of the affairs of a company to traffic in its shares without the restraint which a measure of publicity would exercise.

Criticism (b) was met by the inclusion of section 195 (Register of directors' shareholdings) in the Companies Act, 1948.

With regard to criticism (a), exhaustive examination of suggested remedies showed these to be either ineffective or to be such as would impose an intolerable burden on those concerned. Sections 172 to 175 of the Companies Act, 1948, were accordingly enacted as the best solution that could be devised. Under these sections the Board of Trade is empowered, whenever it has good reason for doing so, to appoint Inspectors who have the right to enquire as to the beneficial ownership of any company. It was then the view of the Clearing Banks that no more was possible and for reasons which are summarised below and elaborated hereafter they are of the same opinion today. These reasons are:—

- (i) The number of nominee holdings in existence. (A Survey of Large Companies published by Mr. R. Harris and Mr. M. Solly in 1959 suggested that as much as 20 per cent. of the equity of some companies was registered in the name of nominees.)
- (ii) The relatively negligible number of cases where undesirable concealment is the motive behind the use of nominees.

- (iii) The problem of drafting effective legislation. The clauses dealing with the nominee holdings introduced with the bill leading to the Act, and which were later abandoned, occupied five closely printed pages, clauses which Lord Simonds indicated were in his opinion quite unintelligible to the ordinary citizen.

The use made of the so-called Nominee Companies of the banks has extended beyond the purpose for which they were introduced. Their origin was the necessity for lending banks to obtain a more complete form of security than that afforded from the mere deposit by obligant customers of stock and share certificates. The stock or shares had to be transferred into the names of bank nominees, usually two bank officials, and to avoid the inconvenience and labour involved by substitution of fresh names upon the retirement or death of the existing nominees, the banks formed Nominee Companies. Appreciation of the advantages offered by the nominee machinery has led to extensive registration in the names of Nominee Companies for reasons which though usually serving the legitimate convenience of customers, bear no relation to advance facilities.

Bank Nominee Companies are not a class by themselves. They fall into the general category of registered holders who are not beneficial owners. However, in the limited field of Clearing Banks and their Nominee Companies some idea of the use of nominees may be gauged from the fact that at the present time there are approximately 800,000 individual holdings, as against 400,000 in 1943. One Clearing Bank has analysed its holdings of stocks, shares and debentures of companies registered under the Companies Acts thus:—

Category	Total	Per cent.
1. As security for advances	7,805	4.68
2. For Stock Exchange Brokers or Jobbers	7,308	4.39
3. For Insurance or Trust Companies	2,603	1.56
4. For Pension and analogous Funds	8,390	5.04
5. For Trustees	2,100	1.26
6. For Residents outside the United Kingdom	4,001	2.41
7. For convenience:		
(a) of customers' Stock Exchange dealings	7,953	4.77
(b) due to absence abroad	3,466	2.08
(c) general	10,432	6.26
8. For Investment Management	28,000	16.81
9. As Executors and Trustees under Wills and Settlements	83,000	49.83
10. For unidentifiable purposes which could embrace concealment	1,505	0.91
TOTAL	166,563	100.00

These figures show the comparatively small extent to which concealment could be a possible motive for use of a Nominee Company. In any case concealment is not necessarily an abuse. The Clearing Banks visualise over the years ahead an increasingly high proportion, particularly of equity shares of companies, being registered in the names of non-beneficial owners.

Since the problem was examined prior to the 1948 Act there has been materially increased use of bank Nominee Companies for holding stocks and shares in respect of which banks here act as depositaries for principals in U.S.A. who issue American Depositary Receipts against such holdings. In such cases one registered holding in the name of a Nominee Company may amount to many thousands or even millions of

shares the beneficial ownership of which is widely spread and completely unknown. The Clearing Banks believe that shares in at least 100 leading United Kingdom companies may be so held. The consent of the company concerned is not required, though normally it is sought as a matter of courtesy.

In the course of time the United Kingdom may move to a system more akin to that almost universally accepted on the Continent and in the U.S.A. whereby shares are either wholly in bearer form or registered in marking names. The Clearing Banks suggest that weight should be given to this consideration, because evidently other countries are prepared to accept whatever disadvantages may attach to the ownership of public companies being unknown in exchange for the convenience and ease of transmission a system of bearer or semi-bearer documents of title confers.

The problems of legislation designed to reveal true ownership include:—

- (i) The need to take into account underlying interests, often in successive layers including, for example, those of life tenants and reversionary and other interests under settlements, joint holders, beneficiaries under wills, and the holders of options. Further, it is to be doubted whether any scheme could be made effective unless agreements, oral arrangements, and even mere understandings between individuals are brought within its ambit. The complexity and ramifications of the subject are well illustrated by section 173 (2) of the Act, which reads as follows:—

“ For the purposes of this section, a person shall be deemed to have an interest in a share or debenture if he has any right to acquire or dispose of the share or debenture or any interest therein or to vote in respect thereof, or if his consent is necessary for the exercise of any of the rights of other persons interested therein, or if other persons interested therein can be required or are accustomed to exercise their rights in accordance with his instructions.”

- (ii) The stumbling block to the building of any scheme for disclosing “ beneficial ownership ” or “ ownership ” has always been the problem of defining these terms. This applies whether a scheme dealing with all non-beneficial ownership holdings is contemplated or whether a more limited scheme directed only to shares carrying a certain percentage of voting rights is under consideration.
- (iii) Difficulties arising from holdings in the name of a United Kingdom nominee for foreign banks or companies and persons resident abroad.
- (iv) Special difficulties in the case of mortgages because normally the mortgage carries with it the right for the mortgagee to exercise the voting rights. In this connection any proposed definition of “ owner ” or “ beneficial owner ” raises insoluble problems unless both mortgagee and mortgagor are to be treated as owners. If a mortgagor who has mortgaged his shares is not to be treated as an “ owner ” within the definition, an intending evader would be free to mortgage the shares for a purely nominal sum; upon the other hand if the mortgagee, as well as the mortgagor, is not to be treated as an “ owner ” anyone bent upon concealment would be able to transfer the shares to someone who in fact would be a nominee for a consideration which would not be paid but would be secured by a mortgage of the shares.
- (v) If it is suggested that disclosure be limited to a particular percentage of the share capital, individual beneficial owners might be faced with the difficulty of not knowing at any given time whether their holdings are within or outside the line of demarcation. The existence of debenture stock convertible into ordinary stock with voting rights, and possibly the existence of preference shares with voting rights which might be surrendered for an appropriate consideration, would introduce difficulties for and add to the embarrassment of an individual holder of a substantial block of voting shares, however well intentioned he or she might be in complying with whatever might be the requirement of the law regarding the immediate disclosure of a holding of a stated percentage of the

capital of a company carrying voting rights. In this connection there would be the problem of aggregation of holdings, which, so far as the Clearing Banks are concerned, applies not only in the case of their Trustee Departments but also in the case of their Nominee Companies. All the Nominee Companies of any one bank, and there may be as many as 50 of them for the convenience of departments or branches of the bank, hold in the first instance for the bank itself any shares registered in their names which have been transferred by the customers concerned, so that after the initial aggregation which would show large holdings held apparently in the beneficial ownership of a bank there would need to be provision for a further analysis and aggregation to lead to some clearer indication of true beneficial ownership, which on analysis might still give a misleading impression if mortgage interests are involved.

- (vi) The fixing of suitable penalties for evasion. In view of the inevitable complexity of any enactment and the number of persons who might be inadvertent offenders, the penalties ought not to be too severe, whereas on the other hand the penalties would have to be adequate to deter those anxious to practise concealment.

If experience has proved sections 172 to 175 to be inadequate, of which the Clearing Banks have no direct evidence, doubtless consideration will be given to making the procedure under those sections more efficacious. Otherwise, as stated, after a searching examination and an exploration of all the alternatives, it was previously found impossible to formulate any scheme which could be made intelligible to the man in the street, watertight to catch the person who is prepared to practise deliberate evasion, and which would not inflict upon companies and the public a vast amount of work out of all proportion to any practical beneficial result likely to be achieved. Share mortgage transactions and settlements of all kinds must remain permissible, and such devices as powers of attorney, powers of appointment, options, and the vesting of the seat of ultimate control in a foreign company erect an insuperable barrier to a complete solution, or to any worthwhile partial solution.

16. Take-over Bids

Generally

Many transactions of a widely different character have of late been given the tendentious label of "take-over bid". Purchases, sales and amalgamations of businesses have, however, been taking place ever since business began. In other times other labels have been used. Between the two World Wars the cry was for "rationalisation"—i.e. the elimination of smaller units. During the last war the call was made for "concentration" as a means of saving overheads and of making the best use of the labour available.

It is true to say that society has on the whole regarded these moves as an evolutionary process necessary for development and adjustment to change.

Rationalisation schemes usually fell in times of business depression. On the other hand take-over bids so called have developed in a period of rising business activity. Contributory factors have undoubtedly been the high level of taxation and inflation.

The great majority of these operations have been undertaken for perfectly proper reasons and in common with experience of the past they have resulted in a fuller employment of assets and wider use of managerial skills. Hence they have been of benefit to the nation as a whole.

The Committee of London Clearing Bankers participated in the preparation of the recently published booklet "Notes on Amalgamations of British Businesses" which set out the current opinion of the City on this subject. At the time of writing of this evidence the Draft of the Licensed Dealers (Conduct of Business) Rules, 1960, has been issued by the Board of Trade; this draft endorses principles and procedure already largely followed by leading institutions.

(e) The financing of such transactions

The Clearing Banks are only directly concerned with take-over bids in the sense that they may be called upon to finance transactions of this nature. They regard themselves as free to make or decline any advance. Applications to finance take-over bids are no exception. They are considered in the light of all the facts and in particular as to whether they conform with the requirements of a normal banking transaction. The Clearing Banks do not consider legislation is either necessary or appropriate as far as their position as lenders is concerned.

The banks make every effort to secure adherence to the principles set out in the "Notes on Amalgamations of British Businesses" to which reference has been made above.

Before allowing its name to be used in connection with any bid the bank concerned, whether or not assisting with the finance, would satisfy itself that sufficient funds to carry through the transaction were available for the purpose.

17. Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders*(a) Adequacy of protection afforded to investors by existing law*

The Clearing Banks consider that the provisions of the Companies Act, 1948, together with the relative Rules and Regulations of the Stock Exchange, afford adequate protection to investors.

(b) Usefulness and necessity of the existing provisions

The Clearing Banks feel that the following points merit consideration:—

- (1) In view of the size of issues and the time needed to clear cheques the period of three days for non-revocation mentioned in section 50 (5) places an undue strain on those handling an issue and they would like to see the period for non-revocation extended from three to five days. It is considered that a non-revocation period of five days should also apply in those cases where a Certificate of Exemption has been granted under section 39.
- (2) Under section 52 (1) (a) any company making an allotment of shares is required to deliver to the Registrar of Companies within one month thereafter a return of the allotments, including details of the number and nominal amount of the shares comprised in the allotment, the names, addresses and descriptions of the allottees, and the amount, if any, paid or due and payable on each share.

This return entails a great deal of work, and in the opinion of the Clearing Banks serves little purpose, particularly in the cases of an issue by way of capitalisation of reserves or a rights issue to existing shareholders. They suggest that while retaining Form 45 the supplementary list containing names, addresses and descriptions of the allottees should be dispensed with. If it is felt necessary to retain the list of allottees for issues other than from reserves or as rights, the return should be made as at a definite date and it is suggested this should be the last day for registration of renunciations. If the Allotment Return is to be retained in any form, it is considered "descriptions" of allottees should be omitted. Such descriptions are not required in the Annual Returns.

20. Reduction of Capital and Purchase by a Company of its own Shares*As to assistance by a company towards purchase of its own shares:—*

Whether section 54 in its present form serves any useful purpose is in the view of the Clearing Banks debatable. The section is exceptionally widely drawn, the period of possible infringement is unlimited in time, the section is difficult to interpret and its ramifications and purpose obscure to the ordinary businessman. Difficulties are presented by the section to what businessmen regard as perfectly legitimate transactions,

and the experience of the Clearing Banks suggests that the section is increasingly ignored. They have no evidence of loss being occasioned either to creditors or shareholders as a consequence.

The most common example is the case where a company has acquired all the share capital of another company with the aid of banking facilities, and subsequently cash, which may be surplus to the current requirements of the acquired company, is transferred by way of loan from that company to the acquiring company, and applied in reduction of the bank debt. In practice no harm ensues, if for instance, the acquiring company gives to the acquired company adequate security for the loan, and even an unsecured loan by the company acquired would not prejudice the creditors, or anyone else, including minority shareholders, provided the acquiring company is solvent and trading profitably. Subject to the question of price and value the same would apply to the sale of an asset.

If the principal aim of the section is to prevent fraud, the present penalty is not a deterrent, and the Clearing Banks believe that few prosecutions have been instituted under the section. Upon the assumption that the section is at least in some degree directed against fraudulent activities, it is in the opinion of the Clearing Banks a matter for consideration whether any such underlying purpose of the legislature would not best be served by a repeal of the section and the substitution of a section clearly defining the conduct and action which is to be proscribed and the offence, assuming that existing penal sections of the Act are insufficient to meet the situation. If this suggestion is unacceptable and the section has to be retained broadly in its present structure as a bulwark, not against fraud but against practices which, although not fraudulent, are considered objectionable and dangerous in themselves, the Clearing Banks advocate that the section should be simplified and clarified.

The section does not draw a distinction between cases where the whole of the share capital of a company is being acquired and cases where a minority shareholding is left. In both instances the interest of creditors is the same, but the position of shareholders has only to be considered in the latter case.

The Clearing Banks do not believe that creditors require protection except at the hands of the fraudulently minded, who are best dealt with under more general provisions of the Act dealing with fraudulent conduct. There could hardly be temptation to strip the assets of the acquired company up to the amount paid for the shares to the detriment of existing creditors except as part of a larger design by fraudulently minded persons.

It is, however, perhaps for consideration whether section 54 in a modified form might be retained, limited to cases where there is a minority shareholding.

It seems to the Clearing Banks that minority shareholders, again in the absence of fraud, might be regarded as reasonably protected if the directors of the acquired company were required to make an appropriate declaration of solvency, supported by an Auditors' certificate, before utilising assets of the acquired company within, say, a period of 12 months of its acquisition, in assisting a purchase of the company's shares. If this suggestion were adopted third parties would require protection against infringement of the requirement.

The subscription of share capital (as opposed to the acquisition of existing shares) by a third party with the assistance of the company issuing the capital, may present rather a different problem, but the Clearing Banks have some difficulty in distinguishing the principle involved.

In any event in the opinion of the Clearing Banks it is essential that legitimate business should not be hampered or made more difficult than at present.

21. Accounts

(f) *Exemption of banks, assurance, and shipping companies from some of the accounting provisions of the Companies Act, 1948*

We have not considered this matter in relation to discount, assurance or shipping companies but only in relation to the special position of the eleven Clearing Banks.

Powerful arguments in support of the exemption extended to banks were marshalled by the representatives of the Committee of London Clearing Bankers in their Oral Evidence to the Cohen Committee. These arguments were accepted without reservation by the Cohen Committee whose conclusions were summarised in paragraph 101 of its Report thus:—

"In the case of banking and assurance companies the interests of the depositors and the policy holders respectively outweigh the interests of the shareholders and . . . considerations affecting the public interest must be taken into account. The reputation for stability of these companies is a national asset of the first importance to the community in general and it is not in the public interest to endanger their stability or the confidence they enjoy at home and abroad. From time to time the values of their assets and particularly their very large holdings of Government and other gilt-edged securities are adversely affected by political disturbances and economic conditions, national and international. In such circumstances it is desirable that their financial strength should be even greater than may appear. The history of the years after 1929 demonstrates the public advantage of their being able to present a reasonably stable position in a time of violent and sudden stress and for this reason it seems to us desirable that such companies should be permitted to retain a buffer of undisclosed reserves. In this country no one questions the stability of our banks, discount companies and assurance companies, but some countries are not so happily placed and countries abroad watch the evidence of stability very closely and react very quickly to any unusual symptoms. We consider, therefore, that banking and discount companies should be absolved from the obligation of showing separately reserves and provisions and transfers to and from such accounts, but that their balance sheets should indicate the existence of reserves and provisions and their profit and loss accounts should be appropriately worded so as to show whether any such transfers have been made during the period covered by the accounts."

The steps in those arguments may be summarised as follows:—

- (1) In the case of banks, the interests of the depositors outweigh those of shareholders.
- (2) Unquestioning confidence in the stability of the banking system is a national asset of the first importance.
- (3) While it is important enough that the banks should enjoy this unquestioning confidence at home, it is even more important that they should do so in the eyes of the outside world; and some overseas countries which are not so happily placed watch the evidence of stability very closely and react very quickly to any unusual symptoms.
- (4) But the earnings of the banks are subject to wide fluctuations from year to year since the results may be much affected by changes in the value of their investment holdings and by their experience in respect of bad debts.
- (5) In consequence, reserves, which in any other business would be considered large in relation to the capital employed and to the normal trading profit have to be built up in good times, in the knowledge that equally large drafts on those reserves may be required in other years.
- (6) Full disclosure in the accounts might embarrass the banks in their policy of making large provisions in good years, while the spectacle of heavy drafts on those reserves at other times might undermine that unquestioning confidence in the stability of the banks which is acknowledged to be a national asset of the first importance.

Today, sixteen years later, it may be definitely asserted that subsequent events have done nothing to weaken this case, indeed the contrary would be true. The Report of

the Cohen Committee in 1945 instanced the history of the years after 1929 as evidence of the strains to which the banks were exposed. At the time of that Report, Bank Rate was 2 per cent., at which level it had remained unchanged (save for a few weeks at the outbreak of war) since 1932. Yields on gilt-edged securities had remained low and, as the Clearing Banks' holdings of these securities had just about doubled during the war, if there had been a fall of 12 per cent. in their value the depreciation would have been equivalent to the whole of the banks' published capital and reserves.

From 1948 the trend of gilt-edged prices was downwards and during the 'fifties violent fluctuations were seen in interest rates and security values. In some years, therefore, certain banks decided to show their investments at a balance sheet value in excess of current market prices, indicating that investment reserves (i.e. that portion of their inner reserves which had been applied to the writing-down of investments) had been more than exhausted. In June, 1956, the deficit between book values and market prices of four of these banks was £63.7 millions, equivalent to 4.4 per cent. of the book value of their investments and to 48.3 per cent. of their published capital and reserves.

Fortunately the appearance of notes in balance sheets had no disturbing effect here although they did not pass unnoticed abroad. If, however, the full extent of the attrition in the banks' reserves had had to be made known it is conceivable that the disclosure could have had a very different effect at home and an even more serious one abroad.

It is the view of the Clearing Banks that a greater degree of disclosure can do nothing to foster confidence and would be much more likely to damage it.

Those who oppose the maintenance of undisclosed reserves might argue that the problems would be eased if the banks were to confine their investment holdings to very short-dated securities. This argument would ignore the fact that the short-dated securities often bear the full effect of a rise in interest rates, and the experience of the last ten years indicates that the short- and medium-dated securities are affected very much to the same degree. While it is true that really long-dated securities are in general an inappropriate holding for banks, the Radcliffe Committee argue (paragraph 507) that the hands of the authorities in influencing the trend of advances and the general monetary situation would be weakened if the banks were to hold only very short-dated bonds. There is also the consideration that yields on medium-dated securities are normally somewhat higher than on short-dated, so that earnings would suffer if the banks were precluded from extending into the medium range, tending either to limit the capacity to build up reserves or to push up the cost of banking services.

So far this question has been examined in relation to the banks' large investments mainly in British Government securities to which the Cohen Committee made particular reference. The following comparative figures of the Clearing Banks illustrate the marked changes which have taken place over the years mentioned below in the principal items of the banks' balance sheets:—

	<i>Published capital and reserves.</i>	<i>Deposits.</i>	<i>All investments.</i>	<i>Advances.</i>
End	£ millions	£ millions	£ millions	£ millions
1938	139	2,254	635	966
1945	146	4,850	1,234	815
1959	274	7,667	1,710	2,938

Published Capital and Reserves as a percentage of:—

	<i>Deposits.</i>	<i>All investments.</i>	<i>Advances.</i>
1938	6.2	21.8	14.4
1945	3.0	11.8	17.9
1959	3.6	16.0	9.3

The latest major change in the make-up of the banks' assets occurred, however, in the 18 months from the middle of 1958. Large sales of investments were made towards meeting the very substantial increase that took place in advances to customers and the relationship between these two "risk-bearing" assets reverted toward the traditional pattern thus:—

	<i>INVESTMENTS</i> (In British Government securities).		<i>ADVANCES.</i>	
	<i>£ millions.</i>	<i>Per cent. of Deposits.</i>	<i>£ millions.</i>	<i>Per cent. of Deposits.</i>
30. 6.1958	2,092	32.7	1,932	30.5
31.12.1959	1,590	20.7	2,938	38.3

The large increase in advances which has taken place must involve the carrying of greater risks which as yet cannot possibly be measured, but for which the banks must be fully prepared. From the nature of their business the banks would find it difficult to explain why at any particular time they thought it necessary to place large sums to their Contingencies Accounts. Equally they cannot discuss in public the affairs of their customers or even of a particular country. A large withdrawal by any one bank from its Contingency Account would be likely to give rise to much uninformed comment. The inevitable effects of inflation as well as the growing trend in industry towards the formation of larger units has resulted in calls upon the banks for advances (often in one hand) on a very much larger scale than ever before. Examples of these calls are where the banks are invited, jointly or individually, to finance the erection of a new power station, the building of fleets of tankers, or expansion in the steel industry, or the export of heavy capital goods. Moreover, when, as not infrequently happens, some large units form a consortium to handle projects of considerable magnitude, calls upon the banks are vastly increased.

In the view of the Clearing Banks it would be disastrous if some temporary change in the structure of interest rates, or a trade recession, or indeed any other circumstances beyond the control of the banks, were ever seen to have seriously depleted or absorbed their contingency accounts for however short a time. This applies to the banks collectively and individually. Different considerations apply to different banks. The individual interests and indeed the nature and make-up of the banks' businesses vary widely. It would be a grave matter if even one of the large banks were to forfeit, for however short a time, the confidence of its depositors; this could only be detrimental to the public interest.

It is also necessary to draw attention to the foreign business of the banks. In 1943 the volume of foreign business handled by the banks in London was probably smaller than at any time during the last 30 years. Since then there has been a great increase in international transactions and London has benefited accordingly, sterling having been re-established as the world's leading international currency. There is therefore now much more at stake should foreign confidence in the British banks be impaired. In the event of confidence being undermined the financing of world trade might pass in part to other foreign banking institutions, the growth of whose capital and reserves has not been hindered to the extent that the British banks' has been as the result of restrictions and severe taxation, the legacy of two world wars. The effect on the country's gold and dollar reserves might be severe, quite apart from the permanent loss of business that it has taken generations to build.

All we have said on this question supports the views expressed by the representative of the Clearing Banks in 1944 in reply to question 4626 of the Cohen Committee, when it was pointed out:

"Bank accounts must be dominated by trends. They are affected by cyclical economic influences, by interest rate movements, and by political fears and actualities both at home and abroad. One must not forget that these trends and influences may not all attack each individual bank all in the same degree and all in the same year and that the disclosure of the results of those attacks if published for different banks would not be good for the body politic . . .

"It would, in my view, be inimical to the public interest that the changes (brought about by these trends and influences) should have their ephemeral effects upon the contingency accounts exposed to the public view—upwards and downwards, in different degree and in different years in different banks . . .

"I suggest none can be damnified by the present system unless bankers, in their balance sheets paint too roseate a view. Auditors do not permit them to do that. The State gets its taxes—it must do. Creditors get security. Shareholders and members are not prejudiced in the long run and they have continuity of earnings. The employees are adequately paid . . ."

The Clearing Banks attach equal importance to their being free to show in their Profit and Loss Accounts the result of a year's operations after making undisclosed transfers to or from inner reserves.

The principal exemptions at present afforded to the banks in the preparation of their Profit and Loss Accounts are in respect of the charge for and method of depreciation, transfers to or from reserve and the amount of tax paid. It is fair to say that these exemptions stand or fall together and must all continue or must all go since to lift the curtain from any single one of them would reveal information which would go some way to disclose some facts about the others, or would at least give rise to more or less intelligent guesswork and some undesirable, because probably inaccurate, speculation about profits.

Under conditions of full disclosure transfers to contingency accounts would have to be explained; this would be impracticable without disclosing existing reserves and why it is considered such reserves are inadequate. Similarly transfers from contingency accounts without explanation would give rise to undesirable and speculative conjecture.

A bank which is compelled to publish its earnings could be placed in the situation of being unable to give any sensible explanation to its depositors and stockholders of the appropriations it was proposing to make. It would be illusory to suggest that there can be any different treatment of the Balance Sheet and the Profit and Loss Account in the matter of full disclosure. To remove any possible misconception, it should perhaps be stated that full and detailed disclosure is already made to the Inland Revenue authorities.

Reverting to the general question of non-disclosure, banks in the Commonwealth have in the main adopted the British system. Of all the English speaking countries

the only exception would appear to be in the U.S.A. and even there full disclosure is not necessarily insisted upon. So far as the American banks are concerned it must be borne in mind that, apart from the large institutions, there are many thousands of small-town banks as against the few banks which operate throughout the United Kingdom. Furthermore, they operate against the background of a strong economy with large gold and foreign currency reserves, as against the very different background which governs the operations of United Kingdom banks.

Whatever the arguments may be for shareholders being fully informed about the internal affairs of trading companies, there are stronger arguments, on the ground of public interest, why other considerations should prevail, in the case of banks. Admittedly, incomplete disclosure requires shareholders, depositors and the public at large to have implicit trust in those at the head of great banking institutions, but this is well recognised to be the case by all concerned; were the position otherwise the banks could never have grown to their present stature, nor hope to maintain it. To demonstrate that the public interest is well served by the present arrangements—a position which depositors and shareholders have for long accepted—the banks have only to point to their record of soundness extending over many decades, a record which is certainly not surpassed in any other country.

23. Provisions as to Returns

The Clearing Banks would welcome relief from the heavy burden placed on them (and in fact on all public companies with numerous shareholders) in complying with the requirements of section 124 and the Sixth Schedule relative to the Annual Return of Members. The onerous nature of this return was recognised by the Cohen Committee and section 124 (1) (c) of the 1948 Act was enacted with the object of reducing the vast amount of wasted effort entailed, by providing that the full Annual Return of Members, which is required under paragraph 5 of Part I of the Sixth Schedule, need only be made every third year so long as a list of changes in holdings is submitted in the intervening years. In the experience of the Clearing Banks this concession has, in practice, proved to be of doubtful advantage. It entails additional work in the maintenance of supplementary records and some banks who have found that this additional work outweighs the value of the concession have continued to submit a full Return of Members each year. One Clearing Bank which avails itself of the provision under section 124 (1) (c) finds that every third year it uses 3,000 sheets of foolscap (both sides) and in each of the intervening years still uses 1,100 sheets. Such return (and the returns for many public companies) is largely out of date by the time it is filed and hopelessly so shortly afterwards. During the war submission of a Return of Members was dispensed with.

The information a Return of Members purports to give is always available for inspection in an up-to-date form, either at the Registered Office of the company or its Transfer Office, and in the case of a public company such inspection is today unlikely to excite comment or to embarrass anyone making an inspection. If, therefore, a Return of Members were no longer required, whilst there might be some loss of convenience inasmuch as an enquirer interested in several companies might not find all their records in the same building as at present, such convenience is largely illusory since the up-to-date information needed by any serious enquirer can at present only be obtained from the company's own register.

The Clearing Banks recommend, therefore, that all public companies whose shares are quoted on any recognised Stock Exchange in the United Kingdom should not be required to furnish Returns of Members. However, to safeguard the interests of shareholders and the public, the Registrar of Companies might be empowered to call for a list of members from any public company, such call not to be made more than once a year.

It is suggested that submission of Returns of Members by companies, other than the public companies mentioned above, should continue but in a less onerous form than is required in paragraphs 5 (a) and 5 (b) of Part I of the Sixth Schedule which call for

particulars not only of shareholders on the register at the date of the return but also particulars of all shares transferred by shareholders (or ex-shareholders) since the last return and the date on which each transfer was registered.

It would appear that this supplementary information is of value only in the case of partly-paid shares and the requirement was presumably originally designed to enable anyone to ascertain the names of those who would be placed on the "B" list of contributors in the event of liquidation. The Clearing Banks accordingly suggest that this information should in future be required only in respect of partly-paid shares.

Furthermore, in so far as a Return of Members continues to be required, it would be of considerable assistance if companies, instead of having to submit the return as at the fourteenth day after the Annual General Meeting, were allowed to compile it at a date within six weeks before or after the Annual General Meeting. Many of them could readily do this from the lists which they compile about that time for dividend purposes. In the case of small companies, where no share transfers may occur during the year, a statutory declaration to that effect would save work for the company and space in the Registrar's files.

As to Sections 113 (2) and 87 (2) (Charges for copies of Registers of Members and of Debenture Holders)

The Clearing Banks feel that in view of today's cost of providing such information, consideration should be given to:—

- (a) increasing the payment of 6d. for every 100 words or part thereof to, say, 2s. 6d.
- (b) extending the period of 10 days within which information is to be provided to, say, 28 days.

24. Company and Business Names

Effectiveness of present provisions (see Sections 17 to 19 of Companies Act, 1948 and the Registration of Business Names Act, 1916); similarity of names; misleading names

At the end of 1958 there were registered in England and Scotland:—

16,360	Public Companies
329,314	Private Companies

i.e., TOTAL
on Registers 345,674 against the figure of 182,943 in 1942 which was quoted in the Clearing Banks' written evidence to the Cohen Committee.

From 1930 to 1942 there were 160 registrations of new companies whose names included the words "bank", "bankers" or "banking". Since the 1948 Act, however, there have only been a dozen or so of these registrations to none of which an exception be taken. On this aspect, therefore, the Clearing Banks are satisfied with the effectiveness of section 17.

There is, however, nothing to prevent a company whose name does not include the word "bank" at any time from describing itself as bankers. Conversely, a company incorporated under the title of . . . Bank may subsequently change the character of its operations and yet continue to use its original name. It is for consideration whether the Board of Trade should be given power to intervene in cases of this nature where deemed desirable.

Similarly, some check might be desirable upon the use of the title or the word "bank" in the case of companies, other than recognised banks, incorporated overseas and trading here.

26. Internal Management and Administration

(a) Annual and other General Meetings

The Companies Act, 1948, section 131 (1) requires every company to hold an Annual General Meeting. Apart from a minor dispensation in the first year of its existence this obligation is absolute.

The directors must lay before the meeting a balance sheet and profit and loss account or if not a trading company, an income and expenditure account.

The company must send a copy of every balance sheet and its associated documents to:—

- (a) Every member, whether entitled to receive notice of general meeting or not.
- (b) Every debenture holder, whether so entitled or not.
- (c) All other persons entitled to receive notice of general meetings.

These documents must be sent out not less than 21 days before the date of the meeting.

There are many private companies for which the holding of an Annual General Meeting is a meaningless formality, for example wholly owned subsidiaries of public companies. It is submitted that the following proposals would save a great deal of needless work without prejudicing the rights of the shareholders:—

- (1) That a private company be relieved from the obligation to hold an Annual General Meeting in any given year if it has obtained the written consent of every person entitled to receive a notice of such meeting at the time when such forms of consent were issued by the company, and if such persons had before giving such consent received copies of the balance sheet and associated documents mentioned above.
- (2) That in order to enable necessary resolutions to be passed the Act should provide that a resolution in writing signed by all persons entitled at that same date to attend and vote at a general meeting of the company, should be as valid and effectual as if it had been passed at an Annual General Meeting of the company duly convened and held.

It is not suggested that there should be any provision to make the Register of Directors' Shareholdings accessible in the absence of an Annual General Meeting. Unless shareholders are completely satisfied with and have confidence in the board they should insist on such a meeting.

29. Other Matters within the Terms of Reference

Directors' Share Qualifications

The Clearing Banks consider that the period of two months within which a director must obtain his qualification shares under section 182 (1) is too short and should be extended.

2nd June, 1960

Supplementary Memorandum by the Committee of London Clearing Bankers

As promised by their representatives, the Committee of London Clearing Bankers have made a further exhaustive study of the exemptions available to banks from some of the accounting provisions of the Companies Act, 1948. The Clearing Banks have come to the conclusion that the principal exemptions were obviously deliberately compiled by the Cohen Committee as a code of privileges to form one coherent whole. Their emphasis as between one bank and another and perhaps even more as between the domestic and the overseas banks, may of course differ.

The specific exemptions from the requirements of the Eighth Schedule which the Clearing Banks were invited to reconsider, together with their views thereon, are set out below:—

- (1) (a) *in Profit and Loss accounts*—of amounts provided for depreciation, renewals or diminution in value of fixed assets (paragraph 12 (1) (a)), and

- (b) *in Balance Sheets*—of the method of valuation of fixed assets including the amount of the aggregate of depreciation provided since the date of acquisition or valuation (paragraph 5 (1)).

The Clearing Banks remain of the opinion that these exemptions belong with the others as part of the whole and for this reason they should not be withdrawn. In many banks the treatment of premises both in balance sheets and in profit and loss accounts is of significance in the overall deployment of inner reserves to safeguard the strength of their positions. In the case of some of the overseas banks we believe this question of the treatment of premises is even more fundamental.

- (2) *in Balance Sheets*—of market value of quoted investments (paragraph 11 (8)):

- (a) when below balance sheet values, and/or
(b) when in excess of balance sheet values.

In regard to (a) the Clearing Banks would not object if disclosure by way of a note on balance sheets, which has hitherto been made voluntarily, were made obligatory.

Entirely different considerations arise in the case of (b). As was stressed in oral evidence, market value is not necessarily a realistic basis of valuation. Disclosure of market values when in excess of balance sheet values would reveal a paper profit which might be fugitive and indeed unrealisable. Furthermore, disclosure of market values when in excess of balance sheet values could lead to conjecture as to the extent of investment reserves. For these reasons we consider the present exemption should be continued.

- (3) *in Profit and Loss accounts*—of the amounts, if any, transferred to or from reserves before publishing the profit figure (paragraph 12 (1) (e)).

The right to make undisclosed transfers *from* inner reserves is as essential to the stability of the banking system as is the right to make undisclosed transfers *to* such reserves. For all the reasons set out in our evidence we regard as essential the exemption from disclosure of sums so transferred.

The formula for the disclosure of net profit as used by the Clearing Banks is to the effect that net profit is shown after providing for taxation and after deducting transfers to inner reserves out of which reserves provision is made for diminution in value of assets. It should be stressed that if a transfer were ever made *from* inner reserves in order to increase the net profit disclosed or even to turn an actual banking loss into a banking profit the formula would have to be changed accordingly. This would certainly be a requirement of the auditors.

Some of the exemptions of less apparent significance were afforded so as to make the published accounts of banks comprehensible, for by the nature of their business certain of the requirements of the Eighth Schedule have no practical application. Clarity, not concealment, was the motive behind these exemptions. Others are of such a nature as to be relevant to the matter of inner reserves.

2nd March, 1961.

APPENDIX XXVII

Memorandum by The Institute of Actuaries

Disclosure of Reserves of Life Assurance Offices

(1) Under the Companies Act, 1948, Life Assurance Offices are among a small group of concerns exempted from full disclosure of reserves. The case for non-disclosure is briefly stated in the Report of the Coben Committee, paragraphs 101 and 102. This memorandum re-examines the situation and makes certain suggestions.

(2) There are basic differences between life offices and other concerns, and a consequence is that different information is required to give a true and fair view. For this reason life offices are subject to different legislation: on the one hand receiving exemption from requirements of ordinary company law which are unsuitable to their special circumstances: on the other, being under obligation to make extensive special returns to the Board of Trade which would have no relevance to an ordinary trading company.

(3) In our opinion both consequences—special exemption and special obligation—are right and should be maintained. The question whether or not to disclose "hidden reserves" is a particular example which illustrates the general case. The principal point is the publication of market values of assets and it is on this we concentrate. We deal with life offices as going concerns, and not with the very rare circumstances of winding-up or sale.

(4) The implication behind the claim that life offices should publish market values is that the excess of market values over balance sheet values of assets is a hidden reserve the size of which would be informative to the public. The essence of the reply is that this excess is *not* a measure of hidden reserve and that its publication would be misleading. A detailed explanation of this statement is given in an Annex but the following paragraphs outline the main points.

(5) The fundamental difference which distinguishes life offices from other concerns is that they issue long-term contracts stretching for many years into the future. To balance these long-term liabilities they invest their assets mainly in long-term securities. Both liabilities and assets include contingent elements such as rates of mortality or future equity dividends.

(6) The reality behind the affairs of a life office is the long series of payments which fall to be made or to be received in future years and it is the sensitive balance between contingent income and contingent outgo which must be measured to decide the solvency of the office and to make a reasonable estimate of the surplus.

(7) Any compression of these long series of payments into a single "present value" introduces subjective and transient elements dependent on the individual valuer, the method of valuation adopted, and the circumstances at the time. Present values are difficult implements to use. For example an increase of $\frac{1}{2}$ per cent. in the rate of interest used in valuing the liabilities can turn a substantial deficit into a substantial surplus. Even in skilled hands, compression of the real future events into estimated present values requires—

- (a) that the valuations of assets and liabilities are related to each other, and
- (b) that to provide any meaningful estimate of the surplus arising over a period, there must be stability between the bases used at the beginning and end of the period under examination.

(8) The particular present value represented by the quoted market value of assets at one moment of time is determined by the outcome of the balance between buyers and

sellers and is not determined on any basis which is consistent with the basis on which the liabilities are valued. The market value of assets can be, and frequently is, subject to large swings without there being any corresponding movements in the underlying realities of future income and outgo.

(9) There are a number of reasons why market values change. A major reason is a change in the rate of interest and in this respect market values usually imply the reverse of the truth. For life offices with long-term commitments and expanding funds, a high rate of interest is beneficial and a low rate dangerous. Market values are however low when interest rates are high and *vice versa*. Post-war history contains several examples. In particular, in 1947 market values gave an appearance of strength when the fortunes of life offices were at their lowest ebb for many years. By 1957 offices had regained much of their strength but the market values at the end of that period gave an appearance of dangerous weakness. The true developments of these post-war years have been properly demonstrated in the published accounts by rising surpluses and rates of bonus.

(10) It is not always easy, even within the industry, for the actuary to dispel the misconception created by the conflict between appearances, as displayed by market values, and the underlying realities. Publication of market values would make the task of concentrating on realities more difficult. For example, it could well lead to pressure to invest short, thereby minimising the risk of large fluctuations in market value, to the detriment of the real need to invest in long-term assets to balance long-term liabilities.

(11) For the foregoing reasons we deprecate the publication of market values of assets. To support the exemption from normal disclosure under company law does not however dispose of the question whether some alternative information may not be required under insurance legislation. Although this is not the place for a full technical discussion of insurance legislation we give brief consideration to this wider question because it is the corollary of the claim for exemption under company law.

(12) It is understandable that the general public should think that the market value of assets is a relevant factor. But it is the wrong question because the reality in the life office problem is not some passing value put upon the assets but the future income they produce. The counterpart of information about market value of investments, which may be relevant for a trading company is, for a life office, information about future income.

(13) For a full appreciation of the whole situation, responsibility must lie with the actuary, dealing with assets and liabilities as essential parts of the same picture. It is his statutory duty to assess the surplus and he must therefore be satisfied regarding both assets and liabilities. In so doing he must take into account all aspects of the assets.

(14) To the outside observer however there is an apparent discrepancy between the extensive information required about liabilities and the absence of similar information about assets. In part this is due to the nature of the growth of liabilities which requires a special apparatus of valuation. But there is a case for consideration whether every aspect of this difference in information about liabilities and assets is justified: whether one should not be reduced or the other increased. In particular, offices supply extensive information, usually quinquennially, in the Fifth Schedule of the Board of Trade returns under the Insurance Companies Act, 1958, which allows the outside observer to judge the spread of the liabilities according to term but they are not required to give comparable information about the spread of term of the assets. To put it briefly, while the current income from the assets is known from the revenue account there is no information about the length of term of those assets to enable the expert observer to judge the balance between assets and liabilities. There are many practical difficulties but the problem deserves examination.

Conclusion

(15) In our opinion there is a strong case for exempting life offices from any general legislative requirement to publish market values of assets but there is a case for examination whether the information given in the Board of Trade returns about liabilities and assets is in the most useful form.

14th June, 1960.

ANNEX

The Special Nature of Life Offices

(1) Life offices are fundamentally different from other concerns in two important respects:—

(i) The contracts they issue are for long terms stretching for many years into the future. To balance these long-term liabilities, the assets are mainly long-term securities.

(ii) The benefits to policyholders include substantial non-guaranteed "bonuses", which are usually a large proportion of the total surplus accruing. A steady surplus policy is an essential part of life office management.

(2) Both liabilities and assets consist partly of fixed and guaranteed elements and partly of other elements to which some measure of probability has to be attached, e.g., payments dependent on death and future equity dividends.

(3) In addition to the balance sheet, which is prepared broadly in normal company form, a life office is under an obligation to provide detailed analyses of its liabilities in the Fourth and Fifth Schedules to the Insurance Companies Act, 1958.

The Valuation Problem

(4) A life office valuation has two distinct, and in some ways conflicting, purposes:

(a) It must demonstrate solvency. This is the main purpose of existing legislation and is the area in which public interest is unquestionably justified.

(b) It must provide a proper control over the equitable emergency of surplus. Since most British life offices are indubitably solvent, and have been so for many years, it is this problem of surplus which is of primary concern to the actuary. It is an intricate actuarial problem which is difficult to publicise adequately.

(5) The reality in the situation is the long series of payments which fall to be made or to be received in future years. These consist on the one hand of the "liabilities", comprising future benefits and expenses less future premiums arising under the assurance contracts, and on the other hand of the "assets", comprising future interest and dividends plus capital repayments arising from the investments. While the reality is the long series of payments, the "valuation" of the liabilities or of the assets is a compression of the series of payments into a single, synthetic "present value". This present value inevitably contains some subjective elements dependent on the individual valuer and the method of valuation he adopts. It may well also be a transient value dependent on circumstances at the point of time at which it is obtained.

(6) Clearly the outcome of a valuation can be meaningless if the valuations of assets and of liabilities are not related—if, for example, a lower present value is given to a liability of £100 in 20 years time than to a similar asset.

(7) The surplus over a period cannot be sensitively measured if there is a change of basis of valuation over the period. Valuations are necessarily broad procedures which have to compress all the details of perhaps millions of policies or thousands of investments into one single present value. Changes in bases can produce distortions which are comparable in size with the surplus which they are designed to measure—and which have no counterpart in the underlying realities of the series of payments which are valued.

(8) The practice has therefore grown up, and is largely inevitable, that well-established life offices adopt a stable method of valuation. Assets are usually kept at book-value and liabilities are valued on a steady basis which is infrequently changed. On the rare occasions when a change of basis is made, special treatment is necessary in the accounts:

but the actuary will usually determine what is an equitable surplus for the period by internal stable valuations at the beginning and end of the period.

(9) This method is satisfactory as a means of establishing a fair surplus, but it does not automatically establish solvency. For most well-established offices solvency is demonstrated as a by-product of their normal stable methods of valuation. A margin between book-values of investments and current market values is created over the course of time with the result that book-values can usually be certified as less than market values (perhaps after bringing investment reserves into account). When markets are very depressed and this certificate cannot be given, it is usually possible, though troublesome, safely to raise the rate of interest employed in the valuation of liabilities since a depressed market is usually associated with a high rate of interest.

(10) In obtaining a present value the most critical factor is the rate of interest. In determining the interest rate for valuing the liabilities the actuary is primarily influenced by his knowledge of the underlying realities. He can rely upon the rate of interest implied by the book-value of the assets in so far as those assets are matched as to term against liabilities, and in so far as there is any mismatch he will use cautious assumptions. In using the rate of interest implied by the book-value of assets he will, of course, make allowance for any speculative element in the current interest income.

Disclosure of Market Values of Assets

(11) It will be apparent from the foregoing that a statement of the market values of the assets has little relevance either to the solvency of a life office or to the proper emergence of surplus. Nor has it much relevance to the capital strength of the office.

There are three main reasons why market values change:

- (a) *The rate of interest alters.*—A change in the rate of interest does not affect the income from past investments and, provided that assets and liabilities are balanced as to term, the underlying realities in the valuation situation are unchanged. Therefore, the consequential changes in market values with their implication of greater or less strength are irrelevant and seriously misleading to the non-expert.
- (b) *The income from ordinary shares or properties alters.*—Changes of this nature do affect the realities of the situation and have some significance. They are, however, not necessarily permanent changes and must be treated with some caution. In any event the effect of such changes is already apparent in life office accounts from the consequential effect of changes in the yield on the funds. This is a more sensible reflection of the change in the situation than publication of increased market values, which immediately capitalise the effect of the change, although the change in fact only fructifies over future years.
- (c) *The market estimation of ordinary shares or properties may change without any accompanying change in income.*—Such changes, which are large and frequent, are especially irrelevant to the affairs of a long-term investor and their publication can only mislead. Market values may have the appearance of being an objective assessment of "real" value. They are, however, only the marginal values in a shifting market determined by the temporary balance between buyers and sellers. They are in no sense a *realisable* value of the assets since any attempt to sell any volume would disturb the market.

(12) This examination shows that market values have little value to the expert, who already has a guide to the real position of the office in the yield on the funds. To the non-expert, market values would often create misconceptions—sometimes seriously. For example, in 1947 market values were high but the fortunes of life offices were at a relatively low ebb. At the end of 1957 offices were in a much stronger position but market values were very low and would have given an impression of dangerous weakness. The true story over those years was the opposite of that implied by market

values and was properly demonstrated in the published accounts by rising surpluses and rates of bonus.

(13) It cannot be too strongly emphasised that the reality is the actual income and outgo over future years and any figures, such as current market values of assets, which capitalise, and therefore magnify, transient and subjective elements in the situation can be dangerously misleading if they create, as they almost certainly would, unwarranted fears of insolvency or claims for large capital distributions.

(14) It is worth stressing that there are three implied "errors" in the publication of market values. The first is that it incorporates purely transient features such as the effect of temporary changes in the rate of interest or temporary optimism or pessimism in the equity market. The second is that it implies that current market values are realisable values. The third "error" is that even if the features are not transient, such as increased equity dividends, market values *capitalise* the feature and bring the implication that what is to be received perhaps in perpetuity is available for immediate distribution.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
TENTH DAY

Friday, 6th January, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN (*Questions 3185 to 3500 only*)

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E. (*Questions 3370 to 3633 only*)

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D. (*Questions 3185 to 3500 only*)

MRS. M. NAYLOR

MR. C. H. SCOTT

MR. R. SMITH

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

SIR OSCAR HOBSON, MR. E. D. L. DU CANN, M.P., MR. G. H. FLETCHER,
MR. O. P. STUTCHBURY and MR. W. G. N. MILLER *called and examined*

3185. *Chairman:* We are very much obliged to you, gentlemen, for coming here to help us, and for the paper you have contributed on the subject of Unit Trusts. To keep our records in order, may I just see that we have got your identities correct. You, Sir Oscar Hobson, as I understand, are Chairman of the Association of Unit Trust Managers and Mr. du Cann, Mr. Fletcher and Mr. Stutchbury are members of the Association; and Mr. Miller is here as secretary of the Association?—*Sir Oscar Hobson:* Yes.

3186. Now your Association includes, as I understand it, the managers of all authorised unit trust schemes as defined in section 26 of the Prevention of Fraud (Investments) Act, 1958, with the exception of managers associated with the Municipal & General Securities Co. Ltd.; and it also appears—measuring the strength of your Association by reference to funds invested—that the Unit Trusts managed by members of your Association represent more than 90 per cent. of the total sum so invested; that is what you put it at in your memorandum.—That is correct.

3187. Now, I gather that it is your view that the unit trust as at present understood—that is, the tripartite scheme with trustee, manager, and investing member of the public—is an institution which should be retained?—Yes.

3188. You regard it as a satisfactory method of providing opportunities for investment to small investors?—Yes. We regard the set-up, particularly when the trustee is a bank or a first-rate insurance company, as having the confidence of the small investor, and in view of the fact that it has had a 20 to 30 years' record, we regard it as a system which ought to be retained, rather than replaced by the American system of investment companies, that is to say open-ended trusts run by companies.

3189. And while you think that this kind of scheme should be retained, you are not wholly satisfied with the legislation under which these schemes have to be operated at present, I gather?—We do not think they should be governed by an Act in which the word "fraud" appears prominently.

3190. I appreciate the point that in a sense unit trusts were put undeservedly into rather bad company, but subject to that, which is really a matter of legislative arrangement, are there any other complaints you have to make about the statutory regulations? Your memorandum does indicate that you think that this legislation ought to be modified.—Yes. We would like greater freedom. We are not too comfortable about the regulation carried on by the Board of Trade, which does seem rather sluggish; it does not move at all quickly. It is quite right, however, that we should be subject to rather more precise and meticulous regulation than other forms of investment. We are concerned very largely with small investors and we do recognise that on that account it is quite right that we should be rather more strictly regulated than, say, investment trust companies or other forms of investment.

3191. Yes. You have made a series of references to the legislation and the way in which it is operated in your memorandum, and you say quite clearly that you regard the present law as inadequate. On the other hand, you say that in your view statutory control should not be diminished, but you say, added to that, that you deprecate day-to-day control by the Board of Trade of the business operations of your unit trusts?—Yes. I think it would be impossible for them to be regulated from day to day; it is quite an intricate business; there are a lot of technicalities; and of course the managers are bound, under the trust deeds, to buy back units from the unit holders day by day and to fix the prices, in accordance with the Board of Trade regulations, at which they do buy units back.

3192. Then would your position be fairly put like this: you recognise the necessity for legislation on the general principles to be observed by all unit trusts, but, subject to that, within the framework of these general principles, you think the trusts should be left to manage their own affairs to a greater extent than is the case at present?—Well the regulation goes pretty far now, the Board of Trade regulate the calculation of the yield of our units which we quote daily in the news-

papers; I think we are satisfied with that, although such regulation does not apply as far as I know to any other form of investment. But we do not want any more day-to-day regulation imposed on us; and I think I may say that this is so particularly since the formation of the Association which my colleagues and I represent here, because we are watching very carefully the conduct of our members, and we have made certain representations to certain members. I am a newcomer to this business, and I have been impressed by the keenness of the members of the Association to behave as ethically as possible towards the investing public.

3193. What we really want from your Association is this. This Committee has been set up to look into (amongst other things) unit trusts, and to recommend any alterations in the law which may be desirable. What we want from you is a statement of the objections you have to the legislation as it now stands and any complaints you have as to the way in which that legislation is administered by the Board of Trade. We have got to come down to the particular in the end, although I do not think it would be for this Committee actually to settle the language of any new regulation or new legislation.—No, I quite understand. My three colleagues here have spent part of their lives in administering unit trusts, and I think Mr. du Cann, for example, would be better able to speak to this particular point, as to the exact area of regulation which we think is needed, than I am.

3194. Could you just summarise it?—*Mr. du Cann*: I think so. I think you put it very well in your summary to Sir Oscar. I think that is exactly the situation that we should like to see. There is no criticism of individuals in the Board of Trade in the very least; we simply feel that as the legislation is currently designed an enforced responsibility is placed on individuals in the Board of Trade, because they have at the moment an obligation to regulate every matter in connection with the administration of unit trusts, and they cannot, of course, be anything like so familiar with the details of the day-to-day operations as those of us who are engaged in unit trust management and trusteeship;

and, because of the present legal framework, a somewhat embarrassing and difficult situation has arisen, both from the point of view of the Board of Trade on the one hand and of the trustees and managers on the other hand. For example, to be specific, there have been occasions when the wrong things have been controlled, and there have been other occasions when things which we think should have been controlled have not been controlled. I could give you examples of that, if you wish. We feel that it is probably right that the Board of Trade should have authority to control what you might call the principle of unit trust management, and thereafter the trustees and managers together should be given an opportunity to get on with the job, and to get on with the job in circumstances which are bound to change. A particular example of the sort of embarrassment which has arisen relates, for example, to the question of the Board of Trade accounts. The Board of Trade takes power to regulate the form of account which is sent out to the unit holders from time to time, and those accounts are at present thoroughly misleading, and we think could be very much improved. Although we have last year's Finance Act which changes the basis of unit trust distribution, we are still tied at this moment to an outmoded formula by which we have to calculate yields. There are examples of that sort which arise from a changing situation, and we think that control of matters of that kind can quite properly be left to us. We are very conscious of our responsibilities in these matters, because we are, after all, dealing with new investors and we are very anxious to see that they get all the proper information to which they are entitled. And we are anxious to see that future legislation protects these investors. But we think that this present control is not satisfactory and that it works very badly in practice.

3195. So perhaps, broadly speaking, what is wanted is something on the lines of what you do suggest in your memorandum, that is to say that certain general principles should be laid down either in the body of a new Act or in a Schedule; and that provision should be made for a

model trust deed, which might also be scheduled to the Act, which would be accepted by the Board of Trade as embodying the essential principles; and that, so far as possible, within those general principles embodied in the model trust deed, each unit trust should manage its own affairs?—I think that would suit us precisely, yes. I think that would be a very satisfactory situation from everybody's point of view, not least from the point of view of the Board of Trade.

3196. Yes. Of course, the difficulty is to distinguish between what is to be regarded as a basic principle and what is to be regarded as a matter of current management?—I think there may be certain marginal matters as to which it may be difficult to decide whether they are matters of principle or matters of detail, but I think in general we are quite clear about the main points of principle and about their formulation.

3197. Well, perhaps we could come back to that a little later on. Now, there are one or two further points that I would like to ask you about in relation to what have been called "mutual funds" to distinguish them from the unit trusts. Now, you would say that the present concept of the unit trust should be retained. When one considers that view in relation to the mutual fund system, do you mean that you would oppose the setting up in this country of mutual fund companies?—I think the point is that we feel that the safeguards for the investor inherent in trusteeship are something which is fundamental, so to speak, from the point of view of the protection of the investor, and we therefore prefer the present system here.

3198. Of course, that rather depends on how the mutual fund is constituted; I do not know if you could help me about that. Is it simply what is called rather loosely an investment trust company—an ordinary limited company carrying on the business of managing investments—the place of the unit holders being taken by shareholders; and the mutual fund makes a market in its shares by a system of buying-in and re-issuing its shares, I suppose? Is that what is contemplated?—That is broadly what happens in the

United States, but there are, of course, two types of open end mutual fund in the United States besides the ordinary orthodox closed-end funds. The open-ended funds are of two sorts. The vast majority of them are companies, but a number of the older ones are trusts of the kind which operate in this country.

3199. Then in the case of the first type, where you have a shareholder instead of a unit holder, the position is that there is no trust fund?—There is no trust fund, no.

3200. There is simply the paid-up capital and there are the assets of the business of carrying on investment?—Yes. There is no trust fund in the United Kingdom unit trust sense.

Sir Oscar Hobson: I think some of them have custodian trustees who look after the securities, but who have no concern with the management of the fund.

3201. The next point is that, where the mutual fund is of the kind we have just been discussing, the shareholders get something which is quite different from their interest in the trust fund under a unit trust scheme?—*Mr. du Cann:* I am not quite sure that they get something which is quite different, because the point is that the prices of the company's shares are calculated daily in strict relationship to the asset value.

3202. Yes, but under a unit trust the unit holder is told that his unit is represented by underlying assets in the hands of the trustee, and those assets cannot be touched by anyone except the trustee and the manager carrying on the trust in accordance with the terms of their trust deed?—That is correct, yes.

3203. But the holder of shares in a mutual fund is simply a shareholder. All he has to look to is the net assets of the company remaining after discharging all the liabilities?—That is correct, yes.

3204. So the two things are radically different in that respect?—Certainly.

3205. But as against that, the shareholder in a mutual fund has a right comparable to that of the unit holder in a unit trust in that he can demand the purchase of his shares by the company?—Yes.

3206. And, of course, that would cut across the ordinary company law?—Yes, it would; and we think that it suffers from one fundamental defect, that is, that the trustee in the United States acts simply as a custodian; he has no regulatory authority.

3207. We have dealt with the first kind, which is similar to an investment trust company but where the shareholders are given a special right to be bought out at a price representing an aliquot share of the net assets in hand?—Yes.

3208. Do you see any objection to having an investment trust company with a provision giving the shareholder the right to sell his shares to the company?—I do not see any objection in principle, no, but I think it would be very difficult to arrange in the United Kingdom under the existing company legislation.

3209. And you, on the whole, prefer your type of scheme, do you?—We do, Sir, yes.

3210. Now, the other kind of mutual fund, I gather, is one in which there is segregation of the subscriptions of subscribers in the hands of a trustee?—Yes. The second type of mutual fund more closely corresponds to unit trusts as we know them in the United Kingdom.

3211. The position is that you have got in effect a unit trust of the kind recognised in the United Kingdom, if you have got a trustee who holds the fund?—Yes, but the trustee's position in the case of these trusts in the United States is not as strong as the position of the trustee in the United Kingdom.

3212. The trustee is an independent entity there, I suppose?—It is an independent entity, but again its functions are much more those of a custodian than a trustee with regulatory powers.

3213. *Mrs. Naylor:* Could the trustee in the United States get rid of the management of the company?—I do not think so. I do not know of any cases where that obtains, and of course the majority of the second type of open-end mutual fund are the older ones. It has not been the practice in recent years in the United States to establish trusts as opposed to companies.

3214. *Mr. Brown:* The shareholders of the company type of mutual fund have power to remove the directors and the management?—I am not sure about that.

Mr. Miller: The shareholders of the fund have a say in the election of directors and must approve certain contracts which are made between the management of the company and their investment advisers.

3215. So there are not just directors of the company, there are also investment advisers?—Most funds have investment advisers and it is the contract between the board of directors and these advisers which must be approved annually by the stockholders.

3216. *Chairman:* One vital point of distinction seems to me to be whether the fund, which the shareholders corresponding to the unit holders look to, is a segregated fund held for the purpose of satisfying their claim and not liable for the debts of the managing company?—*Mr. du Cann:* I think that is absolutely right, Sir.

3217. That is the vital distinction, and you say that in this kind of mutual fund there is segregation of that sort?—So I understand, yes.

3218. Then you attach great importance to the feature of the unit trust system that all the assets in the fund must be vested in a trustee?—We do, Sir.

3219. Is there any other advantage in that beyond the protection it gives against misappropriation of the funds? What other protection is given by having a trustee?—Well, the fundamental point is as you have said, Sir, that the assets of the trust are held in safe custody; but it goes a great deal further than that, because the trustee, at present, has the responsibility of supervising all the operations of the unit trust. We also think that to be important. We further think that it would be right that the trustee should have stronger powers to act as appropriate.

3220. You do say in your summary of recommendations, paragraph 44 (d) of your memorandum, that your proposed new Act should include provision to

ensure that the trustee is completely independent of the manager, that his powers are strong and well defined, and that he is not able to opt out of any of his responsibilities. His powers are to be strong, but what are his powers to be: that is really what I am asking you?—*Sir Oscar Hobson:* In most trusts, if not all, a change in the list of investments to be held by the trust has to be sanctioned by the trustee, so that the managers would not be able to slip in a poor type of investment without the consent of the trustee.

3221. You say that is the case. Is it universally the case so far as the unit trusts in your Association are concerned?—*Mr. du Cann:* No, it is not universal.

Sir Oscar Hobson: In the trusts with which I am concerned, it is. The trustee has to give its permission in the case of any change in the list of investments.

3222. The unit trusts have a published portfolio of investments, I suppose?—Yes. They always start off like this: if they make a public offer, they advertise a portfolio of investments within which they have to invest, but sometimes, and quite frequently, trusts may wish to extend the portfolio to include investments which are not in the original list, and in that case—certainly in our case—the bank, which is the trustee, has to give its permission.

3223. There is that case, then, where there is a portfolio of investments specifying the classes of investments which can be held and the maximum proportion of any one security which can be held?—It specifies the individual companies.

3224. Not just the categories of shares?—No.

3225. Then you say: "One of the functions of the trustee would be to refuse an investment which did not fall within the portfolio", do you not?—Under the trust deed, the original list can be extended if the managers want to invest in other desirable securities, but in that case the trustee has to give his consent.

3226. Yes, I quite follow that. If the managers propose to invest outside the portfolio which they have gone to the

public on, then they must obtain the sanction of the trustee?—Yes.

3227. But I was thinking of transactions within the portfolio?—Oh, no, they have no concern with investments inside the portfolio; they have nothing at all to do with investment of the funds unless the managers wish to go outside the portfolio; then they have to give their consent to the addition.

3228. Yes, and you say that the portfolio probably particularises the permitted investment so far as actually to name the companies?—Yes.

3229. Supposing one of these companies, although a very flourishing concern, met with reverses so that at the moment when the manager proposed to buy some ordinary shares of this company there was a Receiver in on behalf of the debenture holders, would the trustee have power to say: "No, we cannot allow this"?—As far as I know, they could not go to the manager and say "You must sell these shares".

3230. Could they say "You are not to put these shares on us—you are not to buy them"?—I would not like to answer that positively, but I would not have thought so.

Mr. Fletcher: In our case they would. They have a complete veto of any change within the portfolio. The scheme must receive the approval of the trustees.

3231. And in your case is your portfolio a list of investments authorised by name of company?—Yes, actually named securities.

3232. And even so, you say that in your case the trustees can veto investments in securities specifically mentioned in the portfolio?—Yes, a complete veto.

3233. Without assigning any reason?—Yes. Changes of investments within the portfolio can only be made with the approval of the trustee who can withhold approval without assigning any reason.

3234. I think this Committee would like to know which of your constituent trusts gives a general form of veto to the trustee and which of them merely gives the trustee power to prevent the manager from investing outside the portfolio. The first of these two powers would be enormously

important for the protection of the unit-holder. The second of them would be almost a ministerial act because the manager would be committing a breach of trust in transferring outside the portfolio?—There is the case where the trustees contract out of any responsibility in regard to investment changes. It is a matter for the trustees who undertake the task to lay down how far they wish to go.

3235. I have known certain great institutions who act as trustees, and they are always most keen to have a clause put in saying that the trustees are not to be responsible for anything, but they are equally very keen on saying that the trustees shall receive remuneration?—*Sir Oscar Hobson:* We can, if you like, supply the Committee with an analysis of the trust deeds covering this particular point. That, I take it, is what you would like to have?

Chairman: Yes, and I would like to know how far your constituent members would be prepared to give the trustee wide powers.*

3236. *Mr. Mackinnon:* In the case of this trustee who is not allowed to intervene, is he in practice anything more than just a custodian who holds the securities, because one of your fundamental arguments against the American system is that under the American system there is no controlling trustee who can control the investments?—*Mr. Stutchbury:* First of all, in a fund such as we have, where the trustees have only limited control over investment, the kind of thing they watch is whether the managers are buying cum dividend and selling ex dividend. But, of course, apart from this investment function, one of the prime functions they have is in regard to the expansion and contraction of the fund. It is absolutely vital that when the fund expands, exactly the right amount of money is put in in order to create the new units, and similarly when the fund contracts it is essential that the managers get paid no more than they are entitled to under the strict terms of the trust deed on the sale of investments.

* A supplementary note, submitted by the Association in response to this question, is printed in Appendix XXVIII, page 723.

And this is the kind of thing which the trustees have to look after; it is something which could never be done unless they were there; and as between the unit holders who are coming in and the existing unit holders, it is most important that someone should have that function.

3237. *Chairman*: Calculating the value of the underlying securities from day to day compared with the number of units in issue?—It is more or less that, but the situation is different where the fund is expanding from what it is where the fund is contracting, because when the fund is expanding, when you are creating new units, you put in the amount of money required to buy another lot of securities to make the fund of the same strength after the expansion as it was before it. And similarly, when the fund is contracting, the price that whoever has the units that are being cancelled gets paid must be precisely the right price for the securities that have got to be sold. This is a function in which the managers are often personally closely interested because they are often the people who own the units which are being cancelled and so they have an interest in seeing that they are paid as much as possible for them. And similarly, when the fund is expanding, units are sometimes issued to them and they have a personal advantage in seeing that they pay as little as possible for the units. It is most important that your trustee should be there to check on all the calculations, to see that the prices of the underlying securities have been correctly ascertained and that the whole job is being done properly. So that it is not only on the investment function that trustees have an important part to play.

3238. So in some cases the trustees have the power to veto an investment outside the permitted portfolio?—Yes.

3239. And in other cases they have a general power of veto, so that they can refuse to accept shares, although they are within the limits of the portfolio, because they do not think that at a particular period it would be a good thing to do?—Yes.

3240. Then there is this third function of verifying the figures on expansion or contraction of the fund and seeing that

the units are paid out at the correct rate?—And I would interject a fourth one, before the third one, and that is that they must be careful to see that the underlying securities are not always bought cum dividend and always sold ex dividend, because that is a way to push up the distribution.

3241. Is this important function reflected in any clause in the ordinary trust deed?—Very much so. It is one of the things which quite properly the Board of Trade have been very careful about in the past.

3242. So the trustee has this very active duty?—Yes.

Mr. du Cann: In discussing these several individual points, of which we have now got four, this list is by no means exhaustive; there are many other things which the trustee does which are of similar importance.

3243. Well, what are they?—For example, the trustee stands possessed of all the income of the trust, and he has responsibility for its distribution to the unit holders; that is a particularly important function which the trustee has.

3244. *Mrs. Naylor*: And he can remove the management of the company?—*Mr. Fletcher*: Yes, he can do that; and he must approve the appointment of the auditors.

Mr. du Cann: Then he is also responsible for maintaining the register of unit holders.

3245. *Chairman*: That is he performs the functions of a registrar. He keeps a register of the unit holders, transfers in and out, and that sort of thing?—Yes.

Mr. Stutchbury: He has the specific obligation to see that no certificate is issued unless the deposited property is in his own hands before it is issued.

3246. Then I have a note, and it appears from your memorandum, that the trustee is charged with a duty as to the form of advertisements sent out?—*Mr. du Cann*: Yes. That is another important function. The list of the trustee's responsibilities is very long.

3247. So he is an active watchdog; he does not merely go to sleep at the back

of his kennel and come out periodically to take a bone?—Well, he certainly comes out periodically for a bone!

Sir Oscar Hobson: But some of them are more active than others.

3248. *Mr. Brown:* Regarding the reference here to trustees opting out of their responsibility, is it clear that that is so at the time the trust is set up, or is it suggested that this becomes clear at a later date?—*Mr. Stutchbury:* Well, Sir, I have got here—it is something which the Board of Trade never worried about in the past—a perfectly normal trust deed, and clause 32 of it says: "In addition to all indemnities powers and privileges granted by law to trustees and by way of supplement thereto *IT IS HEREBY EXPRESSLY DECLARED* as follows"—and then there are set out several things that the trustees are not responsible for: for example:—"(d) The trustees shall not be responsible for any misconduct mistake oversight error of judgment forgetfulness or want of prudence on the part of any attorney banker lawyer agent or other person appointed by them or bound to supervise the proceedings of any such appointee." Why on earth should they not be responsible for that? These are all standard form, and in the past they have always got away with it; so they get away with it today.

3249. *Chairman:* We have dealt with the various powers which are commonly conferred on the trustee by unit trust documents, but could you say how far you would accept these duties of a trustee as involving basic general principles, so that they might be laid down by any new legislation as matters with which the trustee must conform? In other words, would you set it out in the model trust deed which you propose should be scheduled to the Act?—*Sir Oscar Hobson:* Yes, indeed.

3250. Then the next point is this. Comparisons have often been made between the unit trust system and the limited company—contrasting the position of the unit holder in a unit trust with the position of a shareholder in an investment trust company, and also comparing the position of the directors of the company and the managers of the unit trust. You

rightly say in your memorandum that unit trusts are not companies; they are trusts. Various things, of course, flow from that. It means that, subject to the Prevention of Fraud (Investments) Act, you can offer units without a prospectus and without complying with the provisions of the Companies Act?—Yes.

3251. What provision do you think should be put in any regulation made under new legislation to make sure that the subscriber to the units gets some degree of protection as regards disclosure of the position of the trusts and so on?—I should say that was really taken care of by the trustee. If the trustee is an insurance company or a bank of high reputation, he is not going to become a trustee unless he is assured that the managers are responsible people and will use skill and get good advice in investing their funds. The qualification now in the Act for the trustee does not sound a very satisfactory one. I think, roughly speaking, he has got to have a paid-up capital of £500,000. I think in all cases the present trustees are far above that class; they are mostly either one of the big five banks or one of the highest class of insurance company. I think this is really taken care of if you have that class of trustee.

3252. But if you applied that principle to the ordinary prospectus, the way of the promoter would be much less difficult than it is now. He could simply say "I have got the Midland Bank acting for me."—But the Midland Bank has no responsibility in that case.

3253. Or "Here is an issue of debentures. We have only to get some honest concern to act as trustees for the debenture holders." That would not do, would it?—If we had a standardised form of trust deed ensuring that the trustee could not absolve himself from doing the things that Mr. Stutchbury was talking about, I should have thought that would take care of it.

3254. What I am really getting at is this. Would it be right to include in any trust deed as a matter of basic principle a statement of the things of which any subscriber should be informed in any literature sent to him and before obtaining any subscription from him?—Certainly.

3255. That would be a provision embodying the minimum degree of disclosure which is considered obligatory on every unit trust scheme?—Yes.

3256. Then, pursuing the comparison and contrast between a unit trust and an investment trust company, if one treats the unit holders as being in the position of shareholders, treating them as if they were the same, do you think the unit holders ought to be given, by analogy with the case of the shareholder, powers to remove the trustee or to remove the manager?—Yes.

3257. You think the unit holder should have power to do that?—*Mr. Stutchbury*: Yes.

3258. Of course, if they were accorded that power, you might get some difficulty in the interregnum, so to speak. Supposing somebody gathered a sufficient majority of people to support him, he could insist on the immediate removal of the trustee and the managers, and then you would have the unit holders monarchs of all they surveyed?—But the Court of Chancery will never allow a trust to go without a trustee.

3259. But the question is whether they are going to find one. Beyond that, do you think the unit holders should have power to intervene in that way?—*Mr. du Cann*: Yes.

3260. So you would agree that the model trust deed would have to include provision for defining the powers of the unit holders and the way in which those powers were to be exercised. You would have to have provisions similar to those in the articles of association of a company about meetings and proceedings and so on.—We all have similar provisions in our trust deeds now. It is quite standard form.

3261. You have something like what is common form in a debenture trust deed?—*Mr. Stutchbury*: Yes.

3262. Enabling the rights of the unit holders to be varied by consent of a majority?—*Mr. du Cann*: Yes. There are provisions for calling meetings, the method of the proceedings is described, and there are fairly far-reaching powers

for the removal of the manager by a majority, etc.

3263. Apart from the provisions in the trust deed, there is paragraph 7 of the First Schedule to the Prevention of Fraud (Investments) Act, 1958, under which the trustee can remove the manager?—Yes.

3264. That, of course, is statutory; and, over and above that, you would give the unit holders power to dismiss the manager or the trustee?—Yes. I think we all do, without exception.

Mr. Fletcher: In certain cases it has got to be 75 per cent. of the unit holders, or holders representing not less than 75 per cent. of the units. It varies from trust to trust, I think.

3265. The removal of the trustee might create difficulties, might it not? A power simply to remove the trustee at once on a resolution of the unit holders might lead to difficulty?—I do not think power to remove the trustee is commonly written into trust deeds. It is the manager whom the unit holders can call upon to resign.

3266. I thought that you all said a moment ago that you would be perfectly willing for your trust deeds to contain a provision under which the unit holders could dismiss the trustee? I think that might require some consideration as to its consequences?—*Mr. du Cann*: In one trust deed, at any rate, there is a provision, for example, for a trustee to retire on the appointment of a new trustee, and I think it could be got over in that way.

3267. There would have to be effective control over the appointment of a successor?—Yes.

3268. And that ought to obtain as regards the dismissal of the manager?—Precisely.

Mr. Stutchbury: I think some of the old trust deeds have no provision for meetings of the unit holders, and one of the difficulties that the manager who runs such trusts has is that, we are advised, he cannot at this stage incorporate provisions for holding meetings of unit holders. If new legislation were introduced, it might be convenient to have a clause enabling the

manager and the unit holders to go to the Court and enable the old trust deed to be amended. We find ourselves very much hampered by this in the case of some trusts which have been running since before the war.

3269. They could contain retrospective provisions as to the calling of meetings. I do not think anyone could complain about a retrospective provision of that character, because it is purely for administrative convenience?—Yes.

3270. Then generally as to control, your position is that you prefer legislation to be confined to general principles, and that the day-to-day control should be left to the trustee and the manager?—*Sir Oscar Hobson*: Yes, that is so.

3271. Now, can I just develop that a little? Clearly, consistently with your memorandum, you would not give the Board of Trade by statute specific discretion on matters over which it is now exercising discretion *de facto*—and by that I intend a reference to the admitted fact that the Board of Trade has been in the habit of using its regulatory powers to deal with matters which really do not fall within the ambit of the first Schedule to the Act?—No. If those matters were in an agreed form of trust deed, the Board of Trade would have no reason for intervening there.

3272. Subject to not overburdening the Act with too much detail, specific and exhaustive directions might be given that would eliminate the temptation of the Board of Trade to bring in matters not covered by the Act?—Yes.

3273. Now the next point is this. Would you be in favour of reducing the Board of Trade's powers to certain specified matters of general principle, leaving the operation of the trust in other respects to the discretion of the manager, subject to some control by the trustee? I think we have already covered that point, have we not, and you have mentioned various matters which you agree should be treated as matters of general principle?—Yes.

3274. Then, having got the general principles with which the Board of Trade has to be concerned, one has to consider

how these general principles would be implemented, and as to that I think I am right in saying that you are, as indeed you say in your memorandum, in favour of having as part of the legislation a model trust deed, which would embody all the general principles and which would also deal with specific matters relating to the individual trusts?—Yes.

3275. Then the result we hope from that would be that the Board of Trade would satisfy itself that the model contained all the general principles, and its function then would be confined to seeing that there was nothing in any proposed variation of an individual clause which conflicted with the general principles?—Yes.

3276. And if it did not conflict with the general principles themselves, then there is no reason why the Board of Trade should seek to prevent its inclusion?—That is so.

3277. Then the next point is that it would probably be convenient, I think, to relegate the model trust deed to a schedule which might be altered from time to time by the Board of Trade by a rule-making power given to them so that any alteration in circumstances which called for modification of the provisions of the model trust deed could be dealt with by Statutory Order and not by further legislation, which might be difficult to get?—Yes.

3278. Then there is this possibility—I do not know how far it could be done, but in some respects it might be a most satisfactory provision, and that would be this: the Act having laid down the general principles, should empower the Board of Trade to recognise your Association, subject to the rules of your Association being recast to give effect to the general principles of which we have been talking; and having recognised your Association and approved its rules, it should leave it to your Association and your constituent members to manage their own affairs? Would that be a convenient way?—At the present moment the Association does not include all unit trusts.

3279. No, I was coming to that.—I do not think we should, as an Association, want to be recognised legally. I do not

know about that. I think we would like rather to be an Association of free subjects.

3280. I did say that if it could be done, it would be quite a desirable way of doing it. I was coming to the question of dissentients. Would there be any prospect of bringing everybody into your Association?—Well, there is certainly a prospect. There is one group outside at the present moment; we are hoping to get them in, but I do not know at all whether we shall be successful.

3281. I do not want to be misunderstood. I think it would be quite clearly impossible in the present circumstances to confine authorisation to your Association, and say that no non-member could be recognised?—We do not ask that.

3282. But the bargaining is greatly facilitated if you have one body which can speak for everybody?—Yes.

3283. And the Board of Trade might recognise the Association without any question of giving it exclusive rights?—Well, in fact, officials within the Board of Trade who are concerned with unit trust managers do write regularly to the Secretary of the Association. They may indeed write also to the group outside, but they do recognise us from the point of view of negotiations.

3284. Yes. Then on this possibility which we are discussing—some form of recognition of your Association by the Board—I think probably as far as one could go at the moment is to suggest that the Board of Trade could at all events use the Association for the purpose of collective bargaining.—It would be easier for the Board of Trade if all unit trusts were members.

3285. And for that purpose some form of qualified recognition of your Association might be provided for?—Some *de facto* recognition.

3286. Well, it might be *de facto* if you could not get it *de jure*. And then, so far as your Association is concerned, some provision that approval of the Association and its rules should leave the constituent members free to carry on their business within the fundamental principles laid down by the Act?—And within the rules of the Association.

3287. Yes. And unit trusts would have to make their terms with the Board of Trade individually unless they preferred to come in under the Association umbrella?—Yes.

3288. Now, we have been talking a lot about the general principles to be laid down in any Act. What do you say as regards the following matters from the point of view of general principle: first, that managers should not make a profit for themselves from the transactions involved in managing the portfolio?—*Mr. Stutchbury*: There are two problems involved here—whether they make a profit out of managing the underlying securities and whether they make a profit out of their transactions in their book of units. We are quite clear that the managers ought to make no profit out of transactions in the underlying securities.

3289. And indeed you have made a suggestion to that effect to the Board of Trade, that upon an appropriated investment being transferred to the trustee, the price taken should be the cost to the manager or the market value at the time of vesting in the trust, whichever should be the lower?—Yes.

3290. That seems to eliminate any element of profit there?—Yes.

3291. And you would be content that that should go into the model deed as one of the basic, general principles?—Yes, we would.

Mr. Fletcher: Yes.

3292. The next thing is what seems to be called "making a market" in the units.—*Mr. Stutchbury*: Yes.

3293. That is to say, a unit holder comes and demands withdrawal of his money, and he is then entitled to be paid off at a price to be calculated as prescribed in the trust deed. At this point the question of the manager dealing in units becomes relevant, does it not?—Yes.

3294. As I understand the position, it would not be practicable, when anyone wanted to withdraw their units, to sell small parcels of the underlying securities or investments, and give them the proceeds. In practice, therefore, the managers

would probably pay him out themselves? —Yes. They have got to act as principals, we feel, at some stage in the operation, and in fact we look upon this as being one of the great advantages of the unit trust system over the alternative system of a possible investment trust company which can buy and sell its own shares. The vital fact is the margin between the price at which you sell your unit and the price at which you buy it back. The fact is that an ordinary spread between the bid price and the offered price of the underlying securities, calculated on the Stock Exchange gap between bid and offer price, probably comes to between 12 and 13 per cent. when you have taken the stamp duty and expenses into account. We feel that if an investment trust company were buying and selling its own shares it would be very difficult for it to produce any reason at all why it should not charge that full margin, the point being that they would be dealing with somebody else's money when they sold shares at less than the full offered price, and again when they bought back at above the bid price. However, when the managers themselves are responsible for making this market, they are able to close the gap considerably because it is their own money they are dealing with. Accordingly, they can take a view of the market and close the gap, depending on whether they are selling more units than they are buying back or *vice versa*. In fact, the average spread of our own units is more of the order of 6 or 7 per cent., depending on the market in the individual units, but it is certainly substantially below what the spread would otherwise be. We feel that if an investment trust company were to make a market itself in its own shares, and where the unit trust acts purely as an agent in the sale and purchase of units, the spread would be larger. We feel that this business of the manager making a book in units is one of the great advantages of the unit trust method of investment, because it means that there is somebody responsible for marketability of units, whereas in the investment trust company there is no one responsible for marketability.

3295. I would not dispute that probably your method of dealing with this question is in the best interests of the trust, but my

difficulty is that it is a trust, and that the manager has a fiduciary duty—he is a fiduciary agent, really, is he not? He has a certain fiduciary duty towards the unit holder. One of the rules in regard to a trust is that the trustee shall not profit from his trust. In a case like this I might qualify that by saying, without making full disclosure of the profit he is taking.—I do not think any of us would have any objection to having the profits we were making out of these transactions as public as may be—in fact, we are obliged to, under the existing form of accounts required by the Board of Trade. But this service that we give does represent a very tangible benefit to the unit holder, because it often happens that when a fund is expanding he will get way above the bid price for the underlying securities for any units he sells to the managers. He never gets below the bid price.

3296. *Mr. Brown:* Is there anything to stop him getting less than the bid price? —Indeed there is. This is one of the requirements about which the Board of Trade are most strict and one which is embodied in the rules of our Association, as an absolute prohibition. Similarly, there are occasions when the fund is not expanding and the unit holder manages to buy a unit at a price which is below what it would cost if the fund were expanding.

3297. *Mr. Watson:* Are the profits which the managers make in the unit dealings the subject of taxation? —Indeed, yes. The principle of the thing I think is fairly stated in the appendix to our memorandum, and it is that while you have a fund for which you are buying on a market which is not always easy—the London Stock Exchange—the securities are not always there to buy when you want them. You are not always able to sell when you want to sell them. The managers must have some control over the way the fund expands and contracts, and if they are to have control at all they must be able to deal as principals in their own units.

3298. *Chairman:* And in so doing they may make a profit or a loss, I suppose? —Indeed.

3299. *Mrs. Naylor*: On this question of the agency/principal controversy in dealing in units, should one not break it down into two parts—dealing in units when the fund is expanding, and jobbing in existing units? Is there a distinction to be made there?—There is certainly, yes. The advantage of being able to deal as principal when the fund is expanding is that if you suddenly get a large influx of money and the market knows you have got it, then you may find that your own dealing activities as managers on behalf of the trust are hampered, whereas if you are able yourself gradually to expand the fund in anticipation of demands for your units, you are to that extent able to benefit the fund as a whole.

3300. But what would you say of the view that it is desirable for the “management” companies to act as principals when they are expanding the fund, but a bad idea for them to job in existing units—that they should not be obliged, as in existing regulations, to buy back units?—It seems thoroughly undesirable from the point of view of the movement, because one of the great advantages, from the point of view of the small investor, is that whatever happens, if he wants to sell his units he gets at least the value of their underlying securities.

Sir Oscar Hobson: And without delay—very often in 24 hours.

Mr. Stutchbury: I think it true to say that if you look at the margin between bid and offered price of the fund which does try to run on the strict agency principle, you will find that its spread is among the highest of all unit trusts.

3301. *Chairman*: Could there be any way of limiting the profit made on these transactions?—*Mr. du Cann*: There is competition between different trusts—a dozen or so different trusts—who are all anxious to expand the size of their funds.

Mr. Stutchbury: The other point is that supposing, for example, last March a very great number of units were sold back to us. At that time we were placed in a very embarrassing situation, we will say, but we had the resources and we were able to take the strain. We will say that by now the share index has gone up a very great

deal, and we re-sell those units now and we might, for the purposes of this example, make a very big profit on this individual transaction. It would be awfully difficult at this stage to say that you must re-sell at the price you bought back. What is more, we would then be taking the loss when the opposite situation occurred. You see, as regards these individual transactions, one would like as a manager to be continually turning over one's book each day, but in practice that is not what happens. In practice you get a very large number of units back at some stage, and you may have to hold on to them for six or seven months before you get rid of them again.

3302. Then if I may sum that up, it seems to be your view that from a practical point of view the buying and selling of units by managers as principals, in the sense that they take any profit and bear any loss, cannot be dispensed with?—Not if the advantages of the unit trust movement are to be maintained. The advantages are marketability and, one hopes, avoidance of too large a divergence between bid and offered price.

3303. And it would not be feasible to limit the profit? From the point of view of the managers, they cannot be expected to run the thing at their own expense. But could such profit be eliminated, in exchange perhaps for an increase in your regular remuneration?—There are so many things one has to take into account in assessing what one's margin is to be. For example, there is the incidence of stamp duty. This is a very complicated business, and I do not know if you would like me to go into it, even if I could. The fact is, however, that we have to pay a 10s. stamp duty even when we sell five units to somebody, if they are units we have previously bought back. We have, therefore, a great number of expenses that cannot be accurately measured, and we have to take account of them in our dealing business. I just cannot imagine any sort of machinery that one could get on its feet for eliminating all profits out of this thing—or, indeed, losses.

3304. *Mr. Bingen*: Could one have some idea of the amount involved in this profit or loss in buying or selling units? What is the size of that to the managers,

compared with their ordinary standard income which is regulated by the Board of Trade? Is it normally a profit or a loss and, if it is a profit, is it much more than the profit which is laid down for you by the Board of Trade?—If you have a year of falling markets you lose. It depends on the year.

3305. But overall, the manager must know whether it has been a profitable or a losing business.—In the last ten years it has been a profitable business, but we have a feeling that in the next ten years it may be that we will come out just about all square. It depends on the market.

3306. Would you be able to continue as managers if it was not for the expected profit on the purchase and sale of units?

—*Mr. du Cann*: No, we would not. That is one of our complaints about the current situation; in our opinion the result of the arbitrary regulation of charges is that we are obliged to make money in other ways, either because we are, some of us, part of other organisations or we have other responsibilities and are able to hive off some of the overheads of our business on to other activities. The annual charge, in particular, which we are entitled to levy for management of these funds does not match the costs of the work. We make up the difference by these jobbing transactions.

3307. And the amount of profit made, while disclosed to the Inland Revenue in your management accounts, is not disclosed to the unit members?—*All witnesses*: Oh, yes.

3308. So that they can see it?—*Mr. Stutchbury*: Yes. But I do not think it is true to say of all of us that we could not carry on business if we did not make jobbing profits. Certainly of my group it is true that we would carry on, but we would not expand. By and large it is the large unit holders who pay for the small ones, and the new ones which we are getting in are small ones. If you have a unit holding of £800 you can make money on the charges. New holdings come in at an average of, let us say, £150, and they cannot be run on the existing charges. But it is not true to say that we would go bankrupt if we could not job tomorrow.

3309. Recently Mr. du Cann took over one of the management companies and trusts named in your memorandum. Does that mean that a properly managed unit trust can get into difficulties because it is too small?—*Mr. du Cann*: Yes, it most certainly does. To take the position of that particular company, during the period covered by its first accounts it operated at a loss, and it was continuing to lose money. There is no doubt that management would eventually have become impossible; it was in fact impossible at the time we took it over. Our taking it over was in effect a rescue operation, simply because we had the machinery there to deal with large numbers of unit holders and we could operate it. There is, however, precious little profit in it.

3310. In other words, the underlying securities were sound, and the trust deed was all right, but the management could not continue to run it at a profit?—*Sir Oscar Hobson*: This particular trust had a very small average holding. The units were offered at 2s. 6d., and they were widely advertised. The average holding value was probably smaller than any other trust.

Mr. du Cann: It should not be thought though, Sir, that the average holding in that particular trust is exceptionally low, in the sense that this is a case entirely on its own. If you go up to an average holding of double that of that particular trust, you find the same situation obtaining, namely that it is impossible at the present scale of annual management charges permitted by the Board of Trade to run a trust properly on the basis of service charges alone.

3311. *Chairman*: Then it would appear that the position we have reached is that this buying and selling of units by managers as principals must be accepted; that the adoption of this system, that is to say buying and selling as principals at their risk as to profit or loss, should be fully disclosed in all the circulars and so forth, giving particulars to investors; and of course that the amount of profit or loss resulting in any year from these transactions should be clearly shown in the accounts of the trust.—*Sir Oscar Hobson*: Yes.

Mr. Stutchbury: It is extremely difficult, of course, to know what proper deductions you can make from your profit. I mean, you could show your gross profit from dealing, but that would be very misleading because you have to maintain staff to do it. You have maybe occasionally to borrow money from the bank to finance your book. How are you to take these various factors into account, supposing that you manage several trusts? Theoretically it would be very nice if you could tell people what you made out of your jobbing operations, but again, another thing which needs considering is how you value your stock of units. We value our stock on a L.I.F.O. basis: it is well accepted. But there have been years in which I would have said we have had an extremely good year as jobbers but our system of valuing stock is such that we showed a great loss at the end of the year. By all means tell everybody you are maintaining a book in your units, and if one wants to state the obvious, one could say that you are trying to make a profit on it, but it does not get the prospective investor very much further. The fact remains that all unit trust managers have to maintain a book, come what may. I mean, even M. & G. take units in the last resort, if they fail to get the market to take the units. It really is not possible to produce a fair figure of what one's jobbing profit or loss is.

3312. I suppose it would be bound to appear somewhere in the accounts?—Oh, yes, one could produce a figure when one produces the accounts.

3313. I suppose the unit holders would see the accounts?—*Mr. du Cann:* There is a difference, Sir, between the accounts of the managers and the accounts of the trust. For example, the accounts of the management company which may be responsible for the management of several trusts would be filed at Bush House and sent out to the shareholders of the management company. That account is not always necessarily sent to the unit holders of the individual trusts. Then again, the accounts of the trust, if they are simply a capital account and an income account, would not necessarily show any dealing profit or loss that had been made as a result of jobbing in the units. Accounts

required by the Board of Trade, relating simply to the managers' affairs in relation to the trust, do go round to the shareholders and do show the position.

Mr. Stutchbury: They try and show the position as far as it is possible to do it.

Mr. du Cann: I do not know that it is possible to show the position exactly.

3314. *Mr. Watson:* These profits are the subject of taxation. Has there been no agreed basis with the Inland Revenue as to how they are calculated?—I do not think they are calculated, in the case of all management companies, on the same basis. Ours is a straightforward L.I.F.O. basis, but it depends on when you make your "breaks", when you show your profit.

3315. So there is no uniformity in their treatment for tax purposes?—No, I do not think so.

3316. Would it be possible to show what the profit had been, on which tax was payable, in each individual case?—

Mr. Fletcher: You could show the profit from the whole of the manager's activities; but the difficulty is to break this down. Having ascertained the gross profit from jobbing in units it is necessary to deduct from this the appropriate amount of expense relating to the jobbing. The amount of this expense would have to be estimated.

3317. *Chairman:* I may be wrong but I would think in principle if a manager has made a profit it ought to be disclosed.—Yes, I think difficulty arises where you attempt to break down the global profit from the whole operation of jobbing into its component parts. There is the profit or loss which arises due to circumstances beyond the manager's control—that is, the movement of the market while the manager has held the units on his book, and there is the profit which he makes from the price spread. The Board of Trade say at the moment that you should segregate holding profit or loss which is defined as the movement of the unit price whilst the unit is in the manager's hands. It is not holding profit at all. The manager can move the price, for two reasons—because of market movements

in the underlying securities, and also according to the position of his book of units—whether he is selling more than buying or vice versa. Provided he keeps his price within the prescribed maximum and minimum—there is a difference of about 12 or 13 per cent.—he can move it irrespective of market movement.

3318. But do the Board of Trade prescribe how these profits shall be shown? —The Board of Trade lay down no prescribed form of account, but they say that the manager shall annually submit to the unit holder an account which shall include not less than certain individual items which they lay down in their requirements. One of our complaints, if I can use that word, is that it is difficult to understand why some of the items should be put in, because by the time the account is prepared in accordance with these requirements it serves to confuse rather than enlighten the majority of unit holders. The language is strange; some of the items certainly do not appear to add information of value. We would suggest that it might be adequate if the manager were under an obligation to submit to the unit holders once a year an account which disclosed the gross profits arising from the sale of units, the sale of re-purchased units, and the liquidation of units and the amount of the management charge which he makes for looking after the fund, deducting therefrom his expenses under certain named headings.

3319. What it comes to is that new legislation, you think, or the model deed, should authorise such dealings in units by the managers, and there should be a statutory provision, or a provision in the model trust deed, saying what is to be supplied in the way of accounting for these profits; the proper formula would have to be evolved by you gentlemen, with the assistance of your accountants, and then the Board of Trade would have to be satisfied that it was adequate. I do not think we can take that, just at this moment, any further. When we were dealing with matters to be considered, as matters of general principle, that is the first one that we have covered. Then the next one is that there should be a suitable spread of investments, with restrictions on the proportion of the trust assets which may be

invested in any one company, and a restriction on the proportion of the capital of any one company that may be acquired by the trust. Is that an acceptable general principle? I am not sure how that accords with what we have been told earlier this morning about portfolios consisting of shares in named companies.

Mr. du Cann: It is very common for trust deeds to prescribe that not more than 5 per cent. of the total assets of the fund shall be invested in one security. It is similarly common for trust deeds to provide that not more than 5 per cent. or some other percentage, of a particular class of the capital of a company should be purchased. Some deeds also prescribe a limit of the total amount of securities, and so on. But there would be difficulties in accepting such a principle if you are dealing with specialised funds.

3320. It would not be appropriate in every case?—No, far from it. In the case of a general commercial trust there would be no difficulty, but in the case of a unit trust specialising in investment trusts or insurance, banks and so on, you would get into difficulties if you set those limits too low.

3321. This might not be entirely suitable for inclusion as one of the matters of general principle?—It rather depends how it is written, I think.

3322. It would have to be so written as not to exclude the case of specialised trusts?—Yes.

3323. Then the next point is that dividends and accounts must be distributed to unit holders twice in every calendar year. What do you think about that?—I think we all, with one exception, make two distributions a year, but there is one trust in existence which is an accumulative trust, in the sense that its net income is fully re-invested. I think I speak for everybody here when I say that while it is appropriate that full disclosure should be made twice a year (one of the advantages over the investment company of the unit trusts is that unit holders do in fact always know where their money is invested), I do not know that it is appropriate to stipulate that every unit trust must always have two income distribution periods. There might be advantages in

having four, or in having one, as opposed to two.

3324. So you would say that that is a matter which should be capable of modification to suit the individual trust, rather than a matter of general principle?—I think so. On the other hand, I think that it is certainly right that one of the matters of principle that should be considered is a necessity for full disclosure to unit holders, as frequently as convenient, of the affairs of the trust, its investments, and so on. I think we would all agree about that. (*The other witnesses agreed.*) It might be better to say that information should be circulated not less than once every year, rather than that it must be circulated twice a year.

3325. In considering the adoption of any of these matters as general principles, very careful consideration will have to be given to cases in which they would not be appropriate?—Yes.

3326. Then the next one is that the minimum investment permitted in the unit trust shall not be so high as to be out of reach of the small investor. Do you think there is any substance in that one, as a general principle?—No, not necessarily. For instance, such a restriction might preclude the establishment of a unit trust to cater for, let us say, local authorities or pension funds, or for the trade unions. It is often suggested that a unit trust is primarily designed for small investors, and of course the activities of all of us who are members of this Association are aimed at the small investor, whom we have been successful in attracting. On the other hand, it is equally often forgotten that a unit trust is just as suitable for investment by the large man, and mutual funds are used very much in America by institutions as suitable media for the investment of large funds.

3327. You refer in your memorandum to the man who keeps his money in the teapot, and you would like him to see the advantages of this form of investment, rather than keeping his money where it is not earning anything. It is more a matter of education, in a way, is it not?—Well, Sir, we have always been very conscious not simply of the economic need for providing suitable investment media

for the man and woman in the street but of the social advantages as well. We are all activated very much with that idea, but it is not of course the be-all and end-all of the unit trust movement.

3328. Perhaps then that suggested principle might not be capable of sufficiently certain definition to make it a proper provision?—I think that is so.

3329. The next is that all investments comprised in the portfolio must be quoted investments—that is, quoted on a recognised Stock Exchange. How do you stand in regard to that?—I think we all agree with that, with this exception, that we may wish of course to place money on deposit from time to time.

Sir Oscar Hobson: Yes, or invest in local authority loans and deposits. That is purely a temporary investment.

3330. These investments have no quotation?—No. There is an active market, but they are not quoted on the Stock Exchange. They are a sort of unofficial market.

3331. Then one would have to state that so that it would not exclude certain unquoted investments of a certain description.—*Mr. du Cann:* Yes, that is easily done, Sir.

3332. Then finally, that there should be control over and disclosure of the remuneration of managers, that is the regular remuneration as opposed to the profit on dealing.—We fully agree, Sir.

3333. So that that is a matter over which the Board of Trade should retain control?—I think it right that the amount of managers' remuneration should be fully disclosed to either existing or intending unit holders. On the other hand, however, we do not think it right that the actual amount of the charges, initial, annual or semi-annual, should be controlled by the Board of Trade in the way that they are at the moment.

3334. You say that they have fixed the charges too low?—Very much too low.

3335. And who should fix them?—Well, Sir, we think that if maxima are to be fixed by anybody at any time, they

should be maxima capable of re-examination in the light of changing circumstances. But we feel very much that competition will take care of this point. At present the fact is that the control of charges is largely accidental, and certainly completely arbitrary. It bears no relation to anything; it is not based on any economic assessment of the costs of management or the costs of putting new people on the books and, indeed, it is probably urgent that something is done about that.

3336. Then who would fix it? The managers themselves, in consultation with the trustee?—Yes.

3337. Does the trustee get a proportion of what the managers get?—He may be remunerated in two main ways. The managers are responsible for paying him out of what they derive either initially or semi-annually or both, and he may share commissions with the brokers who are purchasing or selling the underlying securities of the trust. But whatever the situation is there, the managers are still limited to the total quantum of charges, and whether or not the trustee shares commission is not taken into account by the Board of Trade in fixing the charges. This whole subject of control of charges at present is most unsatisfactory.

3338. You say that the Board of Trade ought not to do it—but who ought to do it?—Well, Sir, it is a matter, I think, which can be perfectly well left to the managers and trustees acting together. It is something that competition will take care of.

3339. *Mrs. Naylor*: Would it be necessary to put the total charges over the trust period in any advertisement?—Yes, but I do not think it is appropriate to add the initial and annual charge together and work them out. I do not think that makes sense. The two things are absolutely separate. In the case of the annual charge, clearly you could work out at this moment, roughly speaking, what it costs to service the unit trust and what it ought to cost, with proper investment management facilities, and a reasonable profit margin. Similarly, it is comparatively easy to decide what it costs, or ought to cost, to get a new person on the books. Our complaint about the way the charges are

regulated at the moment is that none of these costs appear to be taken into account.

3340. I am not challenging your view that the charges fixed by the Board of Trade are too low, but I was wondering how effective would be the competition factor in keeping the charges down. How much would the unit holders know of the charges?—*Sir Oscar Hobson*: It is quite possible to put it separately. They are lumped together by the Board of Trade, rather curiously, but in an advertisement it would be possible to put them separately—so much initial and so much annual charge.

3341. Would that bind the managers' annual charge for the whole period of the trust?—It would require something in the trust deed to alter it.

3342. *Mr. Lawson*: Would competition really keep these charges down? Could you not spend more on advertising and get more money in?—*Mr. du Cann*: Not necessarily, no.

3343. *Mrs. Naylor*: Are the charges controlled at all in America?—*Sir Oscar Hobson*: There is a maximum, and it is much higher.

3344. *Mr. Lawson*: Who fixes the maximum in America?—*Mr. du Cann*: I think the initial charge is fixed by the Securities and Exchange Commission at 9 per cent. But the system as far as the annual charge is concerned is quite different, because of the nature of the mutual fund companies. Broadly speaking they take all their expenses out, irrespective of what they are. They take the expenses of the distribution plus the expenses of management. These are taken out before distribution of profits, whereas in our case there is a fixed amount of annual service charge which we generally take annually or semi-annually, which has to cover everything, irrespective of what the expenses are. It is perfectly plain that the amount of charges allowed here is not sufficient to meet the expenses or disbursements. As far as I am aware there is not one group of unit trust management in the U.K. ^{which has a separate appropriate} ~~which has a separate~~ investment analysis and that sort of thing, simply because we cannot afford it. It is

a most unsatisfactory situation, that we should have to rely on other people to provide those services for us. With the limited amount of money that we have we are just paying for the actual physical costs of distribution and running the office, and that is all.

3345. *Mr. Brown*: If there were complete freedom in respect of charges, could it be assumed that your Association would lay down binding maximum charges?—*Sir Oscar Hobson*: It would be quite possible.

3346. Would it not be a danger in that case that it might follow a number of other organisations, and lay down minimum rather than maximum charges?—*Mr. du Cann*: I would not have thought so myself, knowing us, and the meetings we have had since we got this Association started. I would not think so.

3347. *Chairman*: Might I revert to the matter of the model trust deed? The point I think I left unclear was that I did make the suggestion, which I think you were rather disposed to favour, that it might conceivably be possible for the Board of Trade to recognise the Association, subject to its rules being altered so as to embody agreed general principles. I think if that alternative were adopted it would probably be necessary to include, as part of the rules, the model trust deed. The other way, which may be the only feasible way, is to have the model trust deed in a schedule to the Act. Either way you would probably find it necessary to have a model trust deed as your basis. —Yes, I think we absolutely agree with that. That is what we would like to see. We think it would simplify matters from everybody's point of view, because there would be, so to speak, a standard form, and the variations would be more obvious, so to speak. But if the model trust deed were part of the legislation, there should be an easy opportunity to vary it in the light of changed circumstances. That of course is very important.

Chairman: Those are all the questions I have in mind to ask you. I do not know if my colleagues have any more?

3348. *Mr. Scott*: Regarding the proposed power of unit holders to remove a

trustee, I presume the suggestion is that that would be by a majority of 51 or 75 per cent. of unit holders. Does that apply at present to trustees?—*Mr. Stutchbury*: No trust deed at the moment contains any power to remove the trustees.

3349. Had you any thought underlying that suggestion as to why it should be introduced? It would be rather unusual for the majority of the beneficiaries to be able to remove a trustee.—*Mr. du Cann*: I do not think that is something which we particularly want, if I might put it that way. I think if it were thought to be appropriate we would have no objection to it.

3350. You are not urging that as something you would like changed?—No. We certainly think it right that there should be power to remove the managers.

3351. *Mr. Althaus*: You gave us a list of functions performed by trustees for the protection of unit holders, and you told us also that a number of trustees contract out of these obligations. Could you give us any sort of idea of the proportions between the more eager and the more reluctant categories of trustee?—*Mr. Stutchbury*: As a solicitor I used to draft trust deeds, and when a solicitor drafts them on behalf of a trustee, he tries to get out of as many things, from the trustee's point of view, as he possibly can. I think that is pretty well standard form; towards the end of a trust deed you have a great string of things that the trustee is not responsible for.

Mr. du Cann: I think, generally speaking, apart from investment, to which I will return in a second, every trustee takes responsibility for the supervision of the matters which we have already mentioned, and there were other things which we have not mentioned. But every trust deed does contain a general indemnity clause at the end and it is that which we find open to some objection. So far as investments are concerned, I think you can say that the proportion of trustees who possess a power of veto by comparison with those trustees who do not, is probably the majority.

3352. *Mr. Stutchbury* said, in referring to the basis of valuation, that the margin

between the Stock Exchange bid and offered prices amounted, allowing for the purchase stamp, to about 12 per cent. As far as I can see that means a two shilling margin in the case of a £1 share, and a four shilling margin in the case of a £2 share. What I wanted to ask was whether it is your general experience, or that of your members, that you do in fact have to deal at those margins?—*Mr. Fletcher*: The 12 per cent. includes not only the market spread but also the stamp duty, the expenses of purchase, the initial charge, and the expenses of realisation.

3353. *Mr. Brown*: How do you handle the problems of voting in respect of the securities held in the trust?—*Mr. du Cann*: Voting powers actually reside in the managers, and this is one of the matters which, in establishing this Association, we thought it appropriate to consider, just as, for example, the Association of Investment Trusts considers matters of this sort in particular cases.

3354. You would say that the managers do exercise voting power?—As a rule, not.

Mr. Stutchbury: But on occasions, yes.

Mr. Fletcher: If they felt it necessary they would ask the trustees for a proxy to attend the meeting and take an active part in it.

3355. *Mr. Brown*: In other countries I believe that the question of the managers exercising voting powers has caused concern as to whether they would not put themselves into a controlling position in a company, but of course, if you have a limit that would not arise here. On the other hand, there might be a difficulty if institutional investors of one kind or another who do not vote grow so large that the company cannot get a quorum for meetings.

Chairman: Perhaps I might mention, as regards the trustee, section 88 of the Companies Act which relates to dehen-tures, and does avoid provisions indemnifying trustees against breach of trust except in certain circumstances. Perhaps incorporation of that provision in your trust deed might meet the case, but I do not know if the trustees would look at it with any great favour. It seems, however,

that that would be a possible answer.—*Mr. du Cann*: Yes.

3356. *Mrs. Naylor*: With regard to the trustees' indemnity, does not the competition between potential trustees enable you to dictate your own terms?—*Mr. Stutchbury*: Not a bit, far from it.

3357. But you did say it was only the majority of trustees that insisted on such indemnity?—No, all of them.

3358. Then I misunderstood. On the question of yields, am I right in thinking that you do not like the way the Board of Trade makes you calculate yields?—*Mr. Fletcher*: I think we were quite happy with the formula which was effective up to the last Finance Act. Our complaint is that we are still waiting for the new formula.

Sir Oscar Hobson: Six months after the Act, and daily we have to publish yields which are too low by something of the order of $\frac{1}{2}$ per cent. There is still further delay because the trust deeds in most cases will have to be amended, and the Board of Trade will have to pass the amendments to the supplementary trust deeds.

Mr. du Cann: I think there were some managements who disliked the earlier formula in cases where the annual charge was deducted from capital, as opposed to income. I think that was undoubtedly difficult, but I think it is the general practice now to deduct the annual charge from income. In such cases no complaint arises.

3359. Supposing you were able to charge more, either annually or initially. Would you think it desirable for there to be door-to-door sales of your units? I gather it is the expense that has prevented that so far, and not the fact that it would be in breach of the existing law?—That is correct.

Sir Oscar Hobson: It is a very big consideration. One would run into vast expense, I should imagine, by door-to-door canvassing. We have not considered it.

3360. Would you think it objectionable?—*Mr. Stutchbury*: I do not think so. Insurance companies do it.

Mr. du Cann: Not if it were properly controlled and regulated.

3361. Who should it be regulated by?—We would most certainly do that. In the United Kingdom we should only employ salesmen after proper training in unit trust matters, because it is fundamental to our interests that we should not have any sort of wrong salesmanship. But the case for the increase of charges does not simply rest on the costs of canvassing.

3362. No, I realise that, but if you were given your heads, that would be one of the things that the unit trusts would think about. Lastly, if you were able to charge more, would that modify your support of the block offer system?—*Sir Oscar Hobson:* It might, yes. We do not like block offers.

3363. But you are driven into them?—We just do not get results without them. Regular small advertising does not appear to have much effect at all. The only way to interest a considerable number of investors is by simulating an ordinary new issue, which of course is a limited issue, whereas in our trusts there is no reason for a particular limit in most cases.

3364. *Mr. Smith:* It has been suggested that there is a growing popular misconception that there is somehow a guaranteed growth in a unit trust, have you taken any steps to deal with this?—*Mr. du Cann:* This is a point which has exercised us all. I think we have all been very careful in our advertising to make the point that shares can fall in value as well as rise. I would have thought myself that our advertising has been very carefully designed so as to avoid giving rise to popular misconceptions. On the other hand, however, one is bound to admit that in the period of the last boom—from the beginning of 1958, when the share index was down to 154 as against 342 at the beginning of 1960—it would be surprising if somebody did not think that all he had to do was to buy shares or units in order to make a certain profit. I think we have done a good deal in the field of education.

3365. My second question is about advertising, and the supervision of it. How do you tackle the problem?—We have very strong views on this, and it is

looked at by the Association from time to time. In one particular case we have even discussed individual members' advertisements, and how they should be improved.

3366. You have a strong rule, but that is only imposed upon your own members. What about the people who are not members?—There is the Prevention of Fraud Act, but that does not deal with this particular point necessarily. Of course we cannot deal with people who are not our members. I would have thought now that the financial press is so well informed about unit trusts and so on, and so careful in these matters, that if anybody tried to start a unit trust and insert advertisements that were objectionable, the papers would probably refuse them. Secondly, if they were not members of the Association the newspapers would want to know why not. I am fairly confident on that point.

3367. *Mr. Mackinnon:* I suppose you would say that if you had really responsible trustees and the status of the trustees were upgraded perhaps, since the trustees would have to approve the advertisements, that would be a strong protection?—I was taking that as being understood as it is the current practice. Yes, I quite agree. I would say really you need not go beyond that possibility, because it would be unthinkable that you have that sort of trustee as party to an undesirable advertisement.

Mr. Stutchbury: And I think, on this business of door-to-door salesmen, if the sale of units were being canvassed from door to door in an undesirable way the trustees would be the first to hear about it through their branch managers, and they would very soon stop it, which I think they would have a right to do under our existing set-up.

3368. *Mr. Brown:* How can you stop a form of advertisement like that?—The trustees would simply say that the managers were not to employ that salesman to take that literature round. The trustee could not vet each salesman before you took him on, but no doubt this would only be the activity of one or two people who overshot the mark and that would soon be heard about and put right.

3369. It does seem that there is a danger in removing any limit on expenses, that a

new trust could be formed simply on door-to-door canvassing. Experience shows that it may be very difficult to control, whatever the management may wish.—*Mr. du Cann*: It is an interesting point that in the United States, where shares of mutual funds are sold on a door-to-door basis, some companies employ one or two or more thousand individual salesmen. By and large you just do not get complaints of this sort, and the companies concerned are very careful to embark on proper training schemes, fully supervised, and so on. I think if there were trouble and

difficulty, it would probably be very much the exceptional case, and certainly we would look at them ourselves with enormous care, because you have only to get one scandalous case to get a bad name for the whole unit trust movement.

Mr. Brown: We are not thinking of bodies such as your own, but what might spring up outside.

Chairman: Gentlemen, those are all the questions we have for you. I would like to say again that we thank you very much for coming and helping us.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

SIR EDWIN HERBERT, MR. G. L. C. TOUCHE and MR. W. S. GAMMELL
called and examined

3370. *Chairman*: Gentlemen, we are very much obliged to you for coming here this afternoon to help us and for the memorandum which you have submitted. Before we proceed to discussion, may I for the purposes of the record have your names and who you are? You, Sir Edwin Herbert, are Chairman of the Association of Investment Trusts?—*Sir Edwin Herbert*: Yes.

3371. And, Mr. Touche, you are Deputy Chairman of the Association?

—*Mr. Touche*: One of two Deputy Chairmen.

3372. Mr. Gammell, you are the Secretary?—*Mr. Gammell*: That is so.

3373. To begin with heading I of our questionnaire, the order of which is followed in your memorandum, I rather understand that you would be in favour of retaining the *ultra vires* rule, preserving the present position under which companies set out an extremely wide range of objects in their memoranda so that barely anything they do can be *ultra vires*. Are you in favour of retaining the *ultra vires* rule and meeting it by that practice as to the very wide scope of objects, or do you think some alteration should be made?—*Sir Edwin Herbert*: I think you have put it quite accurately. As in so many other instances, we feel the present system

is working all right and it is extremely problematical whether any other system would be better.

3374. On the assumption that the *ultra vires* rule is retained, have you considered whether anything could be done to mitigate the lot of an individual who deals with a company without scrutinising its memorandum and then finds the transaction is *ultra vires*?—We have not come across any instances in practice, I think, which made us apply our minds to that question. I do not know whether they are at all common, but, of course, it applies to many other things beside companies which are subject to the Companies Act.

3375. Yes, but in this particular context what is meant by *ultra vires* is doing something which is not in the list of objects in the memorandum and which cannot reasonably be said to be incidental or conducive, whatever it may be, to those objects. There has been a case within the last few years, *re Jon Beauforte (London) Ltd.*, where a company embarked on an *ultra vires* business and was supplied with fuel, which would have been necessary for any business, but the company actually was doing something which was *ultra vires* and the suppliers of the fuel lost their money.—I think really the best answer I can give is this. As investment

trusts we look at the whole thing mainly from the point of view of our interest as investors, and not only investors but particularly investors in ordinary shares and investors on a long-term basis. We think of ourselves as living with these companies for many years to come. The only reason which would make us sell shares would be if we thought there was something going wrong with the company or the trade in which it was concerned. I think we would say there is something to be said for keeping the *ultra vires* rule. After all, if you decide to invest in a company you want to know what sort of business it is running and, presumably, what sort of business it is authorised to run. We think rather strongly that it is wrong for directors of a company completely to change the nature of the business in which you have invested, at least without reference back to the ordinary stockholders who have put up the money and who are ultimately the owners of the business. If you do take that view, as we do, I should have thought something like the present *ultra vires* rule was almost an inevitable consequence. I doubt very much whether it would be frequent for creditors to be prejudiced by the *ultra vires* rule, but I think it would be very difficult, really, if one took the opposite view. I suppose you would then have to go the whole hog and take the completely opposite view and say that a company could do pretty well what it liked, and could change the nature of its business fundamentally without going through the necessary machinery for obtaining those powers—the necessary machinery, of course, including prior consultation with the true owners of the business, the ordinary shareholders.

3376. So the upshot is that you think on the whole this question should be left where it is?—Yes, I think so, definitely.

3377. Then the next point is connected with that and follows from what you have just said. You suggest, if I may say so very reasonably, that before any substantial change is made in a company's activities the consent of the shareholders should be obtained and at the meeting which votes on the question of consent preference shareholders should have the same right of voting as they have in a

winding-up?—That would be ideal. Of course, this is connected with, but in a way separate from, the *ultra vires* point, because this particular point we are making applies even to a change of business which is within the scope of the existing memorandum of the company.

3378. Something which *de facto* changes the nature of the company's activities, yes, I understand that.—But I do not think this is a matter on which we are recommending legislation, except perhaps with regard to preference shareholders. It is so extremely difficult to define what would be the type of change of business which ought to be put to a general meeting and the type which could properly be left to the directors. I think we are inclined to think this is a matter which is better dealt with by changing the climate of thought or developing the climate of thought, as indeed is happening at the present time. I think many advisers would tell the board that, whether it is a legal necessity or not, it is highly desirable for them to carry their stockholders with them on a matter of this kind; but I am not sure we should recommend any amendment or introduce any new legislation on this.

3379. I put the question because under heading 1 (b) of your memorandum in the second paragraph you say this: "In view of the universality of modern Objects Clauses it is appreciated that a very wide range of activities can be carried out. It is the view of this Association that any substantial change in the nature of the business which the company is, in fact, carrying on should be subject to the consent of shareholders."—All that we are saying there is that we think this is the practice which in fact should be adopted. We are not recommending legislation to make it compulsory.

3380. You think that is how the thing would be done in a well-conducted company?—Yes.

3381. But you do not think that standard of conduct should be imposed on all by legislation?—Because of the difficulty of definition.

3382. Then perhaps the question I was going to put about preference shareholders hardly arises.—I think my answer

would be the same if you did put it because we are not suggesting legislation on this, but we think it would be desirable that the occasions on which a preference shareholder should vote should be extended in the ordinary form of the articles of association to cover this particular case.

3383. The articles would have to be altered to give the preference shares the necessary right of voting?—Yes, but we suggest that is much better left to developing practice and changes in the climate of thought, rather than that it should be dealt with by legislation.

3384. Anyone who thought it was a good idea and wanted to adopt it effectively would have to arrange an alteration of the articles if it was wanted that the preference shareholders should be able to vote?—That is perfectly true.

3385. You would not have a second meeting of preference shareholders. The meeting would be open to everybody to vote?—I think so, because separate meetings of preference or other classes of shareholder are only necessary when their own particular interests are under consideration.

3386. That seems to be right, and probably you would agree that the better way would be to give the preference shareholders an express right of voting on matters of that kind rather than doing it, as is suggested here, by reference to their right of voting on a resolution to wind up?—What would be the difference, if I may venture to ask?

3387. They might not have a right of voting on winding up. I agree the limited voting power given to preference shareholders usually includes a right to vote on a winding up of a company, but I would not be prepared to say whether it is universal?—I think we only introduced that reference to make it clear we were not talking about class meetings, but proposing that preference shares should normally, as a matter of practice rather than by legislation, be given the right to vote with the ordinary shares on a matter of this kind, as they very often are given a right to vote at a winding up meeting.

3388. Would you say that as a matter of good practice other people interested,

such as debenture holders, should have any voice on a substantial change in the character of the business?—I should have thought their interest was very much less direct than that of the shareholders.

3389. If it was a question of lending money on a chain of groceries and the company then substituted for that activity a gold mine in Africa, the debenture holders' floating charge might have floated rather uncomfortably far away?—It might indeed. They have an interest, but I should not have thought as direct an interest as have ordinary or preference shareholders.

3390. You would not suggest any alteration in section 5 which requires a special resolution for any change of objects?—I think this works much better than it did previously. We think the safeguards for ordinary shareholders, preference shareholders and debenture holders under the present system are quite adequate.

3391. So that needs no alteration. Then you gave some evidence before the Gedge Committee on no par value shares, and, while you were in favour of such shares, you did not agree to the suggestion that no par value preference shares might be issued. That point has been raised again in the course of our discussions. I was wondering whether you see any reason to change your view about that? The kind of difficulty which arises is that if a preference share is to be given a preference, then the question arises: in respect of what? If it is not in respect of nominal value it is a little awkward, and if there is to be a fixed dividend of 5 per cent., then 5 per cent. of what?—Yes, I am quite sure that is the reason why we did not favour no par value preference shares and why we still do not.

3392. As to the question of the exempt private company, I understand you do not think the present provisions of the law relating to exempt and non-exempt private companies should be altered. Are you led to that conclusion by any particular dealings you have had with such companies, or anything of that sort?—No, I do not think so. This is merely a general observation because the ordinary investment trust does not as a rule come

into very direct contact with private companies, whether exempt or non-exempt, but we were asked, I think, by the Secretary of the Committee to deal with this, and you should not, I think, if I may say so, attach more weight to this than that we have not come across a particular reason for an alteration.

3393. I put the question because, as it happens, the contrary view has been expressed in a good many quarters. There is a considerable body of people who take the high line of principle that these people have the benefit of limited liability and should also bear the burden; and, more practically than that, there are trade protection societies which guarantee creditworthiness of traders and which, as might be expected, say it makes things very much easier for them if they can go to Bush House and see the accounts filed there by the company in question?—I do not think, my Lord, we are very competent to help you on this particularly, but all we can say is this, that we have not come across any particular reason for suggesting a change. I would not put it higher than that.

3394. Heading 5 deals with powers exercisable by directors and the control retained by shareholders, and under that heading you say, firstly, "It is wrong for the board of a company to permit any substantial change in the control of the company or the nature of its business without referring to shareholders.", and, secondly, "The issue of shares, in particular for cash, without their first being offered to shareholders is deprecated." What I would like to know is whether you can suggest any method of achieving these objects?—We do not suggest any legislative method at all. It is approximately the same point as you put to us just now. We believe that this is the sort of thing which ought to be dealt with in practice because, after all, good practice in the City generally precedes legislation, and I do not think we would say that abuses are such that they ought to be dealt with by legislation. Again, of course, there is the great difficulty of legislation in that it is necessary to have definitions, and they do not always remain right as things change with the years. We think this is the sort of

practice that ought to be encouraged through the climate of thought, but we are not suggesting any legislative change in respect of either of these two things.

3395. Do you think, Sir Edwin, that there is anything in the suggestion that matters of this sort might be dealt with in any legislation by a revision of Table A so as to include these matters?—That might be useful because Table A does not bind anybody, unless they want to adopt it; they can always exclude it altogether or adopt it with modification.

3396. And if some of these things were too vague and general to be the proper subject of actual legislation and were dealt with in a new Table A in some way, that conceivably might be a kind of pilot balloon or aid to education?—That is, if I may say so, a very fruitful suggestion. It might be quite useful, provided that it is not compulsory, which it would not be, of course, with an amendment of Table A.

3397. I should have thought Table A could be amended to this effect quite easily?—Yes, I think we should like that.

3398. Following on that, do you think there would be advantage in giving certain articles in Table A a special status so that they should be deemed to be included in all articles of association unless expressly excluded, with a power to exclude by special resolution; or is that too complicated?—Would it be an exclusion by special resolution, because you adopt articles before a company is formed?

3399. If you could say they could only be excluded at the statutory meeting of the company that would give the shareholders an opportunity to consider the matter; at present the articles get no consideration by anyone—it depends what common form the solicitor has in his office?—I do not think Mr. Scott would agree that they were not considered by anybody.

3400. I do not quite mean that.—I agree that the shareholders, or I suppose the allottees in the case of an original issue, do not get a chance, but I should have thought that it would be very difficult indeed to extend the statutory meeting to deal with things like that.

3401. It would be the first opportunity for the shareholders themselves really to consider under what regulations they should be governed, so to speak?—Is there not also this difficulty, that they would be allottees on the basis of the articles which had come into existence before the issue was made—they would have to be in existence before the issue was made? In fact you have to put them on exhibition, do you not?

3402. Yes.—I do not think it would have the slightest practical effect if you then said that the original allottees, who would be the members of the company at the statutory meeting, could alter the articles. I do not believe it would be anything but a formality; I do not believe it would have any practical effect at all.

3403. Then, under heading 6 . . .—Before you leave heading 5, you will note we do suggest an amendment in the legislation, and that is that increases in borrowing powers should be registered in the Companies Register as well as increases in share capital.

3404. You would recommend legislation to deal with that?—Yes, it is relevant that this should be known, and the Companies Register seems to be the right place from which to know it.

3405. Under heading 6, directors' dealings in their own companies' shares, section 195 has been criticised by other witnesses on the ground that the register of directors' dealings should be open all the year round and not for 18 days only, and that it should be open to the public and not merely to shareholders. Have you any views about that?—I do not see why it should be open to the public because, after all, it is only the shareholders who are at all concerned in the dealings of the directors.

3406. Now it is only open for a limited number of days before and some additional days after the annual general meeting, and the suggestion is that shareholders, at all events, should be entitled to inspect it in the same way as the register of members?—I should have thought that was probably right, because in fact the disclosure has to be made to the board when the transaction takes place,

and I do not see why the register should not be available to the shareholders at any time.

3407. But not to the public who are not really concerned, in effect?—I think this is strictly a legislative provision which reinforces the fiduciary position of the director *vis-à-vis* his shareholders.

3408. Then under sub-paragraph (c) of heading 6 you say: "It is not considered desirable that bodies corporate should be allowed to be directors of public companies." I was wondering why you confine that to public companies?—Where you have interlocking private companies it may well be that allowing one company to be a director of another does no harm. But again we are looking at it as long-term ordinary shareholders in public companies and we feel we ought to be dealing with trustees—if you will allow me to use that term, I know it is not accurate—who are individuals whom we know; but as to whether that applies to private companies we did not feel so sure.

3409. You are not saying positively that it is a good thing to have it for private companies?—No, we feel quite sure it is had in regard to public companies, but we think there may be special circumstances in regard to some private companies. In the previous two lines of our memorandum we did suggest an amendment in the Act, in that we thought that holdings of managers and officers of the company might be dealt with on the same footing as holdings of shares by directors.

3410. As to these matters in respect of section 195 and as to a corporate body not being allowed to be a director, would you regard these as matters for legislation?—Yes, I think so.

3411. Then we come to quite a different matter, the question of shares with restricted or no voting rights, and your conclusion there, I think, is that no legislation would be practicable. You say, in the last paragraph under heading 7: "No solution to this problem has yet been found, but it might well lie with the investing public refusing to take up issues of non-voting shares unless the terms of issue contain provision for protective

voting rights in circumstances appropriate to the company in question." The protective rights, I suppose, would include a right of voting on a resolution to wind up?—Yes.

3412. Or a change of objects, possibly?—Yes, and possibly also a change in the control.

3413. These things would come to pass probably as a result of the pressure of the market and people refusing to buy the shares unless their rights were modified?—We feel that is the only way you can deal with this once you accept the position, as we do, that although non-voting shares are in themselves fundamentally bad things there may be instances where they are legitimate and justified. You then get up against the difficulty of definition because the circumstances which would justify the issue of non-voting shares are so very varied. Therefore, we feel that in the last resort it is a matter of the market. If we all feel so strongly about non-voting shares we should not either buy or subscribe for them, and then if that became the general attitude of the investing public they would die because you could not issue them. A tremendous change has taken place in the last ten years in the general outlook about this. Nobody now, I think, will make an issue or attempt to make an issue of non-voting shares unless there are some pretty good reasons for it.

Mr. Touche: Meaning an issue for cash?

Sir Edwin Herbert: Yes.

Mr. Touche: Yes, I would agree.

3414. One could imagine an example where a family company wished to expand its business without passing over control and found people content to have non-voting shares. That is all right at that stage, but it might be, might it not, that in the course of time the original family would pass away and the non-voting shares would become wholly inappropriate because the purpose for which they had been created had gone?—*Sir Edwin Herbert:* Yes, but I think you have to judge it at the time when the issue is made, because it would not be right really to force a family into the position whereby they had either to issue preference shares

or debentures or to issue ordinary shares with unrestricted votes, which might mean that their competitor around the corner would take them over. I think you must judge this at the time when the issue of the shares is made. I admit that once the issue has been made the task of extricating those shares from their non-voting position becomes extremely difficult. To take another example, there are quite a few companies on the market today who are programme contractors under the Television Act. Under the agreements made by the Independent Television Authority it is essential that the control of those companies shall be left in the hands of those people to whom the contracts were originally given by the Independent Television Authority. Therefore, the Independent Television Authority will not permit the transfer to anybody—outside a very small circle—of voting shares in those companies. Are you to say the public shall have no interest in those companies at all, or should never be allowed to have an interest in them, because that is what you would be saying if you said they were not to issue non-voting shares. It would mean those shares could never be marketed at all, which could not be right.

3415. That is a very interesting modern example of the kind of difficulty one is likely to run into?—Yes. You would have two Acts running against each other then. I do not want to defend the thing as a general practice because we are very much opposed in principle to it. I am only talking about the exceptions.

3416. There are some people who say they would prefer a non-voting share in a given concern if they could get it at 50s. to a voting one which cost 60s. Some people really treat it simply as a matter of price.—That is true.

3417. Coming now to a very different topic, heading 10, which concerns the Board of Trade's powers to appoint inspectors. You say, "It is felt these powers are sometimes used in too dilatory a manner." What I wanted to put to you on that is this. I take it you would agree the appointment of a Board of Trade inspector does not do the company's credit or reputation any good?—Yes.

3418. The mere fact that an inspector has been appointed suggests there is something wrong?—Yes.

3419. That being so, there is something to be said for the view that the Board of Trade ought to make some kind of reasonably reliable preliminary investigation before the appointment of an inspector?—That, of course, we accept, and I think we have pointed out here that companies ought to be protected against any unreasonable applications, but you cannot get away from the fact that so many of these Board of Trade inquiries amount to post mortems, and, though I do not want to name any particular names, I can think of half a dozen instances where the City perfectly well knew there was a proper case for an inquiry long before the Board of Trade, quite properly, have felt they could take action. If one devised, without allowing irresponsible people to ruin companies by asking the Board of Trade to act too soon, some means, some form of consultation whereby the Board of Trade could act in cases and at a time when it was pretty well known in responsible quarters something wanted looking into, it would be much more advantageous than in fact has been the case in quite a number of instances.

3420. Do you see any prospect for the suggestion that the Board might be empowered to seek private access to the books of a concern to see whether there is a *prima facie* case? If there was a confidential communication from the director, or whoever it was who wanted an inquiry, to the Board of Trade followed by a communication by the Board of Trade to the parties whose conduct was being complained of, and the statutory provision made the whole thing, as it were, top secret, so that the Board of Trade could inform themselves without the stigma of the appointment of an inspector, then the public appointment of an inspector might follow if a case were suggested by these secret investigations?—*Mr. Touche*: I think it would be a good thing. The Board of Trade could make some contact with the company before taking the step of appointing an investigator.

3421. A preliminary enquiry which was made highly secret by statute and nobody would divulge anything about it at all?—Yes.

3422. Do you think something of that sort might be worth exploring?—*Sir Edwin Herbert*: Yes, I think it would be an excellent thing to explore, because there are two things to avoid, as we see it. One is such caution that prevents action being taken at a time when it might be some use to the stockholders, and, on the other hand, premature action which might damage the prospects of a perfectly properly conducted company. If we could get something in between those two, that is what we would like to see.

3423. The next heading on which I would ask a question is number 11, which deals with the vexed question of the disclosure of beneficial interest in shares. You suggest the directors should have "a statutory right at any time to call for disclosure by a nominee of the beneficial owners of shares." That suggestion has been made by others and, like several other suggestions on the same point, has been criticised. It is a very controversial matter?—It is.

3424. The sort of views we have had expressed about it are, first, that it would be wrong in principle to give private persons powers of this kind over other private persons, that is to say a man's share is his own and what he does with it is his own business. He can have his house held by a nominee for him if it suits him. Why should he not be entitled to do the same thing as regards shares?—I do not see any reason at all why a shareholder should not take that line, but if he does he cannot expect the director to regard himself as being fiduciarily related to him in any way, because he does not know who the beneficial owner is. That can be a very serious matter when you have things like take-over bids. For example, a company may come along and say to the directors "Will you recommend your shareholders to sell those shares to us for, shall we say, £x?" The directors have no idea at all, if the nominee system is used, whether those bidders have already acquired an interest in the company or not; they do not know whether the

persons for whom they are trustees, if I may use that inaccurate term, include the hidders or not. And supposing the bidder offers £1 is it not relevant to the directors to know in advising their shareholders whether or not the bidder has been buying the shares in the market for, say, 15s. or £2? How can the directors really discharge their fiduciary duties to their shareholders if they do not know who their shareholders are and what their interests are, or what the conflicting interests of the shareholders amongst themselves are? How can they know that, unless in those circumstances they have a right to call for disclosure of the beneficial interest?

3425. Arising out of that, might I put two questions? I think I am right in saying that most suggestions for the regularising of take-over bids include a provision to the effect that the hidders must disclose their true identity and the nature of their interest?—Certainly. Does that mean the bidder has also got to disclose how many shares he has bought in the company already and what he has paid for them?

3426. It could be made to include that, I think; I think that would fall within the general principle?—I am now only dealing with the question you put to me: why should a shareholder be in any different position from the owner of a house? As far as I know, the owner of a house does not require a director or anybody else to exercise fiduciary duties towards him, whereas a shareholder does.

3427. If a man is content to take the risk and to have an imperfect title, there is no reason he should not say "I am content Mr. Jones's name should appear on the register, and I will keep the beneficial interest and rely on Mr. Jones to look after my interest"?—That is perfectly true, but how can he then expect the directors, with full knowledge—and that is necessary—to act in a fiduciary capacity towards him? To Mr. Jones, yes.

3428. He takes the risk that if he goes to the directors and makes some complaint to them, they will say "Yes, we know Mr. Jones, but who are you? You are not on our books"?—I do not think it is quite as simple as that.

3429. As to the directors' fiduciary duty and the necessity that they should know to whom that duty is owed, do those considerations really stand in cases of the great companies whose shareholders change from day to day? Can the directors ever know in whose favour they are exercising their duty?—I do not think this is of any importance in regard to companies like that, but you could conceivably even there, I think, imagine a case where it would be justified for a director to know. One of the most difficult things, I think, that directors have to judge is how much information to disclose in the annual report or elsewhere about the business, because we as shareholders like to have as much disclosed as possible but we do accept that all directors have got to consider that what they say is going to be made public. What they say to the shareholders is of importance, and I could imagine circumstances in which the directors would be properly influenced as to the amount of information they disclosed by consideration as to whether one of their competitors, for example, had bought a large number of shares and put them in a nominee's name.

3430. A competitor could put a man in holding one share in his own right, could he not? It does not really affect the position whether he is a nominee or not?—I think if a large number of shares was seen accumulating under one nominee name, that would give one a good indication. Of course, you can defeat anything if you try hard enough.

3431. Assuming the desirability of a beneficial interest being made known, what system can be devised which would produce results in any way commensurate with the work involved?—That is really why we put it in this way. We are in favour of the nominee system as a system, but we think there are exceptional cases where the directors should have the right, at their discretion, to call for a disclosure by a nominee shareholder of the beneficial interest he represents. I should contemplate that it would only be in fairly rare instances directors would wish to exercise that discretion.

3432. The difficulty is, first of all, to say on what occasions the director should be

allowed to exercise that power?—That is why we did suggest it should be left to the discretion of the directors.

3433. That is a short and simple answer, but do you think it would be workable? It puts rather an onus on the director, does it not?—It does put an onus on the directors, but I am thinking that a director does have a very severe onus on him in any event, namely to do the best he can to hold the balance between the different classes of shareholder, and I should have thought that it would ease his burden, on the whole, if he felt in a suitable case he could find out who the real people were whose interests he was supposed to look after.

Mr. Touche: I should imagine such a power if it existed would only be used very rarely, when, for instance, there was a large nominee holding building up and the directors were in some doubt as to what the object of the shareholder was. In the ordinary way directors would not ask for the beneficial interest to be declared.

3434. How would they know a large nominee interest was being built up?—It would appear in the register.

3435. The same person, or the same series of people, buying the shares one after the other?—You might see in the register that, say, 20 per cent. of the issued shares had been accumulated and passed into the name of such and such a bank nominee, which is obviously not the beneficial owner, and you do not know who the beneficial owner is. In a case like that you would like to know because it would affect a lot of decisions in the conduct of the business, quite possibly.

3436. It would be desirable to know it, but the bank nominees would be put in a rather difficult position, would they not, because they act as nominees for all sorts of people and for all sorts of quite legitimate purposes?—Yes. Of course it might not be one beneficial owner at all; the large holding might in fact be spread among a great number of the bank's customers.

3437. *Mr. Bingen:* I think Mr. Touche said it might affect a number of decisions taken by the board if they saw a large

nominee holding being built up. Provided the directors are running the company in what they conceive to be the best interests of a fluctuating body of shareholders, doing everything they think right to improve the value of the company to the investors generally, why as a general proposition should it matter whether their shareholders are X, Y or Z?—They could, for example, be competitors.

3438. Provided they are running the company in what they conceive to be the best interests of their shareholders what does that matter?—*Sir Edwin Herbert:* I think it might be a perfectly relevant thing for a director to know, if he was considering whether the company should enter into a contract with that particular person who was buying for control; or if he did decide to enter into a contract, what information he should disclose to him. I can think of a number of instances where it is difficult for the directors to carry on the business properly unless they know who their shareholders really are—not normally, but there are abnormal, exceptional cases.

3439. *Mr. Lawson:* What would you do in the case of a number of nominees? The directors might approach the first nominee and get a reply that the holding was for the XYZ company, but would the directors then have power to go to that company and enquire for whom it held, and so on all the way down the line?—I do not think one could do that really, it would not be practicable. This is not the complete remedy, but it goes some part of the way.

3440. If somebody wanted to conceal his holding he has only got to put a couple of nominees between himself and the registered holder and he has done it. This suggestion might help a little, but it would not be really effective, would it?—Not where it was so important to conceal that the buyer had carried out every precaution he could think of.

3441. *Mr. Mackinnon:* This very point does arise on Board of Trade investigations into the ownership of shares under section 173 and in section 174 (2) the Board of Trade were given certain sanctions to impose on people if they did not comply with the requirements. Do not think I

am saying the proposal is right or wrong, but it does seem that this problem has been tackled by the legislature in the case of a Board of Trade inquiry and it would not be beyond the realms of possibility to apply similar provisions to an inquiry by directors. One thing which can be done by the Board of Trade under section 174 (2) is to ban the transfer of the shares if the position is such as to merit it.—The principle, shall we say, has been breached by sections 173 and 174.

3442. *Sir George Erskine*: What you really want to achieve is to ascertain whether in fact there is a substantial holding by one man. Mr. Touche's illustration was that if, say, the directors found 20 per cent. of the capital was held by a bank nominee company they should have the right to ask them to give the names of the beneficial owners. Would it meet your point if it were only required to do that if in fact, say, 10 per cent., or half of the total nominee holding were held by one individual?—I think a limitation of that kind, if thought to be a proper precaution, would help.

Mr. Touche: I do not think this point is material in relation to small holdings. It is only in relation to substantial holdings of, say, 10 per cent. or more. In other words, I would agree with you.

3443. *Chairman*: As to section 174, I have gathered from our previous discussions that the objection to that is delay, that by the time the Board of Trade inquiry into beneficial interest has been completed the contemplated mischief, whatever it was, would have been done. Is that your view, Sir Edwin?—*Sir Edwin Herbert*: Yes, and also, of course, the whole thing is governed, is it not, by the opening words of section 173: "Where it appears to the Board of Trade that there is good reason to investigate the ownership of any shares in or debentures of a company and that it is unnecessary to appoint an inspector for the purpose . . .", then they may take certain action. I should have thought the circumstances, under which a director might legitimately want to know who his shareholders really were, were probably wider than the circumstances under which the Board of Trade as a substitute for appointing an

inspector can take these steps under section 173.

3444. Have you considered the reverse way of dealing with this? It has been suggested that the onus might be put on any shareholder who became the beneficial owner of, say, 10 per cent. of the shares of a company held by nominees on his behalf, to disclose that fact to the board?—I do not think that is necessary because, granted that we are only thinking of the small minority of cases where disclosure might well be called for by the directors, why break into the well-established nominee system by making it an obligation, in certain circumstances, to disclose 10 per cent., or whatever it may be? I do not see why that should be done, provided that the directors, in suitable cases, could call for it to be done.

3445. Yes, but the point of this suggestion was that whereas a nominee might not know the ultimate beneficiary for whom he held shares, there would be little doubt that, in the vast majority of cases, the beneficial owner would know what shares he was beneficial owner of, if you follow me?—I do not suppose there are many cases where there would be holders of more than 10 per cent. Yes, it might be a help.

3446. If I recollect rightly, the Coben Committee did make a recommendation of putting the onus on the beneficial owner, but they set the holding as low as 1 per cent., and it was argued that that would cause great difficulty because there were too many possible cases?—*Mr. Touche*: As against our suggestion, that alternative has the effect of putting the machine in motion for a great number of cases where it is not really required; in other words, everyone who has the minimum which it is required should be disclosed has to make this disclosure.

3447. Someone might have a gift to him by will of, say, 25 per cent. of the capital of a company, and those shares might remain vested in the executors of the will who were not as yet ready actually to transfer them: in that case you would say this beneficiary is being harassed quite unnecessarily. Is that the kind of example you have in mind?—No, I was thinking

further, that the remedy we were proposing only comes into operation at the discretion of the directors, and in the normal way they would not worry who the shareholders were. It would only be on some special occasion that they would use it.

3448. The directors would act selectively, whereas the reverse operation would apply to everyone, whether the holding was relevant for this purpose or not?—Yes.

3449. *Mrs. Naylor*: You are assuming that directors would not use this power except with very great judgment and responsibility. If you measure the number of times in which it would be used against the number of times a beneficial owner of 10 per cent. of the capital would have to declare his interest, you would be expecting it to be used very rarely?—I think so, yes.

Sir Edwin Herbert: I think so, too. It would be quite a nuisance to start such an enquiry, and I cannot think directors would use it out of idle curiosity.

Mrs. Naylor: I think some would; some of those you feel should have been investigated by the Board of Trade!

3450. *Mr. Bingen*: Reference has been made to the trustee position of directors and that it is very nice for them to know who their beneficiaries are. In certain companies they do not know. But the chairman of a large public company has told the Committee that he could not care less who held his company's ordinary stock from day to day and that his duty was to run the company to the best advantage of everyone. He had the general obligation to make the company a success. How can you reconcile that approach with the approach that "I must know who my beneficiaries are"?—When dealing with a big company I would agree it does not matter a scrap to the directors who the shareholders are. We are thinking here of certain special cases which arise from time to time where it does matter, or we think it could matter very much to the directors, in deciding what is their proper duty, that they should know who their particular shareholders are. It does not apply to the ordinary

anonymous shareholders in a big company. It does not apply in a great many cases, but there are instances where we believe it is important and justifiable for the directors to know with whom they are dealing. I could not agree more that in the ordinary, normal case with shareholders coming in and going out day by day, it does not matter who they are.

3451. Would the exceptions be cases of companies where, because of undervaluation of assets or mismanagement the shares have been undervalued and somebody has been secretly buying for control so that the directors would then be unseated?—Not necessarily those cases. I can think of quite a few cases over the years where a perfectly well administered company with a fairly small body of shareholders has been running its affairs perfectly well and properly, but where a competitor has deliberately tried to acquire shares. In those circumstances, how can the directors of that company do their duty properly if they have no means of knowing whether their competitor is in fact endeavouring to become the leading shareholder in their company.

3452. *Mr. Leslie Brown*: Is there an implication there that you are thinking in these special cases of the directors acting with regard to their own interests as directors rather than as managers of the company?—I am thinking entirely of the company and the general body of shareholders. I have no sympathy whatever with directors who let their company get into a condition where a take-over bidder has an obvious case and who then, with death-bed repentance, try to get the shareholders' support which they have never earned for 20 years.

3453. *Chairman*: It is a difficult subject, and I do not think we can carry it much further. It seems on the whole that most people are agreed, in certain circumstances, that disclosure would be most desirable; but it is extraordinarily difficult to evolve an effective system. All we can do is to add your suggestion to the others we have received and see what they come to. The next point arises under heading 16, take-over bids. First of all, might I ask you generally whether you are satisfied, broadly speaking, with the new Board of

Trade regulations on take-over bids? Most people seem to think they cover the ground, subject to their effect being woven into any new company legislation?—The answer is yes, we are. Referring to your phrase, "subject to their being woven into any new company legislation", we are not certain that they should be woven into any new legislation. So long as the Board of Trade has the power to keep them in their present form, we are not sure that would not be better.

3454. There would have to be some modification. As they are framed they apply only to licensed dealers, and one would have to make them applicable to all dealers?—In that sense, I would agree; but I would not much care to see Board of Trade regulations cease to be Board of Trade regulations and become provisions in an Act of Parliament.

3455. Yes, I see. One might provide for the general adoption of those regulations?—Yes.

3456. Then there is a point under the same heading where you say: "It seems wrong that, while the law and the regulations of the London Stock Exchange require the publication by prospectus of much detailed information before money can be raised from the public by the issue of shares or securities, no such information is required when shares are offered by one company in exchange for the shares (which are money's worth) of another company." In other words, a prospectus is required if I offer my shares in company A for cash, but a prospectus is not required if I offer my shares in company A for shares in some other company?—Yes.

3457. As to that, I take it you would not require a prospectus on exchanges of shares except in cases which would have required a prospectus if they had been cash transactions?—I think this has been largely put out of date by the issue of the Board of Trade regulations.

3458. On take-over bids, you mean?—Yes. If they had been dealt with in the way we discussed in answer to your last question, I think this paragraph would be satisfied.

3459. I see. But so far as it is material, you would agree, would you, that any

alterations of the law to bring exchanges of shares within the prospectus provisions should apply only to cases where a cash transaction would have necessitated a prospectus?—Yes, certainly.

3460. *Mr. Bingen*: Suppose a large company whose shares are quoted is trying to acquire a very small company and, instead of paying cash, offers its own shares and issues new shares which in turn will get a quotation: that would not require the issue of a prospectus?—No.

3461. Otherwise it would hamper a large number of minor dealings, would it not?—No, we had not that in mind at all.

3462. Then under heading 21, on Accounts, you say "it is desirable that the following details should be given", and you begin with "Sales and gross turnover figures (except in the case of exempt private companies)". That question as regards turnover figures has been the subject of considerable discussion in the Committee, and it has been put to us by a number of witnesses that it would be harmful for some companies' businesses if a hard and fast requirement as to disclosure of turnover were enacted in all cases. It has also been submitted that an attempt to comply with this requirement might involve some companies, particularly those pursuing a multiplicity of activities, in a great deal of work without any compensating advantage to anyone. Have you any views on that?—*Mr. Touche*: If there were such a requirement, there would always be occasions when some people would find it inconvenient. But, after all, it is common practice on the Continent of Europe, where they do not in the ordinary way disclose a true figure of profit. They do at least disclose the turnover. It is a common practice in the United States and Canada. I do not see why it should not be here. If you have this information in ordinary cases and it is not complicated by special considerations, it enables you to calculate a great number of ratios, profit margins and so on, to see whether the company is maintaining its share of the trade in the industry, whether the profitability is rising or declining, and it renders the accounts very much more meaningful.

3463. Yes, I see. Then you say that the names of subsidiary and associated companies, to put it shortly, should be disclosed in the accounts, and a good many arguments have been raised against the desirability of doing that. Amongst other things, it is said that this disclosure might prejudice the position of a company in foreign countries where it may get on a lot better if the connection is not known. Do you think there might be any substance in that?—There might be. I should have thought probably the connection would be known. But as regards companies in this country, especially the very large companies, if an investor knows the names of subsidiaries, he can get a very much better idea as to what businesses they do actually carry on and what is the nature of the business in which his money is invested.

3464. I see it has that advantage to people who desire that information, but the question rather is how far they should be given that information if it is really going to be harmful to the company to give it?—Of course this harmful argument is always cropping up, and I think most of the time it is just humbug.

3465. I suppose that is a matter of opinion. Then other companies say they have so many subsidiary companies and some of them are so small, it would be a waste of time to give a complete list?—Well, there is not a very great deal of time wasted. It is only the printing of the information and the shareholder does not have to read it if he does not think it is material.

3466. That again, I suppose, is an answer. Then there are other arguments such as that a company which is carrying on a business of manufacturing certain commodities may wish to engage in the retail trade in the same or similar commodities, and it might find it less embarrassing in its dealings with the retail trade if its connection with retailing were not known; that is to say, it might put them in an embarrassing position if the retailers knew that they, the manufacturers, had embarked on retail trade; and it is said as a matter of commercial expediency that it is quite legitimate in such a case that the connection should not

be disclosed?—I can see there would be an advantage in the connection not being disclosed at a certain time. I should have thought, after a certain lapse of time, the other retailers would probably come to know of the connection.

3467. I see. We have had that answer given to us before. It is only a matter of time, and the connection will become known anyhow; so it is not a very important point. That is how it is put?—Yes.

3468. Then there is the question of a concern such as a high class hotel establishing a business of mobile coffee stalls round London; and in a case of that kind it might be advantageous to the parent company that the connection should not be known?—*Sir Edwin Herbert*: Why start the business, then?

Mr. Touche: If the connection were known, I think it might very well put up the price of the shares. It is diversification into a more popular type of business.

Mr. Bingen: It would be much more likely that a coffee stall chain would buy up the hotel!

3469. *Chairman*: Then you suggest that the accounts should include a directors' valuation of unquoted investments in subsidiary and associated companies. Do you think the directors would be competent to make such a valuation and would they have the necessary facts on which to make it? They would as regards subsidiaries, I suppose, but I think this extends to companies of which they have not actual control?—If the subsidiaries are consolidated, this point is not relevant. It does not matter in those cases. Of course, in the case of investment trusts and investment dealing companies, it is common—in fact, it is usual—for the directors to place some value on the unquoted securities. It gives some indication; and, after all, they made this investment and they are still deciding to retain it. They ought to have some idea of what they consider the value to be, within broad limits. What this is aimed at is the concealment of gross undervaluations or gross over-valuations.

3470. And you say that the directors' valuation ought, if they are doing their

duty, to be sufficiently accurate to guard against that?—Yes.

Sir Edwin Herbert: No responsible director would put his name to this valuation without getting the necessary professional and expert help in making it which he needed.

Chairman: Quite. I think those are all the questions I have, but I expect my colleagues will wish to ask you some further questions.

3471. *Mr. Watson:* There is just one point I want to raise. Would it be fair to say the activities of the Association are mainly directed to the protection of the interests of the shareholders of your constituents?—That, I would say, is the major part of the work, yes.

Mr. Gammell: That is the object laid down in our constitution.

3472. And you have found the present machinery is entirely satisfactory?—

Sir Edwin Herbert: Yes, with the exceptions to which we have drawn attention. We would not say it is entirely satisfactory. We think there are unsatisfactory things, but that the proportion of those unsatisfactory things which can be dealt with satisfactorily by legislation is very small.

3473. I note, for instance, your remark under heading 9, protection of special classes of shares: "It is not considered that this is a subject for legislation. The rights of shareholders are a matter of contract to be contained in the terms of issue. It is for shareholders to decide what conditions are acceptable." There are occasions, are there not, when there is an attempt to vary these rights, either with regard to dividends or voting rights, and, as an Association, you come in to the extent that your constituents may be interested and you endeavour to achieve a satisfactory solution or adjustment of the proposal?—That often happens, yes. I would say in 95 per cent. of the cases we deal with, the directors of the company concerned probably talk it over with us before they come to a final conclusion, and with other associations too.

3474. There is just one other question I wish to ask, and perhaps it is not a fair

one to ask without notice, but it is a question that has come before us. In any of your investigations of this kind, have you come across the situation where a company has invested the funds of its own pension fund in its own ordinary shares, and has that raised any difficulty?—I do not think it has raised any difficulty so far as the members of our Association are concerned. If I may venture to express a personal opinion, I think it is a wrong practice. I do not mean that it is an improper or dishonest practice, but it has always seemed to me that the object of a pension fund is to make sure the employees' pensions are not dependent on the fortunes of the business in which they are employed. Therefore as a matter of prudence I have always made it a principle to make quite certain in any of the companies of which I am a director that the funds are in fact invested outside the business; not because I think it is improper, but for the peace of mind of directors I would like to see it invested outside. Otherwise you have a sort of moral obligation still left.

3475. *Mrs. Naylor:* Could we come back to the question of access to the register of directors' shareholdings? You thought it right that shareholders should see it at any time, but what about potential shareholders, because you excluded the public?—Yes. What is a potential shareholder? At what stage does a person become a potential shareholder?

3476. I think they might be represented by the financial press?—I thought that might be it! I think the financial press would be acting for the public rather than the shareholders.

3477. Do you see any real objection to the public looking at the directors' register?—I cannot see any reason for it at all.

3478. Except that it is so easy to get round it: any member of the public can soon find someone who is a shareholder?—Of course. But I think the relationship between a director and shareholders in a particular company is not a matter of concern to the public.

3479. On this question of Board of Trade inspections, I am wondering

whether the idea of an informal approach in the first instance really advances us very much, because I presume there is some kind of informal approach in any case?—Yes. The Board of Trade cannot do anything unless they are satisfied within the terms of the Act that there is a case for action and are satisfied that their Minister could justify the action in Parliament, which is another aspect of the matter. I should have thought, if the Board of Trade had some sort of private preliminary access, it might avoid some of the difficulties we have had.

3480. In order that the Board of Trade might act more promptly would it not be necessary for all companies to file returns, something in the way that they are filed in the United States with the Securities & Exchange Commission? I know documents are filed here with the Registrar of Companies, but action does not follow as a result of that, of course?—I tremble at the thought of copying the actions of the S.E.C. in any way whatever!

3481. Not even in a modified form?—Only to the extent we have been discussing this afternoon. I do think we have got to be very careful not to have things too complicated. My experience of the S.E.C. is that it is so complicated, so long and so tautologous that very often, in trying to provide for everything, it really does not provide effective protection for the ordinary person at all. When you get a prospectus running to 70 pages of foolscap, I do not think the ordinary person can make head or tail of it anyway, and I do not think there is any protection to it, nor do I think that sort of protection is necessary.

3482. *Mr. Mackinnon*: I know this, in a sense, is a small point, but it looms rather large in certain quarters: this question of pre-acquisition profits. In your memorandum you say: "In particular, the regulations under which pre-acquisition profits are frozen in an amalgamation require amendment." The more one thinks about this, the more difficult is the method of attacking the problem. I was wondering whether your Association had any views on how this could be attacked, and whether, for instance, you could allow going back two

or three years on pre-acquisition profits with the consent of someone like the Board of Trade?—We do not see the solution of it ourselves. We felt we must draw attention to it, because it is one of the things which impede legitimate and desirable amalgamations, as we all know.

3483. Assuming it is the law at the moment that when you issue fully paid shares in exchange for a consideration other than cash, you have to establish a share premium account by valuing the assets that you receive and subtracting from them the amount of the fully paid shares issued—and there is conflict in certain circles about this—do you yourself consider that to be the correct principle, or would you say that we should distinguish between the issue of shares at a premium for cash and the issue of shares for other than cash?—That is a big question to answer without notice. I should have thought probably there is a case for distinction between the two.

Mr. Touche: I would like to avoid the question and approach it from another angle, if I may. Where the rub comes is when you have two companies which have been in business for a number of years and have accumulated considerable reserves which are revenue reserves and available for distribution. Then, when you put them together, whether you use a holding company or one of the constituent companies as the surviving unit, you find part of those revenue reserves are no longer available for distribution, no longer available to provide for tax on the previous year's profits which have been earned before the merger and are, as we say, frozen. That is a technical nuisance which makes amalgamations more troublesome, and it is difficult to see why, because two companies are put together like that, these reserves should not be available for distribution.

3484. Logically, the reserves are in the price which you have calculated notionally for the purpose of getting at the share premium account?—Yes.

3485. So that you would modify the rules for the share premium account?—*Sir Edwin Herbert*: That is rather what I had in mind when I said there did seem to be a case for differentiating between

an issue for cash from an issue for other consideration, because the object of the share premium account is to state the true position in the accounts. That follows from the substance of the matter, which is, as Mr. Touche has indicated, that reserves and provisions should be available for distribution or other purposes which are not now. Is it not desirable to consider, in those circumstances, how you should calculate your share premium account rather than reverse the question?

3486. *Mr. Lawson:* If one of the two companies which Mr. Touche had in mind is a company with a very large balance of pre-acquisition profits and a very large cash balance or assets which can be converted into cash, and if the purchasing company can issue its shares at a premium so that it then brings those shares in that second company into its balance sheet at a low value and does not create a share premium account and then can distribute the profits of the second company into its own company and can pay a dividend, it is very nearly the same thing as issuing shares for cash at a premium and using the premium to pay a dividend. That is the difficulty, is it not? —*Mr. Touche:* Yes. The difficulty seems to arise out of the technicality that one of these companies is a purchasing company and the other is an acquired company, whereas from the economic point of view they have merely merged.

3487. I think we all appreciate the difficulty which arises on mergers. Directors like to feel that this huffer of pre-acquisition profits is not entirely frozen because they fear that a rainy day will come when they will want to use it. I am wondering how often, in fact, they do require to use it, and I am putting the question because of what Mr. Mackinnon said. If we were to provide that in appropriate cases the Board of Trade might give permission for a reserve of this kind to be distributed, would there in practice be many cases coming up to the Board of Trade so that they would be inundated with cases, or would it be rather a rare event?—In the economic climate we have been living in in the last ten years or so with regard to any major mergers, it would be most unusual; but you could conceive that if you had a very serious

loss following a merger, the shareholders might be deprived of a dividend, whereas if the companies had not merged they could have been paid their dividend out of previous years' profits.

3488. Yes, I see.—I agree with you it would be very unusual in companies of any size, partly because of the general prosperity of industry and partly because the level of dividends has been substantially below the level of profits in nearly all companies.

3489. And two companies do not usually merge when they are in difficulties. They take a good look at the situation before they come together. There are one or two other questions I would like to put to you on accounts and, first, about your trust company accounts themselves. You say in paragraph 11 of your evidence that some companies publish details of their portfolios of investments with their annual accounts, or make them available in one form or another. It has been suggested to us that it should be made compulsory for investment trust companies to publish details of their portfolios. Have you any views on that?—*Sir Edwin Herbert:* I cannot see what possible advantage there would be in making it compulsory. I can think of a normal well-established investment trust company, and I do not think it matters much from the shareholders' point of view whether the portfolio is published or not. But I can imagine the case of certain investment trusts in a state of transition where it might be contrary to the interests of the shareholders to make it compulsory to publish the actual portfolio at a given date. It must be, of course, at a given date, must it not?

3490. Yes. My second point relates to correspondence which, you probably remember, passed between your Association and the Board of Trade following the passing of the 1948 Act. The point at issue, you will remember, was that the accountants, I think, were saying that profits realised on the sale of investments were in their opinion under the Act a reserve which ought to be disclosed, whereas the current practice of trust companies was to utilise that surplus to write down the book value of their existing portfolio. The Board of Trade

gave a ruling to the effect that that custom was permissible subject to one or two relatively simple safeguards. I take it you would probably require us to clear up that ambiguity one way or another, would you not?—Provided it is cleared up in accordance with present practice, yes.

3491. I thought that might be your answer!—We regard this as rather an academic point, frankly. It is one which the Institute of Chartered Accountants bring out from the bottom drawer and give a dusting to and produce whenever there is a new Committee on the Companies Acts. The end result, as we see it, is exactly the same whichever way this is done; that is to say, the balance sheet shows the value of the investments at the appropriate time. All that happens, as I understand it, is that many investment trust companies do not show how they get that final figure. The final figure is not affected, as I understand it, but it may be that the percentage increase over the original cost or the book value or the depreciation (if there is depreciation), may be affected according to the way in which you do this. But we really do regard this as academic. Some companies do it one way; some do it the other. The end result, we believe, is the same whichever way you do it, and the only figure which can be affected by this method, whether it is done one way or the other, is the percentage of appreciation over or depreciation on cost or book value, as the case may be. We do not think it is really a point worth worrying about.

3492. Thank you very much. Now, as regards investments in associated companies or companies where the holding may be up to 25 per cent. (paragraph (3) of your answers under heading 21), your proposals go rather further than those which have been made by other witnesses in that you would like to see pretty full details of each one of these investments. You would like to have the percentage of capital held, the total profit of each company and the proportion paid out in dividend. Would it not be adequate for your purpose as investors if total figures were given of these holdings without

going into all that detail?—*Mr. Touche*: I think it probably would be all that one could require. It would be interesting to us as investors to know how much came from each particular source, but the main object of our proposal was to see what was the holding company's equity in the undistributed assets which are not disclosed. The totals would disclose that.

3493. I think that is more in line with what a number of other witnesses have said. May I ask you one other question on accounts. As you know, there has been some considerable controversy amongst accountants as to whether the profits which are required to be shown by the Companies Act should be computed purely in money terms or whether they should be real profits in the economists' sense. It is quite a major issue, and Mr. Touche will remember many discussions we had on it some years ago. Have you any particular views on that broad problem?—*Sir Edwin Herbert*: I would say that the desire of the long term investor must be to have put before him in the most accurate and comprehensible form the true economic position of the concern in which he is investing or has invested. I do not think there would be any dispute about that. I think the question is not so much the substance of the matter as the form in which that information should be conveyed. Speaking for myself, I would say there are probably three separate things to be considered. First of all, there is the company's accounts, which is the thing specifically put by Mr. Lawson. I do not see myself, speaking as an amateur and not as an accountant, how they could be in anything but money. I suppose an account is a document delivered by someone who is accountable to someone to whom he is accountable in respect of something for which he is accountable, and the company's accounts must be an account by the company to the shareholders and possibly the debenture holders. Therefore the company is accountable and the shareholders are the persons to whom the company is accountable. The subject-matter in respect of which they are accountable must be the money they have received from the shareholders or the debenture holders,

and therefore the accounts must show what has been received on the one hand and how that money has been spent; not what the value of the present assets representing it may be, but how the money has in fact been spent. I should have thought that applied both to the balance sheet and to the profit and loss account. Therefore I should have thought the company's accounts ought to be on a money basis. Then you come to the question of the tax computation, which is a different thing altogether. You may utilise some of the figures which you find in the balance sheet and profit and loss account, but it is primarily a computation and not an account. Its form and substance are governed by the fiscal regulations for the time being. Neither of those two things may necessarily give any clear idea as to the true economic position of the business, either in any particular year or generally. One would hope companies would try and tell their shareholders as much as possible about the true economic position of the business, but, if so, I should have thought it was something to be done in the report or some other document, and not by altering the form or substance of the company's accounts. I am sorry; that is rather a long answer.

Mr. Lawson: Thank you very much indeed.

3494. *Mr. Scott:* Do I understand your recommendation to be that there should be no legislation at all about non-voting shares?—That is our recommendation.

3495. And that your recommendations as to good conduct in certain circumstances, so to speak, are matters that might be incorporated in any amended Table A, but that there should be no legislation at all so far as non-voting shares are con-

cerned?—Subject to this, that I suppose Table A would contain what it does today, namely, one share, one vote.

3496. But you would not advocate that Table A should contain a restriction against the power of a company to issue non-voting shares?—No, not at all.

3497. You say in your memorandum that you would welcome any modification to existing enactments which would enable companies to amalgamate more simply. I think there is a procedure in America whereby a company automatically determines by resolution of its shareholders on a merger. Had you in mind some procedure of that sort, which avoids liquidation: the succeeding company takes over the commitments, liabilities and assets, and the other company ceases to exist without any liquidation?—I think this part of our memorandum was intended to lead up to our suggestion that some simplification of the provisions of sections 206 and 208 would be helpful. I do not think it was intended to do more than that.

3498. Are you in fact familiar with the American procedure, which I believe is simpler?—I have personally come across it, yes; not in an investment trust connection, but in other connections.

3499. It seems to be the only respect in which American procedure is simpler than ours?—Yes.

3500. *Chairman:* Well, gentlemen, those are all the questions we can think of to put to you, and we are very much obliged to you for coming and giving us so much time—and an interesting discussion, I may add. Thank you very much.—We are very grateful for the opportunity of being able to come and amplify what we said in writing.

(The witnesses withdrew)

MR. S. L. FAIRBAIRN *called and examined*

3501. *Chairman:* Mr. Fairbairn, we are much obliged to you for coming here this afternoon to supplement what you tell us in your memorandum. For the purpose of our record, we can properly describe you as Chairman of Municipal

and General Securities, Ltd., which manages a number of unit trusts?—Yes, that is right.

3502. We were this morning discussing unit trusts with the Association of Unit

Trust Managers, and it seems that they take a rather different view from you about the present form of unit trust schemes. They favour the existing conventional tripartite arrangement where units are provided against a fund of underlying securities and that fund is held by a trustee and managed by managers; in other words, the form contemplated by the Prevention of Fraud Act. We understand that you for various reasons favour a different form of trust: in effect, you would be in favour of using an investment trust company so constituted that it was able to make a market in its own shares by issuing them, paying them off and re-issuing them.—Yes.

3503. Could you say why you favour that form?—Entirely for the reasons stated in my written submission—in one word, the main reason, Sir, is economy. I think everybody will agree that the management of unit trusts is not an easy way to make money. You will have noticed from the written evidence of the Association to which you have just referred, that they want to make higher charges and that they say they cannot make ends meet, and I think there is a good deal of justification for that. There are, however, two ways of making ends meet. One of course is to charge more for the article or the service you are rendering; and the other is to make economies. I thought it was well worth while considering what possible economy could be made, for instance doing without a trustee, who is rather expensive. I daresay this Committee has examined the details of the cost of running a unit trust.

3504. We have not been informed—or, at least, we may have got information, but I have not familiarised myself with it—as to the rate of remuneration which the trustee gets.—On pretty good evidence which I have from one of the trustees who act for a great many trusts, he looks upon himself as reasonably remunerated if he is getting 9s. a year per unit holder, and he considers it costs him nearly that much to keep an account—or at least he did two or three years ago, and I do not suppose prices have changed very much. Now one unit trust which was in difficulties the other day had an average unit holding of about £80, and I think that I am right in saying that their annual charge

was one-half of one per cent. or perhaps three-eighths of one per cent.—they would be getting 8s. a year per unit holder total remuneration—so that if you say a trustee costs 9s. per holder you will see what I mean when I say that the trustee is an expensive item in the whole set-up.

3505. You mean you are running on a narrow margin of profit?—Yes; I do not think anybody would gainsay that—I certainly would not, and the Association certainly would not.

3506. So that a relatively small saving might make a great difference proportionately to the result?—Yes, and I think it is for those reasons that one should consider dispensing with a trustee. Of course, I have nothing against trustees if they do not cost anything!

3507. One does not imagine that these large institutions would perform such services for nothing. On the other hand, if you are paying out money, you may or may not be getting value for money. Do you attach no importance to the security given to unit holders by the fact that their claims are against a fund held by a trustee of high repute?—Comparisons are notoriously odious, and it depends on many factors, such as who the trustee is or would be. I think that the hoards of directors of a great many investment trust companies would be very much insulted if they were told that they could not be trusted to look after the public's money without having to have a trustee as an additional safeguard for the public. This idea of what I might call co-operative or mutual investment has been run without damage to the public at all—at least, I cannot think of cases—without a separate custodian trustee. The function of management and custodianship of investment trusts has been vested ultimately, as I understand it, in the directors of the company, and it has not been thought necessary to have an additional or separate custodian. They choose what safe deposit they will have but the responsibility is solely theirs. That seems to me to be a more economical way of doing things.

3508. What is the status of the people who would be unit holders under the present conventional scheme and of the people occupying a comparable position in your company version of the unit

trust idea?—I am not sure I have followed what your question is after, but as I see it the unit holders would be in exactly the same position from the point of view of security as would the shareholders in an investment company.

3509. Exactly—whereas a unit holder under the tripartite scheme gets a share in a specified portfolio of investments held by trustees?—Yes.

3510. Under a company scheme instead of a unit holder you have a shareholder, whose claim is against the ultimate assets of the company after creditors have been paid. Is not that right?—I think that introduces a complication—creditors. I was dealing simply with the question, which I thought you were raising, of the reliability of the custodian.

3511. I was comparing the characters of the two types of arrangement. It is right, then, is it not, that under the conventional, tripartite arrangement, the unit holder has a share in a fund vested in a trustee?—Yes.

3512. In the company version of such schemes, instead of unit holders you have shareholders and instead of a fund held in trust for them you have the general assets of the company?—Yes. I would think that the position of the general assets of the company, and any liabilities on them, is unchanged between one scheme and another: the only change is that in one case there is a separate custodian and in the other there is not.

3513. If these funds are not to be part of the general assets of the company they would be held as any trust fund for the exclusive benefit of the shareholders, who correspond to the old unit holders?—Yes, with just the same—and no more—liability as I see it.

3514. So that you would cut out the trustee and furnish the directors of the managing company with two "hats". One, that of directors of the investment company, the other that of managers of the fund?—Yes, they are, of course, managers of the fund at the moment.

3515. Then they would become at one and the same time directors of the investment company, trustees of the fund and managers of the trust. Would that be

right?—It seems to me that there would not be a trust; there would only be a company.

3516. I am afraid I am not making myself clear. If a company has assets belonging to it and those are assets which are not fixed with any trust, then if the company is wound up those assets are liable to be applied in discharge of the company's liability?—Yes.

3517. And its shareholders only come in when all claims of creditors and so on have been satisfied?—Yes.

3518. I want to know whether under your company scheme the people who subscribe would be in the position of shareholders and not in the position of beneficiaries under a trust?—In the position of shareholders.

3519. So that that would make a radical alteration in the character of schemes of this kind, would it not?—I expect you are right, but I had not thought so.

3520. We are not suggesting that any unit trust or any company performing similar functions would ever do anything not in the highest way correct, but one has got, without assuming that every director is a rogue, to consider the possibility of things going wrong; and if your trust company were to fail there would then be no trust fund to which the subscribers could look; they could look only to the surplus after all liabilities had been discharged?—I think, Sir, where I am perhaps not quite following you is that you are assuming that things could go wrong in a way in the case of a company in which they could not go wrong in a trust, and that is where I am rather at sea. I do not quite see where the introduction of the company form as opposed to a trust form makes it easier for things to go wrong.

3521. Where there is a trustee, having regard to what is required in the way of qualifications, I suppose it can be said that the fund cannot be misapplied?—Yes, and that is where I started; I had hoped I had made that plain: that if you think you need somebody to prevent embezzlement or misapplication of the fund, then a trustee, a second party, can be useful—but only for that purpose

as I see it, and I do not think you can count upon him being useful, as I say in the memorandum, if he merely conforms with the qualifications at present laid down in section 17 (1) (d) of the Prevention of Fraud (Investments) Act, 1958. There are many companies with an issued capital of £1m. with £1m. paid up, who I should have thought would not have been necessarily wholly reliable in the sort of circumstances you are talking of.

3522. That is a matter of improving the status of the trustee?—I feel if you think it is necessary to have a trustee at a price—and it is simply a matter of price, because I am not otherwise against it—then I think you should improve the quality and make more certain of it. I have got nothing against existing trustees, but there could be all sorts of trustees in the situation as it now exists.

3523. Yes. Are there any advantages in your company form of investment operations of this kind offered by the company form as compared with the tripartite form, apart from saving the trustee's salary?—It is almost entirely a matter of economy. I did also mention that the people who would then take the place of managers and who would be the directors of the trust company, would I think appear more unambiguously in the light of quasi-fiduciary agents for the shareholders, and it would not be argued, as it is now in the case of a trust, that they could buy underlying securities on their own account and sell them to the trust.

3524. Could not these matters be specifically dealt with in any trust deed constituting the unit trust?—Yes.

3525. You think that dealings by managers as principals should at all costs be avoided?—I believe one can avoid managers acting as principals, if not in all cases, then in 99 per cent. of cases, without the unit holder suffering any damage as a result.

3526. We were told something rather different this morning.—Of course, there are two schools of thought.

3527. Yes — different views were expressed, and so far as underlying assets are concerned the Association have

apparently suggested to the Board of Trade that where a manager buys underlying securities and vests them in the trustee, then the value attributable to those investments at the date of vesting should either be the cost to the manager or the market value at the date of vesting whichever is the less?—Yes.

3528. And if they bound themselves to that, that would be a satisfactory solution so far as underlying investments are concerned?—Yes, that would be one solution but I believe they should not even do it at all.

3529. So far as dealing in their own units is concerned, they say that that is administratively essential to the working of their trusts and that they could not carry on unless they were allowed to keep any profit they made, on the other hand, being liable for any loss they made. —It is not essential from the point of view of the mechanics of the trust; it is, of course, a source of income to the managers, and a perfectly reputable source of income, although I think we all feel that it is invidious for us in our quasi-fiduciary position to be concerned as principals in the units at any time. This could be done just as well by the managers acting as agents for the trust; so that from the point of view of the mechanics of running a trust it is not important, but it is at present an important source of income for the managers—one has to face that. Unit trust managers do not get fat easily, and jobbing in units is very remunerative. I believe a way round that is to say that this is not a proper source of income for managers any more than it is for managers to make quite a sizeable remuneration out of buying underlying securities at one price, appropriating them to the trust, turning them into units and re-selling them in that form at a considerably higher price. That used to be done, but is done no longer. They used to say, "If we do not do this, then we cannot make enough money to live." I believe the answer to all these protests is to make enough money out of proper sources. If the managers were to run this revolving fund, buying back units and re-selling them for the account of the trust, they would forgo a source of income and I think they would then be entitled to higher charges.

3530. That was put to the gentlemen whom we saw this morning, and I think that the difficulty they were in as to that was to assess in advance the amount of profit likely to come from this source so as to be able to arrive at a fair equivalent.—I think that we could, with our long experience, arrive at something which could meet that, but it is bound to be a bit of a hit and miss story at first. However, that is not a difficulty that worries me at all.

3531. You think there would be no difficulty in adjusting the remuneration so as to reimburse them for that?—No, it would not work out precisely; but what you are trying to do is to replace—by a certain fee, if I may put it like that—a less certain jobbing profit.

3532. *Mrs. Naylor*: You say one might be able to estimate fairly well the profit or loss in the following year, but would not one have to commit oneself twenty years ahead in specifying the charges—such things as the loading charge and the annual service charge—for the whole period of the trust deed?—I think you have got to make a long shot in either case. If you are going to set up in this business you make an estimate of what you are going to make from the revolving funds—it may all be hideously wrong, of course—but I do not think your estimate of the annual charge need be more wrong, and I rather think it would be less wrong—each of them is liable to a good deal of error, and neither is a guarantee of £x per year.

3533. *Chairman*: As to the merits of the transaction, as I understood the witnesses this morning, if they are not allowed to buy in units as principals they face a difficulty when a unit holder comes to present his units and demands payment, and they say that it would be disastrous if whenever that happened they had actually to go to the underlying securities, realise some small parcels of each and hand the proceeds out to the unit holder. Therefore, they say they should be allowed, acting as principals, to buy the units proffered?—I think that that is really entirely answered by saying that the buying back can be done for the account of the trust just as it can be done for the account of the managers.

3534. *Mrs. Naylor*: Mutual Funds in America do have that provision, do they not, that jobbing in the existing units is for the account of the Fund?—I am very loath to say what goes on in America. I have made many inquiries and I have never been able to get clear exactly what goes on in America. I would say, with that reservation, that there is no revolving fund there, that they buy back and go through the accounting motions of liquidating those units and then issuing others. But I think the whole situation is changed by the fact that the preliminary charge in America is so large that it removes all use in trying to have a narrow margin between the bid and offered price; the preliminary charge is 8 or 9 per cent., and there you are: the whole point of a revolving fund is to try to narrow the margin.

3535. *Chairman*: I think we have dealt as far as we can this afternoon with the two points of dealing in underlying investments and dealing in units, but there is a third matter I think to which you have attached importance, and that is that in your view managers should not be allowed to pay any commissions in respect of the marketing of units.—I think I have said that expressly.

3536. I think a contrary view is held by the members of the Association?—Yes.

3537. In the ordinary way, where you have a trustee whose duty it is to manage a fund for others, he is entitled to employ proper agents to carry out operations such as the purchase and sale of investments for his trust?—Yes, indeed—a stock-broker.

3538. I would feel very much aggrieved if I as a trustee had bought an investment and paid some commission and were to be told I could not recover such commission. That would mean that I would have myself to go and buy an investment on the Stock Exchange.—I think you are now referring to commissions on purchases and sales of underlying securities, are you not? I was simply referring in my memorandum to commissions on the units.

3539. I am much obliged. You say: "Managers should be prohibited from

paying commissions to investment agents such as Stockbrokers, Solicitors and Accountants." You say that does not relate to underlying securities but to units?—Yes. I believe that the agents, stockbrokers and bank managers, should be unequivocally the agents of the investor or would-be unit holder, and that the unit holder should pay his agent just as trustees acting for a trust fund pay the stockbroker who buys securities for them. When a member of the public who is contemplating buying units goes to a stockbroker or to his bank manager, my view of the thing is that the latter should unequivocally act as his agent, not as agent of the managers; such a person in other words should not be acting for managers trying to sell something to a member of the public.

3540. I am not quite sure that I entirely follow that.—Well, if somebody is contemplating investing money and he goes to his bank manager or his stockbroker and the latter says, "Well, you have only got a little money to invest; I think you ought to have a good spread and so I advise you to go in for a unit trust", I think the right situation is that the charge for giving that advice should be made unequivocally by the investment adviser to the member of the public. The procedure which I am criticising is the procedure whereby a member of the public in fact, but without knowing it, pays for that advice as a result of something being put into the price of the unit, which, after it reaches the managers, or *en route* to the managers, is handed over to the agent who advised the purchase of the units.

3541. It would be all right for a member of the public to pay the agent if he knew he was paying the agent?—Yes, but under the existing system he pays him without knowing and sometimes—indeed, very often—pays the commission without having used an agent.

3542. Those are two different criticisms, of course?—Yes.

3543. It is really a question of disclosure, is it not?—Disclosure would help, but I doubt if it would really cure the evil which was referred to by a previous Board of Trade Departmental Committee, which in 1936 had been told of this abuse and of excessive payments to agents.

3544. Is that the Anderson Report?—Yes. They said: "It is undesirable for remuneration to be at a level which may induce the recommendation of this class of security for any reasons apart from intrinsic merit"; and when I look at the evidence of the Association of Unit Trust Managers I see that they are asking to have larger remuneration which, as I said just now, has a good case for it. But I am a little apprehensive when I see one of the reasons is to pay agents and when they go on to say specifically, in paragraph 40, that they should not be restricted in any way as to how much they pay agents—that this is an ordinary commercial arrangement and that they should be free to enter into competition to influence other people's agents. It is that sort of thing that I feel apprehensive about.

3545. *Mr. Scott*: Is Mr. Fairbairn's criticism that it would involve the unit holder in unnecessary expense, or that it is morally wrong, so to speak, for him to go to his solicitor or bank manager and get advice from them, when that advice might be coloured by the fact that they are paid by the managers for every unit they sell?—I think where he does not want to use an agent or thinks he does not need an agent he ought to judge for himself and not to pay for advice he has not received. That is the first part of Mr. Scott's question. On the second part, I am perfectly certain that some agents are influenced by the fact that they get a commission which their client does not know about, and, consequently, that it can be, if they are not careful, a very large commission. I have direct evidence of that and I could give it to the Committee in confidence if you wanted it.

3546. *Chairman*: Then this is a matter which, along with various other matters, will have to be taken into consideration when this Committee comes to consider what, if any, legislation is required in the case of unit trusts—that is one of the points which will have to be looked at.—I would think so, yes. May I just say one thing on this? I have never heard any good reason why managers want to have a commission in the price, I believe the reason is as I have stated, a reason which they would not readily admit, but I have never heard a good reason.

3547. Yes. That point will have to be looked into. Now, taking a rather different aspect of the matter, Mr. Fairbairn, what is your own feeling about existing legislation on the subject of unit trusts?—Well, I think it has done quite a lot of good, and I daresay there could usefully be more done. It has certainly done away with abuses in offered prices. It has recently done some good with the bid price. They are two very important things. It has also done away with abuses in calculating yield. In the early days of calculating yield some managers did not hesitate to include the proceeds of sales of rights and, indeed, even the proceeds of sales of what were then called bonus shares, and lump them together with income and calculate the yield upon that basis. That has been stopped by regulations issued by the Board of Trade.

3548. The Association criticise the existing law very broadly on the lines that it has led the Board of Trade to attempt to control and indeed, *de facto*, to control, unit trusts in matters of day-to-day management on which they do not regard Board of Trade intervention as appropriate; and their view is that legislation should be confined to laying down certain general principles to which every trust must conform, and that these general principles should be embodied in a model deed which would be standard for all trusts, apart from such variations as might be necessary or appropriate to fit a particular trust.—I cannot remember any trust in which we have felt that our day-to-day operations were hindered by the Board of Trade. I daresay something could be said for a standard trust deed—I speak with a great deal of ignorance here—something rather corresponding to the Table A in the Companies Act. But this would be used only when you were producing a new trust. You would go to the Board of Trade and say, "We have conformed with or we have incorporated the whole of the standard trust deed", and then it would be quickly passed. Or you would say, "We have not conformed with item 70 but we have done this instead". I can see that for that sort of reason a standard trust deed would expedite the authorisation of trusts.

3549. Yes—and it is hoped by the Association it might encourage the Board

of Trade to leave what they call matters of day-to-day management to the managers and trustees.—I am at a loss to know what is their object there. I do not think we have ever felt that about our day-to-day operations. I think there have been justifiable complaints about the time it has taken to get supplemental deeds authorised by the Board of Trade, and this suggestion might help that, but I am puzzled to know what they mean by interference with day-to-day operations.

3550. For instance, one of the requirements made by the Board of Trade is that a dividend should be paid at least twice a year—that kind of thing.—I would not have called that a day-to-day operation. Yet I do not see why they should not be paid twice a year, though in special trusts there is good reason why they should not be.

3551. You have not felt yourself restricted?—No, and I would not have classified the payment of a dividend twice a year as a day-to-day operation.

3552. It is part of the business aspect of managing a trust?—Yes.

3553. And then there are the various provisions as to fixing prices. One view is that, subject to protective general principles being observed, matters like that are best dealt with by the people who are running the trust and who presumably know their business.—Certain regulations are laid down as to how prices must be calculated and they are very important, because managers should not be left free to produce what price they like.

3554. You say that you personally have not experienced any difficulties there through the Board of Trade interfering too much in matters of detail?—None at all.

3555. And I think you also say that when it comes to questions of principle it is rather difficult to say what is a question of principle and what is a question of day-to-day management?—I have never really thought about it as being a question of day-to-day management in that sense; but whether you pay two dividends a year or not I would not have thought was day-to-day management because that would be incorporated in the trust deed.

3556. Then various suggestions were discussed with the Association, and some of these I am afraid you would not like very much: one proposal is that the Board of Trade should approve rules for the Association, including I think a model form of trust deed, and, having approved those rules, should authorise the Association or its members to carry on unit trust business. That, of course, would not cover people who were not members of the Association, but assuming for a moment the Association contained every single operator of this kind, it would be a very convenient way of dealing with the matter.—I am not sure I am with you—that the Board of Trade should approve rules? What happens after that?

3557. Then members of the Association come in under a sort of umbrella of authorisation to carry on business.—And nobody else could?

3558. No; it would not be sought to prohibit anyone else from doing it or carrying on this kind of business. But they, of course, individually, would have to satisfy the Board of Trade that they were observing, and would continue to observe, the rules for the time being in force.—I cannot conceive such a situation and I think it is highly unlikely. I hoped you were going on to say that nobody outside should carry on business, because then I should have a long holiday, but that is not to be my hope it seems! Taking the point rather that people outside would have to conform, I do not think that would inconvenience us; I think the only inconvenience would be caused if it were the other way round. If I may invert the situation: if the Board of Trade approved our code of conduct and said we could carry on and nobody else could carry on unless they conformed, then I think that would cause disquiet.

3559. It is not sought to exclude anybody. This would, it was suggested as far as members of the Association were concerned, be a convenient method of negotiating with a view to procuring the enactment so far as necessary of the appropriate rules, and that it would be easier to bargain with a body representing, say, fifty separate concerns than to bargain with fifty separate concerns.—It is not as many as fifty—it is about a dozen.

3560. You would not want to have anything to do with such an arrangement, and your views are not in line with their views?—I am not at all sure that by the time the Board of Trade have finished with them our views would not be brought very close together.

3561. Then that indicates that in any negotiations with the Board of Trade your trusts should be included in order that you could give your views?—We have always said that we are very happy to co-operate with the Association and, indeed, we have co-operated in a very friendly way in so far as their activities are designed to look after unit holders—which, of course, is the sole object of the Board of Trade. We are only too happy to do that and we are all the time collaborating on that. We do not always see anything like eye to eye, but we are always discussing that aspect with them.

3562. So on the whole your view is that there is really no need for any further legislation at the moment?—There are one or two things we would like to see tightened up, not necessarily by legislation. I do not know what powers the Board of Trade have under the existing legislation. I think they might require further legislation, but not much.

3563. I think your views about those matters are sufficiently set out in the memorandum you have given us?—Yes.

3564. There would have to be legislation I should think to cover the conception of a share which not only has no par value but the price of which varies with the value of the fund or the assets, and of a company which is allowed to reduce its capital by purchasing its shares?—Yes; that is in the interests of economy.

3565. You would not seek to impose this organisation on other unit trusts, who prefer the other method?—No, but what I have said is that consideration should be given to it.

3566. Yes. You would put it in quite a neutral form?—Simply that it should be considered. It seems to me worth considering.

3567. Then you would say, I gather, that as regards the other matters we have been discussing those should be taken into account in any new legislation?—Yes.

Chairman: Those are all the questions I have to ask you, Mr. Fairbairn, but of course some of my colleagues may want to put some questions.

3568. *Mr. Scott:* One question. You comment on the establishment of management funds and say they should be abolished.—Yes.

3569. Is that to avoid the initial cost that is involved in establishing management funds?—Yes. I do state the reason for that, that it adds to the preliminary charge, and the preliminary charge—as I see it—is a charge which should be kept down as much as possible. How you fix your charges depends on how you look on this business. We are not manufacturers selling a manufactured unit. What we are offering the public is our services over a more or less long period, and therefore it should be a "pay-as-you-go" payment year by year. But I think you must have a preliminary charge, though of course it is arguable, and I think you want to keep it down for the reasons which I have stated here because it does falsify a yield. I am no actuary and I am sure your Committee could work out quite quickly the difference between a 10 per cent. preliminary charge on the price which would lead, if you are thinking of a 5 per cent. investment underlying it, to a 4½ per cent. yield, and a one per cent. per annum charge for ten years, which would yield four per cent. If you amortise the preliminary charge, then the whole thing works out the same as I understand it, so that you do want to keep the preliminary charge down for that reason. Furthermore, anybody getting in late in the life of the trust—for instance, if it happens to be going to close down—is much more hit by paying a large preliminary charge. As to not having a management fund, my recent discussions with trustees about it have shown, I think, that it is quite unnecessary.

3570. It is, of course, intended to be for the benefit of the unit holder?—Yes, to ensure continued management, not in any

other way. It comes out of the unit holder's pocket and never goes back into it, but it may ensure him getting a service which he would not otherwise get.

3571. Do you think that it should be abolished completely?—Yes.

3572. Principally to cut down cost?—To cut down the preliminary charge.

3573. *Mr. Brown:* I am not quite sure of your conception of the company form; you would abolish trustees and make directors do the duties of trustees, but would there be a management company or could management then be carried out by the directors and employees of the company?—You would have an investment company as you have it today but with power to buy back and re-sell its shares.

3574. The management would be in the hands of the directors and staff of the company?—Yes.

3575. And paid for as such?—It could happen as it is done in America: the directors of the investment company can sub-contract with another company to render the management service for a specified fee, or a fee specified as ours is now—say ½ per cent. per annum—so that it could come to precisely the same thing as you have in the present situation.

3576. You would then have the management selecting and buying investments and also advertising units?—It would be doing everything which the management does today.

3577. In other words, you just cut out the trustee?—Yes.

3578. What, in your view, would be the powers of the shareholders: would they be the same powers as shareholders in any existing company, including the power to remove the directors?—Yes, I think so.

3579. Completely free?—I would have thought so.

3580. In the present system you have the Board of Trade determining the charges?—Yes.

3581. You are not happy with the actual form or the amount of the present

charges, but you would still, in your proposed company form, have maximum charges laid down by the Board of Trade?

—Yes. I think that if one wants to go on retaining control of charges—and I think the opposite is arguable as the Association also seems to think, although I am not quite as strong as they are about it—I would think that it would be desirable that the control should also be applied to these companies.

3582. There would have to be this control and there would have to be a fee paid to the managers, plus the expenses of the company?—I think that the company would sub-contract with another company to perform the services and that other company would make a profit or loss out of the $\frac{1}{2}$ per cent. per annum.

3583. There would naturally be the expenses of the company holding meetings and so on.—I should have thought the sub-contracting company could do that.

3584. On the present position on control of advertisements, would you visualise that would go on in the same way?—Is there much control of advertisements?

3585. Well, I am very ignorant on this subject, but from the discussions I have gathered that there was.—Some advertisements I see do not satisfy me.

3586. I thought at the moment at any rate trustees had to approve all advertisements?—That is so; they have to be submitted to them.

3587. The Board of Trade do not?—I believe I am right in saying that every trust deed has to provide that every advertisement is submitted to the trustees for their consideration; the trustees do not have to approve them, but they can have a word about them.

3588. That would disappear. Would you think it should be replaced by any sort of control of advertising?—I think that it is extraordinarily difficult to lay down regulations on the whole question of advertising, but I would like to see certain disclosures required which are not now required.

3589. There must be some sort of sanction if there are such requirements?

—I do not think I would require a third party to pass upon it. I think one could devise a control just as one has in law now providing for the issue of shares, whether by offers for sale or in a prospectus.

3590. And penalties if the advertisements were not in accordance with the rules?—Yes; I believe that you would get much better advertisements than you are now getting, under the control of the trustee, if you had certain requirements which I think should be statutory.

3591. Better for whom?—For the investing public.

3592. *Mrs. Naylor*: Supposing that there were a higher charge allowed to management companies, do you think they might develop door-to-door selling of unit trust units, and would you approve of it if it so developed?—I believe door-to-door selling is legal.

3593. Yes, but it is too expensive?—Yes, but as long as you go from No. 1 to No. 3 and not to No. 2, as I understand it, it is all right.

3594. I did not know there was that refinement!—I do not know what other managers would do; I should have thought not.

3595. You would think that it should not be allowed?—No, but it depends who does it.

3596. You think it should be allowed but under certain controls and regulations?—I know people who know much more about this than I do who think this door-to-door habit is very dangerous, but I do not know.

3597. Is it safer where there is a trustee?—I should not think a trustee would have any control over that.

3598. Although the trustee today is supposed to vet advertisements?—He cannot vet what goes on on a doorstep.

3599. No, but these things get back. If there is an undesirable type of selling by a representative, one is told these things get back to the trustee.—Yes.

3600. *Mr. Brown*: In the insurance world it may be ten or fifteen years before

it gets back!—I am sorry, I do not think I have a very useful opinion about that.

3601. *Mrs. Naylor*: On this question of trustees I have been getting the impression that you think that during the last sixteen years, since the Prevention of Fraud Act has been in force, some actions of unit trust management companies could be criticised. Do you think trustees have been any protection to the unit holder against the extension of any practices of which you disapprove? Have they been any use?—Yes, I think they have. I think they have been some use in advertisements, for example; and I say that because I have occasionally mentioned my opinion about certain advertisements to trustees and I have noticed an improvement.

3602. *Mr. Smith*: I am still trying to get this difference between the company form and the present tripartite form and on what basis you make this claim of the greater economy of the company form. I gather that a trustee costs about 9s. a year for each unit holder and there is another 8s. for management expenses, and that is a fair bit off the unit holder's possibilities before he gets anything. But why is the company form going to be much cheaper if the company is to fulfil two capacities, that of trustee and that of management?—I am very glad Mr. Smith has raised that point. First of all, I did not make myself quite clear. The 9s. and the 8s. are not to be aggregated; the 9s. is what the trustee costs, the 8s. is the total remuneration coming to the managers out of which to pay the trustee and themselves. I did not make that clear in the case I cited. In our case the average unit holding is much larger and therefore the 8s. is £2 or £3. But Mr. Smith's point is, how do you effect an economy simply by getting rid of somebody if somebody else has to discharge the same function? I think the answer is that there is a great deal of duplication. There are two sets of registers kept where really the managers do all the work on the register, and the trustee keeps a copy of it, so that there would be a considerable economy in work done.

3603. Yes. Forgive me, I am on the outside of this and I am puzzled as to

how the board of directors would be so much cheaper than a trustee.—Well, the board of directors are there already; my colleagues and I are there as the board of directors of my company, which is a part of the tripartite organisation. There is my company, with its board of directors, and then there is Barclays Bank or Lloyds Bank—the trustees—with their organisation; and what I am suggesting is that the whole of the work could be done by my company without a custodian trustee.

3604. *Mr. Brown*: And your board of directors would act as directors of the investment company with no extra charge?—Yes; we would contract to do it, for example, for exactly what we contract to do it for now.

3605. *Mr. Althaus*: Is your point that if the unit holders are not going to trust their directors they should not invest in those units at all, and that a great deal of the work which is charged for by trustees is, in fact, done in the offices of the parties who are managing the fund?—Exactly.

3606. *Mr. Watson*: Did I understand you correctly, Mr. Fairbairn, that your company keeps a duplicate register?—Yes.

3607. Is that a general practice?—I believe so.

3608. Because I had understood that the duties of the trustee were usually combined with those of registrar, and that it was their duty to maintain the register and pay dividends half-yearly to the shareholders?—Yes.

3609. And that, in addition, where holders had decided that they did not want dividends but that they wanted new units instead of dividends, they so arranged it, but I seem to have been mistaken?—It may differ from one organisation to another, and I cannot speak with any certainty about that, but I think I am right in saying it is general practice. I think there cannot be any doubt, whatever the position now, that if you have one large reputable organisation it could under its own roof more economically discharge all the duties.

3610. You quote a trustee in one particular case as getting 9s. per annum per unit holder's account: was that a trustee maintaining the register alone or was there a duplicate register?—There was a duplicate. I think I ought to say in that context, as Mr. Watson probably knows, that some trustees are remunerated by the commission on the purchase and sale of their securities; but that does not vary what I have said.

3611. You have made the suggestion that, presupposing that the rate of remuneration is raised to the managers, than all profits from dealing in units should be for the benefit of the trust or company?—My point there is that if the managers are not to act as principals, then it is desirable for somebody else to run the revolving trust—whether you are a company or a trust, in either case that is desirable.

3612. You think that equally satisfactory results would be forthcoming if the revolving fund were operated for the benefit of the trust to those which you describe in paragraph (3) of your summary, where you indicate that over twenty-nine years' experience profits have emerged every year, in good times and bad, from this operation?—We have never made a loss; always a profit.

3613. But in doing this kind of work you have had to exercise a good deal of judgment as to whether it was wise to retain a number of units in your hands, or whether to have them cancelled?—Yes.

3614. Would you consider that that judgment would continue to be exercised as effectively if the manager might have the feeling that he was not operating the revolving fund for his own profit?—It is not a question of great judgment. In some groups they may run a book for a £½m.; but we never do that at all. We might have a book of £20,000. I would have thought that would be the way to do it. If you run these large books there may be difficulties; for instance, I know of one management company that has lost £30,000 in one year in running a book of hundreds of thousands of pounds.

3615. So that you think that the same experience could be expected under your

proposed régime?—Yes. You might lay down a maximum amount of units to be held at any one time.

3616. One question in regard to your objection to commission. You will be aware that in Scottish banks at least one, and I think possibly two, unit trusts can be purchased over the counter and that the banks are remunerated in some small measure for that service. Does your objection to commission extend to that?—I am not, of course, familiar with that operation; we do not do that ourselves, but I would think that is not a commission. My objection to commission is very largely that it is a commission which ought to be as between the investor and the bank manager or stockbroker. What Mr. Watson is describing I think is rather different—a bank rendering a service to a management. I think it should be remunerated per transaction, say, at the rate of 1s. 6d., and that would come out of the preliminary charge. It seems to me quite different for a man to go into his bank and conduct such a transaction over the counter—as I understand it—from an investor going into the parlour and talking to his bank manager, getting advice from his bank manager, who then rings up London and places an order. The latter, I believe, is a transaction which ought to be paid for by the investor. The former is something which the bank or the bank's staff at the counter are doing as a clerical job for the management of the unit trust.

3617. The purchaser comes in of his own free will and says, "I want to buy" because he knows he can buy at that point and he is not influenced, but your point is that no one should be paid a commission for influencing him to buy?—I should have thought certainly not.

3618. One further question. Are you in favour of block issues by unit trusts?—What do we mean by block issues? I am sure the answer is No, but it is rather a loose term.

3619. *Chairman:* I think we were told that a block offer was a block of units which were offered at a specified fixed price; it was a definite number of units and the offer was open for a limited time.—A definite number of units at a fixed price?

3620. The suggestion against it was made that that might indicate to the purchaser that this was an exceptional bargain.—Yes, that of course is a criticism. The Association's evidence says that the main criticism against this is that it creates a false impression and, as the Committee will no doubt notice, the Association does not in any way refute that; it simply says that if they could find a way out they would be very glad to do so. They suggest that they should be allowed to make higher charges and then they would not have to resort to this way of selling. The objection to the block offer is that it does create a sense of opportunity which in fact is not there. It is of the essence of unit trusts that units are on offer all the time in any amount you like but at a price which fluctuates or is liable to fluctuate and you pervert the whole business—in other words, you are going against the whole nature of the thing—if you say that only a certain number are offered at a fixed price.

3621. *Mr. Watson:* You are not in favour of that?—No.

3622. It has been put to us that they were the chief means of getting support for the movement?—I think nearly all deceit is designed to get support. Of course, it is quite untrue, though I am sure they do not mean it to be untrue, that it would not be fair not to let newcomers do this in competition with old established firms; the latter did not build their businesses up in that way. There is no unfairness about forbidding this admitted deceit.

3623. Not quite deceit?—False impression. If you are creating a false impression is not that deceit?

3624. You mean, by offering a certain number of units over a short period of time, that is unsatisfactory?—You deceive people into thinking there is an advantage and that they had better come in quickly. I think it is proved up to the hilt that they do exactly that: where the advertisement simply says that units are on offer at the price of the day it does not have the lure that the block offer has.

3625. *Mr. Scott:* What is the deceit or false impression that is said to be created by a block offer in that form?—It creates an impression in the public's mind that the price specified is advantageous.

3626. But the only statement is that they can be purchased at that price for a limited period, ten days or whatever it is, and whatever market changes there may be during that ten days the price will not alter?—I think the usual form is at that price or the price of the day, whichever is the lower.

3627. There is a maximum beyond which they would not have to pay, so that there is that advantage, and they feel it is not worth while trying to sell unit trusts at all unless they can get a large number of investors, and the advertising cost of doing that would only be manageable if there were some sort of block offer. I feel that where you use the phrase "admitted deceit" the Association has not admitted that they are creating a false impression.—They have said the criticism is there, but they have not done anything to refute it in their evidence.

3628. It is just a vague impression which should not be given to the public that they are getting a bargain?—I do not think it is vague; I think it is a telling impression that they are getting a bargain.*

3629. *Chairman:* It is a sort of catch-penny transaction?—I think it is a cheap-jack transaction.

3630. But it would be difficult to pin a definite charge of fraud on a unit trust on the strength of that?—I would be happy to say it creates a false impression, whether that is fraudulent or not.

3631. *Mrs. Naylor:* Am I right in thinking that yields published by unit trusts since the Finance Act are really too low because the Board of Trade formula for calculating them has not been adjusted in the light of the present tax position?—Yes.

3632. Is it a very difficult formula to adjust?—Yes, very difficult; it introduces things like double taxation relief and profits tax. Previously they were not subject to profits tax. I think some

* See page 739 for a supplementary memorandum on this subject by Mr. Fairbairn.

people have been very much concerned about it.

3633. Where does responsibility reside for delay in determining this formula? — A draft was produced by the Board of Trade only just before Christmas for managers' comments and the final form of the regulation has not yet been circulated. The Board of Trade must,

therefore, accept much of the responsibility for the delay.

Chairman: Those are all the questions we have to bother you with, Mr. Fairbairn. We are much obliged to you for your help.—Not at all; I hope some of it will help.

Chairman: Thank you very much.

(The witness withdrew.)

APPENDIX XXVIII

Memorandum by the Association of Unit Trust Managers

1. Introduction

The Association of Unit Trust Managers (hereafter called "the Association"), formed on the 13th October, 1959, comprises the Managers of all authorised Unit Trust schemes (hereafter called "Unit Trusts"), as defined in section 26 of the Prevention of Fraud (Investments) Act, 1958 (hereafter called "the Act"), operating in the United Kingdom, with the exception of the Managers associated with Municipal and General Securities Company Limited.

2. A list of Members of the Association is attached at Annex B.

3. A copy of the Constitution of the Association is attached at Annex D.*

4. The value of the invested funds of Unit Trusts operating in this country at the end of March, 1960, amounted to approximately £206 million. Of this sum 90 per cent. was managed by Members of this Association.

2. Extent of Evidence

5. The Association is of the opinion that its views have special claims to attention in relation to Unit Trusts, and has refrained from commenting on the other topics which your Committee has been asked to review. The uniqueness of the subject matter is referred to again at the end of this Evidence.

3. Definition of a Unit Trust

6. A Unit Trust is a method of investment by which persons pool their subscriptions under a Trust Deed. The subscriptions are invested for them by a Management Company, and the investments so acquired are held by a Trustee. Both the Trustee and the Management Company are parties to the Trust Deed which sets out their respective responsibilities.

7. Unit Trusts vary as to detail but the general principles behind the management of all of them are as follows:—

Monies subscribed by the public are invested in securities. Through his subscription each subscriber acquires a fractional interest in this block of securities and the dividends received from the investments form the income of the Trust. The net income is paid to all investors in the Trust Fund in proportion to the size of their holdings.

The primary functions of the Trustee are those of a custodian of capital and income, and of a registrar. The Trustee holds the securities in which monies subscribed by the public to the Trust Fund have been invested by the Manager. Some Trustees also have the right to veto proposed changes in the securities comprising the Trust Fund.

The Manager is responsible financially and otherwise for the administration of the Unit Trust, for the maintenance of a duplicate register of unit holders, for calculating the unit offered and bid prices, for preparing income distributions, for maintaining a market in the units of the Trust and for managing the investment portfolio of the Trust Funds.

* Annex D has been omitted.

4. Brief history of the growth of Unit Trusts in the United Kingdom

8. The modern history of Unit Trusts in the United Kingdom began in 1931. In that year the first British Fixed Trust was formed. It was not until 14 months later that a second Unit Trust was started, but from then until the outbreak of the War the movement grew rapidly. By March, 1939, 96 Unit Trusts had been formed. The total of their net assets was estimated to have been over £80 million.

9. During this period, Unit Trusts operated without any specific Unit Trust legislation. In 1935 the Stock Exchange published a report on Unit Trusts, and in 1936 the Board of Trade issued a report of a Departmental Committee set up to review Unit Trusts. Both reports agreed that Unit Trusts met an investment need and stated that some form of legislation was required to protect the public. They also suggested that common standards of operation should be formulated and that all Managers of Unit Trusts should conform to these standards.

10. Although Managers made efforts to bring their Trust Deeds into line with the recommendations of these two Committees, no action was taken by the Government for some time. Even in 1939 when the Government of the day introduced a Bill to control "share pushing", it was stated that it was not intended to introduce legislation covering Unit Trusts. However, late in the Committee stage of the passage of the Bill (eventually enacted as the Prevention of Fraud (Investments) Act, 1939) provisions were inserted for the regulation of Unit Trusts. This Act has since been re-enacted and consolidated in the Act.

11. For some years after the War the movement made little headway due mainly to restrictions on new capital issues, but since 1957, the amount of money invested in Unit Trusts has increased almost continuously. At the end of 1959 the value of the funds invested amounted to £200 million, of which, it is estimated, approximately £50 million was new money subscribed in that year. In the first three months of this year, despite falling equity prices, the value of funds invested by unit holders increased by £6 million while the number of unit holdings grew from 519,000 to 617,000.

5. The present position

12. The operation of Unit Trusts in the United Kingdom is, at present, controlled by the ordinary law of Trusts and by the Act. Under the Act the Board of Trade (hereafter called "the Board") have certain powers which are exercised chiefly at one remove through control of the Trust Deeds under which Unit Trusts operate.

13. Section 17 of the Act lists four conditions which must be fulfilled before the Board may declare a Unit Trust scheme to be an authorised Unit Trust scheme. The units of authorised Unit Trust schemes alone can be offered to the public. The Board must be satisfied

- "(a) that each of the persons who are respectively the manager and the trustee under the scheme is a corporation incorporated under the law of some part of the United Kingdom, and having a place of business in Great Britain at which notices and other documents are received on behalf of the corporation, and
- (b) that the scheme is such that the effective control over the affairs of the corporation which is the manager under the scheme is and will be exercised independently of the corporation which is the trustee under the scheme, and
- (c) that the scheme is such as to secure that any trust created in pursuance of the scheme is expressed in a deed providing, to the satisfaction of the Board, for the matters specified in the First Schedule to this Act, and
- (d) as respects the corporation being the trustee, either—
 - (i) that the corporation has a capital (in stock or shares) for the time being issued of not less than five hundred thousand pounds, of which an amount

of not less than two hundred and fifty thousand pounds has been paid up, and that the assets of the corporation are sufficient to meet its liabilities (including liabilities in respect of the repayment of its capital), or

- (ii) that more than four-fifths of the said capital of the corporation is held by another corporation being a corporation in relation to which the conditions as to capital and assets specified in sub-paragraph (i) of this paragraph are fulfilled.

Provided that, if with respect to any Trust the Board of Trade are satisfied that, by reason of the special circumstances of the Trust, the fulfilment in relation thereto of the conditions specified in paragraph (c) of this subsection is impracticable, the Board may dispense with the fulfilment of that condition in relation to that trust, so far as it appears to them that they can properly do so without prejudicing the interests of the beneficiaries".

14. By far the most important of these four conditions is that the scheme must be "*such as to secure that any Trust created in pursuance of the scheme is expressed in a deed providing, to the satisfaction of the Board, for the matters specified*" in the First Schedule to the Act (hereafter called the Scheduled Matters).

15. The First Schedule reads as follows:—

"Matters for which Trust Deeds pursuant to Unit Trust Schemes must provide

1. For determining the manner in which the manager's prices for units on a sale and a purchase respectively, and the yield from the units, are to be respectively calculated, and for entitling the holder of any units to require the manager to purchase them at a price calculated accordingly.

2. For regulating the mode of execution and the issue of unit certificates, and, in particular, for securing that no unit certificate shall be executed or issued in respect of rights or interests in any property until steps have been taken, to the satisfaction of the trustee, to secure that the property will be vested in him or, subject to any prescribed conditions, in a nominee for him approved by the Board of Trade.

3. For prohibiting or restricting the issue by or on behalf of the manager of advertisements, circulars, or other documents containing any statement with respect to the sale price of units, or the payments or other benefits received or likely to be received by holders of units, or containing any invitation to buy units, unless the document in question also contains a statement of the yield from the units.

4. For securing that any advertisement, circular or other document containing any statement with respect to the sale price of units or the yield therefrom, or containing any invitation to buy units, shall not be issued by or on behalf of the manager until the trustee has had a reasonable opportunity of considering the terms of the document, and shall not be so issued if, within a reasonable time after the document first comes under his consideration, he notifies his disapproval of the terms thereof in writing to the manager.

5. For the establishment of a fund to be applied in defraying the expenses of the administration of the trust and for regulating the application of that fund.

6. For the audit, and circulation to holders of units, of accounts relating to the trust (including accounts of the manager in relation to the trust and statements of his remuneration in connection therewith).

7. For requiring the manager (subject to any provisions as to appeal contained in the deed) to retire from the trust if the trustee certifies that it is in the interest of the beneficiaries under the trust that he should do so.

In this Schedule the expression 'units' means securities (described whether as units or otherwise) which may be created in pursuance of the unit trust scheme, and the expression 'unit certificates' means certificates of the acquisition of such securities."

16. Although the matters on which the Board have to be satisfied are specifically set out in "requirements" issued to Managers, the Board have nevertheless taken the view that they can regulate any matter relating to Unit Trusts, their power of sanction being that they can refuse a certificate of authorisation if their views are not met. This construction which the Board have put on their powers has often placed Managers in the difficult position of attempting to draft Trust Deeds without knowing either what rule might next be insisted upon, or what additional detail the Board are intending to make the subject of a non-statutory regulation.

17. The four conditions set out in paragraph 13, a Trust Deed containing the Scheduled Matters, the requirements of the Board, and the various interpretations which have been placed by the Board on the words in the Act and in the Scheduled Matters, form the framework in which Managers have to operate the Unit Trusts for which they are responsible.

6. Comments on the present situation

18. The Association considers that the growth of Unit Trust funds will continue at a high rate. Taking into account the difference in size of population and gross national product it is possible that the scale of increase of Unit Trust funds in this country within the next two decades will compare with that of their counterpart (Mutual Funds) in the United States over the last 20 years. There, in 1940, 68 Mutual Funds were in existence with net assets totalling the equivalent of approximately £90 million—a sum similar in size to that invested in Unit Trusts in the United Kingdom at the same date. In 1959 there were 155 Mutual Funds in existence with assets worth approximately the equivalent of £5,600 million. Most of this development has, moreover, taken place in the last ten years. The growth of Unit Trust funds in Australia, Switzerland and Western Germany has also been substantial during the last two or three years.

19. As the Association is of the opinion that the Unit Trust movement in the United Kingdom is already developing at a pace which makes the present law relating to it inadequate, it follows that legal changes must be made if the Board are to exercise reasonable control and if Managers are to deal efficiently and expeditiously with the expected rate of expansion.

20. The Association appreciates the way in which officials of the Board attempt to make the system work under the present law which was enacted somewhat haphazardly. Nevertheless it is felt by Members of the Association that in the negotiations they have had with the Board over the statutory regulations and details of Trust Deeds, some of the finer points of the operation of Unit Trusts did not appear to have been understood by the officers of the Board. The result has been that the movement has to work within regulations which are unsatisfactory and which are liable from time to time to be interpreted inconsistently. The Association is of the opinion that it is justified in suggesting that a common set of rules does not exist.

21. The Association hopes that your Committee will give special attention to this general criticism of the provisions of the Act relating to Unit Trusts and its operation by the Board, and that you will recommend changes in the present law which will remedy the existing unsatisfactory state of affairs. Members of the Association have been very much concerned about these matters for a long time. The following paragraphs set out their general recommendations for improving the situation.

7. General recommendations

22. The Association has considered in particular whether the present constitution of a Unit Trust with its Trust Deed, Trustee and Manager was not unnecessarily cumbersome for what is, in essence, the administration of a simple financial operation, namely the pooling of a large number of individual savings to be invested by skilled managements, and whether one of the American methods of achieving the same ends (namely Investment Companies entitled to buy or sell their own shares), might not be more efficient and economical.

23. Mutual Fund Companies in the United States were started in their present form at the beginning of the 1930's. Their activities were regulated originally by the Securities Act of 1933 and Securities Exchange Act of 1934. The Public Utility Holding Company Act of 1936 contained a provision directing the Securities Exchange Commission (S.E.C.) to make a study of Investment Companies and to report its findings to Congress.

24. Subsequent to this enquiry Congress passed the Investment Company Act of 1940 (copy of which is attached at Annex E*). The terms and conditions of this Act, which passed both Houses of Congress without a single negative vote, are held to embody the consensus of opinion of all the principal Mutual Fund Companies, many of which participated in the drafting of the measure and actively encouraged its enactment.

25. The Investment Company Act of 1940 sets forth specific standards for the general formation of investment companies, their capital structure, method of operation, management, underwriting contracts and affiliations. It also regulates the sale of investment company shares and limits the amount of portfolio investment a company may have in a single security or corporation, or in certain types of securities. This Act does not, however, deal with supervision of management, investment practices and policies, or dividend payments. These functions are properly left to the management of the company. Many of the provisions of the Act are based on the doctrine of full disclosure and are of an informational nature aimed at protecting shareholders. The more important of these insist on: the filing of a detailed registration statement with the Securities Exchange Commission, including a declaration of basic investment policies which cannot be changed without the stockholders' approval; complete financial statements, reports of portfolio holdings and annual reports filed with the S.E.C. and made available to the public; reports to shareholders on at least a semi-annual basis; a requirement that a new investment company should have a minimum capital of \$100,000 before stock can be offered to the public; the effective separation of the directors of the investment company, the sales organisation and the investment advisors.

26. The Association has discussed whether the Unit Trust movement in the United Kingdom could be more conveniently organised by entitling investment companies conforming to certain criteria to redeem their capital and advertise their shares under modified prospectus provisions by means of an Act similar to the United States Investment Company Act, 1940. Although this Act has many notable features, one of which is the insistence on the separation of those responsible for the management of funds and those responsible for the selling and distribution of shares, the Association has finally decided not to recommend any radical alterations in the present concept of Unit Trusts in the United Kingdom. In coming to this decision the Association has been influenced by an overriding advantage which Unit Trusts here have over Mutual Funds (or over any other system it has studied), namely the protection given to unit holders in the United Kingdom by the Trustee.

27. However, even though the Association considers that the present concept should be retained it is of the opinion that the legal structure should be radically revised so

* Annex E has been omitted.

as to give stability in law to the movement, to take account of its present size and growth, and to make it efficient and capable of rendering a telling contribution to the growth of the nation's savings in the future.

28. The Association recommends that the best way of achieving these objects is to codify in a separate enactment, to be called the Unit Trusts Act the legislation relating to Unit Trusts. In making this recommendation it is not part of the case of the Association that the statutory control which now exists should be diminished in any way. Indeed Members of the Association would welcome the introduction of a comprehensive law which would set out specifically the matters included in the present Scheduled Matters and the Board's regulations, which would take into account the Association's own recommendations on how the movement should be controlled, and which would embody any other matters which your Committee considers should be incorporated. The Association would ask, however, only that the provisions of the proposed Act should not attempt to establish minute control over the day-to-day operations of Managers.

29. Such an Act would have the major consequence of giving Unit Trusts a definitive legal status similar to that which companies derive from the Companies Act, 1948.

30. Even if the present system by which Unit Trusts are regulated were less unsatisfactory than it is, the Association would still maintain that the movement deserves to be administered by a separate Act recognising the special problems of Unit Trusts. In paragraph 10 the point was made that in 1939 the control of Unit Trusts was included almost as an afterthought in an Act originally designed to regulate "share pushing". Managers of Unit Trusts have ever since been particularly resentful of having to operate under an Act with the discouraging title of the Prevention of Fraud (Investments) Act. In the opinion of the Association a movement which is designed to encourage personal savings and which has been singularly free from fraud, is entitled to be administered by an Act with a more helpful and appropriate name.

31. Moreover, the grounds which might have originally warranted the inclusion of the regulation of Unit Trusts in the Act are not valid today. All parties represented in Parliament are on record as being well disposed towards Unit Trusts: successive Chancellors of the Exchequer have paid tribute to the movement; and recently the draft 1960 Finance Bill has envisaged that practical assistance should be given to unit holders by proposing that management expenses should be a charge against untaxed income. The size of the invested trust funds, the experience and standing of the managers concerned, and the part the movement plays in stimulating the savings of the public, fully justify the enactment of a separate Unit Trusts Act. All the more so since the recently formed Association has been given powers to set up common standards of behaviour to which all members must conform.

32. The Association does not agree with one particular suggestion that has been made to it, namely, that legislation relating to Unit Trusts should form part of a revised Companies Act. Unit Trusts are not companies, and to include them in the provisions of a Companies Act would lead only to confusion.

33. As part of its recommendation that a Unit Trusts Act should be proposed the Association has a further observation to make. In a business which depends entirely on public understanding it is unfortunate that the basic document regulating each trust, the Trust Deed, is at present in most cases, a long and complicated document which differs only in detail from Trust to Trust. Even though existing Unit Trust Deeds say the same thing their preparation is however a complicated business, and rarely, when sent to the Board for approval, are they in a form which can be quickly scrutinised and authorised by the responsible officers there.

34. The Association therefore suggests that the Unit Trusts Act which it has proposed should contain a specimen form of Trust Deed in a way similar to that in which the Companies Act, 1948, contains a specimen form of Articles of Association for a

Company limited by shares; and that any Unit Trust shall be constituted under this specimen form except to the extent that the document constituting the Trust sets out alterations or additions. Such a procedure would have the advantage that it would result in a short and comprehensive Trust Deed which would be much more intelligible to investors and which the officials of the Board would be obliged to scrutinise only for its general objects and for deviations from the provisions of the specified form.

35. In view of the urgency of presenting this Evidence to your Committee, the Association has not had time to produce the specimen form of Trust Deed which it would like to see embodied in any proposed new legislation, but it would be happy and willing to collaborate with the Board in drafting one, if it were to be so invited.

8. Additional comments and further recommendations

36. In paragraph 16 it was stated that the Board take the view that they can regulate any matter relating to Unit Trusts. For instance, although neither the Act nor the Scheduled Matters give the Board powers to prescribe Managers' scales of service charges, the Board have, nevertheless, exercised this power since the War. They have not always however been consistent in the way they have permitted the total charges to be distributed between the initial service charge and the periodical charge. On occasions in the past, when agreeing to the extension or conversion of an existing Unit Trust, the Board have permitted higher charges than they were willing to grant to Managers of new Unit Trusts, notably in 1954 when they authorised a Second Series Trust to make total charges of 16 per cent. over the life of the Trust. The Board's existing practice in connection with charges is set out in its letter COS 3252/57 dated the 25th October, 1957 (a copy is attached at Annex C). Under present arrangements the maximum total charge generally permitted over the 20-year life of a Trust is 13½ per cent. The Association has two comments to make on the Board's present policy. Firstly, the choice of 20 years as being the life of a Unit Trust for the purpose of calculating the total service charge is arbitrary. Secondly, the initial service charge and the periodical management charge should be considered as being distinct from each other and their purposes should not be confused. The initial service charge is used to meet initial costs. The major part of initial costs is made up of the advertising outlay needed to attract new investors, commissions payable to banks, stockbrokers and other agents when units are sold through them, and the general expense of putting a new subscriber on the register. These are once-for-all operations and it seems reasonable to suggest that costs of this nature should be written off against the initial charge. The periodical charge is designed to cover management costs which in common with other expenses of this nature are increasing continuously. The Association is of the opinion that in addition to there being a case for changing the Board's basis for computing the service charges, there are good reasons for increasing these charges at the present time. In particular an increase in the initial charge would enable Managers to attract new investors from a wider field. This matter is discussed in more detail in paragraphs 5 and 6 of Annex A.

37. In paragraph 26 it was emphasised that the position of the Trustee is the keystone to the present operation of Unit Trusts in the United Kingdom, and in the opinion of the Association guarantees its superiority over all other existing methods of operating this form of investment. It follows, however, that the law should continue to insist that the Trustee should be completely independent of the Manager, that the Trustee's powers should be strong and well defined and that he should not be able to opt out of any of his responsibilities. Doubtless your Committee will want to consider whether the present legislation is sufficiently strong to ensure that these requirements are carried out.

38. In paragraph 28 a recommendation was made that the provisions of any new legislation should not attempt to achieve minute control over the day-to-day operations of Managers. It is the opinion of the Association that the present law, implemented by the Board's requirements, which in theory controls the scope of Managers down to

the last detail, is unreasonably restrictive in many respects and is often in fact rendered nugatory by the speed at which the movement is expanding.

39. It was possibly right that in the early thirties when the Unit Trust movement was an untried method of investment, Managers should have been closely controlled. Similar reasons for such stringency over every day matters do not now exist. Over the years common standards of conduct have emerged which are now the basis of the operations of all Managers. Although there are differences in detail between the running of one Trust and another, these differences do not necessarily make one either superior or inferior, or more or less desirable, to the other. The important distinction lies in the skill of Managers in choosing the original portfolio of securities and the subsequent management of investments. In some cases the present regulations hamper this skill which in itself cannot be the object of legislation.

40. When the operations of Managers are being considered item by item, it may for instance be argued before your Committee that the law should state the scale of commissions which Unit Trust Managers should pay to intermediaries (such as Stockbrokers or Banks) on the sale or repurchase of units. The Association considers that this is not a subject matter for legislation. It is a commercial transaction and it devolves on the management companies themselves to decide what they are prepared to pay out of their limited sales charge by way of commission in exactly the same way as they have to decide what proportion they are prepared to spend on advertising.

41. In another direction the Board's regulations require Unit Trust Managers to circulate to unit holders each year a statement of the financial affairs of the management company in relation to the Trust. The Association is only too well aware from comments made by unit holders and others that the prescribed forms of the accounts are tortuous, and, when completed, not easy to understand. Sometimes they are even misleading. It is suggested that detailed consideration should be given to what is essentially necessary to disclose the financial operations of Managers to the public. The Association is certain that examined from this standpoint, many of the figures that are now required to be given, will be found to be irrelevant, and could accordingly be discarded. The Association suggests that the present accounting requirements could possibly be satisfied by a form of auditor's certificate.

42. Yet another activity of Managers which is controlled in great detail by regulation is the attention they must give to their advertisements. The Association realises that great care has to be taken over this matter. The problem is different with a block offer than it is with an advertisement stating that units are on tap and inviting immediate applications for them at current prices: it is different again when an advertisement merely invites enquiries from the public about the aims and objects of the Unit Trust. It is the view of the Association that it is right to lay down minimum statutory regulations for all kinds of advertisements inviting applications for units. The control of advertisements which merely invite enquiries from the public can be safely left to the Trustee. The principle behind new regulations should be that no Manager should issue, or permit to be issued, any advertisement, circular or other document relating to any authorised Unit Trust managed by him which misleads, or tends to mislead the public, or prejudices, or tends to prejudice, the interests of existing unit holders. If legislation were drafted in this general sense, with certain minimum statutory information required in cases where the advertisement incorporates an application form for units, the details that should appear in advertisements might, perhaps, be left to the Association and the Trustees acting jointly.

43. There are many questions of the type mentioned in the last three paragraphs which are not suitable for detailed regulation by the Board and which, given a basically strong law defining specifically the responsibilities of Managers and incorporating a specimen Trust Deed, could be left to a greater extent than they are at the moment to the Association in collaboration with the individual Managers and the Trustees.

9. Summary of Recommendations

44. To sum up therefore, the Association recommends that

- (a) legislation relating to Unit Trusts should be codified in a separate enactment to be called the Unit Trusts Act.
- (b) this Act should contain a specimen form of Trust Deed, and any Unit Trust should be deemed to be constituted under this specimen form except to the extent that the document constituting the Trust sets out alterations or additions.
- (c) this Act should set out specifically the present Scheduled Matters and the Board's regulations, should take into account the Association's own recommendations, and should embody any other matters which your Committee considers should be incorporated, but should not attempt to establish minute control over the day to day operations of Managers.
- (d) this Act should include provisions to ensure that the Trustee is completely independent of the Managers, that his powers are strong and well defined, and that he is not able to opt out of any of his responsibilities.
- (e) many details of the operation of Unit Trusts which the Board now attempt to regulate should in future be dealt with by the Association acting in collaboration with the individual Managers and Trustees.
- (f) the existing prescribed form of accounts should be studied with a view to deciding whether they might not be replaced by a form of auditor's certificate.

10. Conclusion

45. As was pointed out earlier in this Evidence it seems to the Association that your Committee's consideration of the subject of Unit Trusts forms a unique section of its investigations. In view of the comparative unfamiliarity of financial, legal and academic circles with the topic of Unit Trusts, you will probably not receive much evidence on the subject. Those who know anything about Unit Trusts are principally confined to officials of the Board, the appropriate departments of those Banks and Insurance Companies which act as Trustees of Unit Trusts, the professional advisers of the Managers, and the Managers themselves.

46. With deference and respect for the labours which your Committee faces, the Association has kept its evidence as brief as is compatible with giving a fair summary of its opinions. If your Committee wishes for further explanations either of the points made in this Memorandum and its Annexes, or of other matters which are raised in connection with Unit Trusts in the course of your Enquiry, the Association will be glad to submit a further Memorandum, or to meet your Committee, to answer the specific questions which you might raise.

47. The Association is anxious to take all necessary steps to help this matter towards a speedy conclusion, for with the movement expanding at the present pace, it is of more than ordinary importance to Managers that they should know as soon as possible what the legal provisions for regulating Unit Trusts in the future are going to be, so that they might already prepare to arrange their affairs accordingly.

ANNEX A

Memorandum on certain technical difficulties connected with the Operation of Unit Trusts

There are certain technical difficulties inherent in the operation of Unit Trusts which the Association wishes to bring to the attention of your Committee. No matter which system is finally proposed for regulating this particular form of investment, these difficulties, for which no agreed solution has yet been found, would remain to be

settled. They are caused by basic factors which Managers and other responsible bodies are not able to control. It is over their solution that some controversy develops within and outside the Unit Trust movement.

2. It seems best to examine these difficulties under their conventional names and then to state the Association's attitude to them. The three difficulties are:

- (a) block offers at fixed prices;
- (b) principal systems or agency systems;
- (c) appropriation funds or cash funds.

(a) Block Offers at Fixed Prices

3. The sales operation known as a "block offer" is an offer to the public of a certain number of units at a stated fixed price over a given period of time. The offer is open for anything up to a week and is always accompanied by considerable advertising and publicity expenditure. It is argued by some people that a block offer is wrong for a number of reasons—the most cogent of which is that this form of offer creates the false impression that the proposed purchaser must invest at once at a price which is predicted in advance, whereas, the whole idea of a Unit Trust is that units shall always be on offer at a price which fluctuates according to the value of the underlying securities.

4. The first point to be borne in mind is that no Manager likes making block offers for the following reasons: administratively they load a peak burden on to his office staff for a short period of time; they give rise to a host of investment problems; they put the Manager at risk for large sums of money since if he acts as a principal and the market falls he may be selling a large number of units at a loss, and if he acts as an agent and the market rises he may have to cancel the offer after he has incurred big expenses in advertising.

5. If Managers could find a way of increasing their funds without block offers they would give up this practice without regrets. It is, however, the necessity to sell enough units to make the operation economic which is the root of the matter. Block offer advertising brings in the small investor in a way which other conventional advertising used on a scale that the Managers can at present afford, does not. The existing scale of charges which Managers are allowed by the Board is insufficient to keep up the pressure of a sustained advertising campaign which a decision to do away with block offers at fixed prices would entail if the present momentum is to be maintained.

6. Although it may be argued that these charges should be sufficient to cover the expenses of any reasonable sales organisation, the amount which they permit to be spent on advertising is small compared with advertising expenditure of other organisations which set out to attract investment savings such as Life Insurance Companies, Building Societies and so-called Investment and Industrial Bankers. In the United States, for instance, although the average sales charge which is included in the offered price of Mutual Funds is $7\frac{1}{2}$ per cent., the permitted maximum is 9 per cent. It is the opinion of the Association that the maximum charges that the Board are now prepared to sanction should be revised upwards.

7. The Association is further of the opinion that, in view of the amount of new savings brought in by block offers at fixed prices, it would be quite wrong at the present time to legislate for their abolition. Among other effects, such a provision would favour the established groups to the detriment of newcomers who are bringing a noticeable spirit of rivalry into the movement.

8. There is another argument in favour of block offers which even if distasteful to the purist is firmly believed in by many Managers. Granted that the primary purpose of the Unit Trust movement is to furnish facilities for steady, sustained regular saving,

it must nevertheless secondarily cater for a different kind of customer as well. That is the individual who saves in a teapot or under his mattress to achieve a definite objective, say £100; or the individual who has just been given £10 and wishes to invest it; or the person who has just been left £100 in a will. This type of customer actually wants to know how to invest this money profitably, and the block offer provides him with just such information. That he welcomes it is seen by the response to many block offers.

9. The Association, however, realises that block offers give rise in certain circumstances to the possibility of abuse. These possibilities are quite different when a Manager acts as a principal (i.e., if he actually owns the units before making the offer) than when he acts as an agent in the offer; they are quite different in an initial offer from what they are in a subsequent offer (when there are existing unit holders whose rights must not be prejudiced); and they are different again if the fund operates in a "bad" or "restricted" market in its underlying securities from what they are when the market is good. Consequently, the rules regulating block offers will have to be exceedingly complex.

10. It is particularly urged that neither Parliament nor the Board should seek to impose incomplete rules, because these would give rise to the impression that all block offers which comply with them are not open to abuse, and ones which do not comply with the rules could be dishonest (neither of which would necessarily be true).

11. The guiding principle must be that block offers ought not to be made in terms which would prejudice the financial interest either of existing unit holders in the Trust or acceptors of the offer. The Association is in the process of drafting rules for its Members to follow in order to see that this principle is kept. It may well be that your Committee may come to the conclusion that this is a problem that the Association can be left to deal with itself.

(b) Principal Systems and Agency Systems

12. The second unsolved technical difficulty centres round the availability of securities on the Stock Market and the facilities for buying and selling them without moving prices sharply. This is the cause of the investment problems of which mention was made in paragraph 4 of this Annex in connection with block offers, and is true notwithstanding that up to now, Managers have been dealing in relatively small sums of money. The problem will become more serious as the amounts of money involved become larger. In the ideal business community for the operation of Unit Trusts, all securities would enjoy an "unlimited" market on any business day, and large purchases or sales would only marginally affect the price. Unfortunately, this is not the case in the United Kingdom at present. Many securities have "bad" or "narrow" markets and Stockjobbers do not carry unlimited books. In the event, some marketable securities may for long periods be missing from the jobbers' lists when a Manager wants to buy, and unsaleable when he wants to sell; while in other cases quite small sales and purchases may give rise to sharp falls and rises in price.

13. This problem is relevant to the question of whether a Manager should act as a principal in maintaining a market in his units or whether he should act simply as an agent.

14. It is argued that this question should never arise because it is wrong, and therefore to be avoided at all costs, for a Manager to act as a principal. If he does so it is said that he puts himself in a position where he can be tempted to exploit purchasers and vendors of units to his own advantage.

15. This is not the view of the Association. None of us would wish to deny that the agency system has a strong appeal but in practice it cannot be made to work

with certain Unit Trusts. Moreover, not even Managers operating agency systems can avoid acting as principals when they are called upon to repurchase units, because a forced sale of securities to pay out one unit holder might lead to a diminution of the value of units held by the remaining holders.

16. The advantage of a principal system is that it enables the Manager to keep the contraction and expansion of his Trust Fund more under his own control than does the agency system. The expansion of the Trust Fund can then be arranged when suitable securities can be bought for it, and contraction allowed (if needs must) when securities can be sold. Where a Trust Fund is invested in securities which have a "narrow" or "bad" market (such as those of investment trusts), it is essential that neither operation should be done under pressure and this can be more surely avoided when the Managers act as principals.

17. It has been said that Managers should not invest in "narrow" or "bad" markets but, as a matter of fact, the most successful record of any Unit Trust over the last ten years belongs to a Trust which invested exclusively in securities with a very bad market and which could only be run on the principal system. In this Trust the Managers have to buy securities whenever the stock they want is on offer and they can only be sure of having the cash to do this if they are able to create units at the same moment. As far as is known, it is not suggested that the Managers of this Trust have, in fact, succumbed to the temptations they are alleged to face by reason of acting as principals. If the theory of the agency principle can be maintained only by rejecting what has proved to be one of the most successful Unit Trusts in this country then surely the theory must be mistaken.

18. There is a further argument in favour of permitting the principal system which seems to Members of the Association to be conclusive. It is the opinion of some Managers that one of the best media for selling units of a Unit Trust will in the future be sales "over-the-counter" at Banks or on the shop-floors of factories. The advantages of this medium is that an investor gets his Certificate immediately in exchange for his money, with no trouble from Contract Notes, delays in receiving a Certificate or other administrative troubles.

19. Sales "over-the-counter" can only be made where the principal system is employed by the Managers, for, in order to be able to run a Unit Trust the Manager must know how many units are in issue. But where a sale is made over-the-counter at some inaccessible branch Bank, it may be a matter of days before the bargain is reported to the Managers. In a Unit Trust run on the principal system, the Manager will always maintain a stock of units more than sufficient to provide for any possible demand. In an agency system, however, quite apart from the necessity of having to issue Certificates for units which will not exist for several days, it is difficult to assess the price at which the unit should be created. During the period between the sale over-the-counter and the moment of creation of the units, the price may have risen or fallen appreciably.

20. In pointing out the advantages which Unit Trusts operating on the principal system have at the moment over agency type Unit Trusts in the matter of selling units over bank counters, the Association does not, however, wish to give the impression that this difference will always necessarily work in favour of the first type of Unit Trust to the detriment of the second. Doubtless, if selling units over bank counters became a universal practice, agency type Unit Trusts would soon adopt measures to put themselves on a competitive basis in these respects with Unit Trusts operating on the principal system.

21. To sum up, it is the Association's view that both the agency system and the principal system have advantages and disadvantages. It is right that both kinds should be allowed to exist and no special rules or legislation on this topic are called for.

(c) Cash Fund or Appropriation Fund

22. The third and last difficulty to which reference will be made in this evidence centres round the way in which the "value" of any security is to be assessed at any particular time, not only for the purpose of valuing the Trust Fund (and thereby each individual unit) but also for the purpose of deciding what is the price of any investment on its inclusion in, or its rejection from, the Trust Fund as the Fund expands or contracts.

23. The "value" of a security is related to the price at which it can be bought or sold in an open market. Quite apart from variations that there may be from minute to minute due to the advent of news, or the laws of supply and demand, the value will also depend on the number of shares bid for or offered at any moment.

24. It is therefore felt that the "lowest" market dealing offered prices and the "highest" market dealing bid prices of a security as certified to the Managers by a member of a recognised stock exchange constitute probably the best means of valuation. This method involves considerable trouble particularly on the part of the stockbroker concerned. An easier method is to take the quotations of the Stock Exchange official list which is, of course, prepared by an unimpeachable and independent body. These prices may, however, be very nominal and the "spread" is normally wider than with a dealing quotation. The effect of using a quotation with a "spread" greater than that applying in the market is that new applicants will pay slightly too much for their units and retiring unit holders will be given rather too little. We feel that whichever method is used it should be followed consistently with no option to vary the basis, since given any latitude in this matter Managers could manipulate offer and bid prices to their own advantage.

25. It is the difficulty of assessing the "value" of a security which gives rise to controversy about the respective merits of "cash" funds as against "appropriation" funds. In the former, units are created or extinguished against deposit or extraction of cash in the hands of the Trustees. In the latter, units may be created or extinguished against an appropriation or expropriation of securities as well as cash. In the days of fixed trusts, the latter method was in many ways the most practical, and provided the securities are appropriated or expropriated at their true value there is no theoretical objection to a practice which is much criticized today. In fact, if a fund is run on the agency system but some of its securities have a narrow market, it may be in the unit holders' best interest for the Managers to purchase desirable securities having a narrow market whenever these come on offer and appropriate them to the fund when there is a demand for units, rather than risk missing the desired securities altogether.

26. In practice the trouble arises because there is no way of discovering what the true value of a security is. Consequently book profits or losses may be made too easily on these appropriations or expropriations.

27. What is not so often recognised is that the cash fund technique for creating units is also open to abuse. There are some days (the day after the results of the 1959 General Election were known, for example) when large scale purchases of equities are virtually impossible. If, on such a day, unlimited creations of units for cash are allowed in a fund which advertises that it is an equity fund, then the unit holders already in the fund are having the value of their units seriously depleted by the dilution of the existing equity portfolio with cash. In these circumstances it is very important that existing unit holders' interests should be properly safeguarded by limiting the amount of cash that may be put into and held in the fund for any period of time.

28. In the result, the Association recommends that on balance it is best that the creation and extinction of units should only be permitted to be arranged in exchange for cash and that, by the same token, after an initial offer, some limit should be placed upon the amount of cash that can be held even temporarily in a fund run on the cash fund technique.

ANNEX B

List of Members of the Association of Unit Trust Managers

A.E.G. Unit Trust (Managers) Limited
Allied Investors Trusts Limited
Bank Insurance Trust Corporation Limited
Commercial Fixed Trust Limited
Commonwealth Unit Trust Fund (Managers) Limited
Community Units (Participating Industrial Development) Limited
Crosby Trust Management Limited
Domestic Trust Managers Limited
First Provincial Unit Trust Limited
Moorgate Unit Trust Managers Limited
National Fixed Investment Trust Limited
Orthodox Unit Trust Limited
Philip Hill, Higginson, Erlangers, Limited
Proved Securities Limited
Scottish Bank Insurance and Trust Shares Limited
Scottish Industries Unit Trust Managers
Selective Unit Trust Managers Limited
Shield Fund Managers Limited
Unicorn Securities Limited

May, 1960.

ANNEX C

Copy of letter sent by the Board of Trade to all Unit Trust Managers

Board of Trade,
Insurance and Companies Department,
Horse Guards Avenue,
Whitehall,
London, S.W.1.

Ref. COS 3252/57 25th October, 1957

Dear Sir,

Unit Trust Service Charges

You will be aware that for some years past it has not been the practice of the Board of Trade to authorise a new Unit Trust Scheme, or an extension or conversion of an existing Scheme, in which the initial service charge exceeds 2 per cent. (or 3½ per cent. if the Managers pay commission to agents) or the periodical charge exceeds ½ per cent. per annum. For a Trust having a 20 year term, the total charges on this basis amount to 13½ per cent.

While these limits have been operative, the Board have received a number of representations from Management Companies as to the inadequacy of the charges authorised, particularly in respect of the initial service charge. The lowness of this charge is said to make it difficult for the smaller Trusts, or those newly established, either to operate profitably or to take full advantage of recent increased interest in Unit Trusts by expanding sales by means of more intensive selling techniques.

The Board have therefore had under consideration the question of authorising amended arrangements for Trusts which might wish to *redistribute the present total of permitted charges* by an upward revision of the initial charge and an appropriate reduction in the periodical charge. In their review the Board have had regard to the need to fix the initial service charge at a level which would not unduly penalise the shorter term unit holder, and to ensure that the more intensive methods of selling which increased initial charges would permit, do not lead to abuse.

The Board have now decided to allow a limited redistribution of charges, and have recently authorised a Unit Trust Scheme of which the main features are:—

- (a) An initial service charge of 5 per cent. and a periodical charge of $\frac{3}{4}$ per cent. per annum. This redistribution of the present total charges (amounting to $13\frac{1}{2}$ per cent. over a 20 year term) makes allowance for interest at $3\frac{1}{2}$ per cent. per annum for that period in respect of the higher initial charge on the unit holder.
- (b) All sales of units are to be made through a Sales Company licensed by the Board of Trade under section 3 of the Prevention of Fraud (Investments) Act, 1939.
- (c) The initial service charge, as well as covering commissions paid by the Management Company to the Sales Company, is to cover the cost of commissions paid to agents.
- (d) The Managers are required to make all re-purchases of units, without exception, at a price not lower than the "Board of Trade price".

You will see from this letter that the Board of Trade are prepared to consider amendments of current authorised Schemes in accordance with the principle described in paragraph 3 hereof.

Yours faithfully,

(signed) P. J. Mantle.

Supplementary Memorandum by the Association of Unit Trust Managers

1. An analysis of the trust deeds of unit trusts (45 in number) currently operated by members of the association reveals a great variety in the methods by which trustees exercise control over the manager's power of investment, and adds support to the Association's original recommendation that the long and complicated documents which at present constitute unit trusts should be replaced by short and comprehensive trust deeds.

2. The first unit trusts formed in the United Kingdom during the nineteen thirties were fixed trusts, based on a limited number of specifically named securities. Even in these trusts, however, the managers usually had discretion, albeit in very limited circumstances, to vary the securities. Today there are no fixed unit trusts in existence in the United Kingdom. They have all been replaced by trusts which are more or less flexible in character. Most modern unit trusts are fully flexible.

3. Ignoring differences of detail, trust deeds constituting existing unit trusts can be divided into three main categories, namely—

- (a) those which set out in a schedule to the trust deed a named list of permitted securities in which the trust funds may be invested to the exclusion of all other securities;
- (b) those in which the manager selects a list of securities for investment, which, when consented to by the trustee, becomes known as the "authorized list of investments"; and
- (c) those in which the manager may invest in any security provided such security is an "authorized security" as defined by the trust deed.

4. Most trust deeds fall distinctively into one or other of the above mentioned categories, but there are some which, though definitely belonging on balance to one group, nevertheless have certain common characteristics with those in other groups. Broadly speaking there are six trust deeds in the first category, twenty in the second and nineteen in the third.

5. In addition to these broad categories there are several other general limitations on the manager's investment powers which apply to a greater or lesser extent to trust deeds of all types.

6. The main characteristics of each type and the general limitations referred to above are outlined below:

The named permitted list type (six unit trusts)

In this category there are six trusts, two of which are based strictly on the principle of a named list, three of which embody the principle with a variation, and one in which the named list is so comprehensive that the manager might be said to enjoy in practice as great a freedom over investment as those whose trusts fall into a less restrictive category. Two trust deeds in this group each contain a list of 34 named securities. If any of these named securities should be taken off Stock Exchange lists for any reason such as the nationalization of the company concerned, the insolvency of the company, or the merger of the company with another, neither the trustee nor the manager is empowered to substitute other securities. A *Third* trust deed in this group had originally a named list of 60 securities but the manager has powers to delete up to five securities each year and to substitute another five of his own choice without reference to the trustee, who, however, is entitled without assigning any reason to veto the manager's choice if the inclusion of such a selected security would infringe the terms of the trust deed. Yet another variation of the general principle underlying the trusts in this group appear in the *fourth* and *fifth* trust deed. In the first of these the proceeds of the trust may be invested in any one of 100 shares of which only 95 are named. The remaining five are selected by the manager, subject to the approval of the trustee. In the second, 70 securities are named in the trust deed and the managers may with the consent of the trustee choose a further five securities for investment. In the deed of the *sixth* trust which falls by definition into this group there is a list of 450 named securities. Although no investment may be made in a security not so named, the list is so extensive that the manager's powers of investment can be said to be restricted only in a very wide sense.

The authorized list type (twenty unit trusts)

In trust deeds of this category the selection of investments is in all respects the responsibility of the manager, but the trustee's consent is required before a purchase is made of a security chosen by the manager. Once a trustee has signified his consent the security concerned becomes part of the trust's "authorized list of investments".

Although in these cases the selection of a security is the manager's responsibility, the deed provides that the trustee is entitled at any time at its entire discretion and without assigning any reason to give notice to the manager that it is not prepared to add a security to the authorized list if such an inclusion would in the opinion of the trustee infringe the terms of the trust deed or be detrimental to the interests of unit holders. A further restriction of the powers of the managers of some trusts of this type is that the number of securities in which investment can be made is limited by a provision in the trust deed and cannot be exceeded without the consent of the trustee. In thirteen of the twenty trusts in this category the manager has complete control over the purchase and sale of any securities which the trustee has admitted to the "authorized list". In the remaining seven, however, securities, even though they may be authorized, can nevertheless be purchased, varied or sold only with the consent of the trustee, which consent may be given or withheld at the discretion of the trustee.

The authorized security type (nineteen unit trusts)

The third major category of trust deeds concerns those in which the manager is free to invest the trust fund in any security provided such security is an authorized investment as defined in the trust deed. An authorized investment is usually defined as any investment for the time being authorized by law for the investment of trust funds and any investment which the managers may select for the purpose of investment of the deposited property and in respect of which permission to deal or which dealings are permitted on a recognized Stock Exchange in Great Britain, or on a Stock Exchange in the British Commonwealth or the United States of America is effective and to which the trustee raises no objection. In this type of trust the trustee is neither responsible for the purchase and selection of any investment nor for the sale, exchange or alteration of any investment except to be satisfied that any such purchase or change does not infringe the terms of the trust deed nor result in the acquisition of an unauthorized security in particular. If such a purchase would, in the opinion of the trustee either cause such infringement, or result in the acquisition of an unauthorized security, the trustee has the right in these cases to inform the manager, without assigning any reason, that it is not prepared to countenance the proposed transaction.

General Limitations

Apart from these distinguishing characteristics which divide trust deeds into three groups, the general restrictions on the investment powers of a manager applying either jointly or severally, and to some degree or other to trust deeds in each of the three categories, include limitations on the classes of securities that can be held, the proportions of various classes that may be held, provisions relating to partly paid shares, percentage limitations on the amount which may be invested in any one company and, in some, the total number of securities in which the trust funds may be invested.

7. It should not be overlooked when considering this subject of the extent of the power exercised by trustees over the manager's investment policy that the attitudes of trustees themselves vary greatly in this matter. In the mind of some of them the responsibilities of a trustee should include a detailed control over the manager's investment decisions, while others refuse to adopt any form of veto or to accept any responsibility except to a minor degree.

8. It is the opinion of members of the Association that the control which trustees have exercised over the managers' powers of investment has on the whole worked satisfactorily. However, in a few respects, some of the methods of control have resulted in a certain rigidity and unnecessary administrative work in the operation of the unit trusts concerned. For instance the existence of a too restrictive list of named securities in which trust funds must be exclusively invested does not allow the manager

to use his investment skill to adapt the investment policy of the fund to changing circumstance for the advantage of unit holders. Furthermore it seems to us unnecessary for the trustee in those cases where he consents to an "authorized list of investments" further to extend his powers by retaining control over changes in the portfolio within the authorized list.

9. In the opinion of the members of the Association the principle which should underlie any new legislation envisaged for the points discussed in this letter, is that the trustees should have, and should be seen to have, sufficient control over the manager's powers of investment to ensure that the interests of unit holders are protected at all times. It is therefore essential that the powers of the trustee should be fully defined in this sense in the trust deeds by which unit trusts are constituted.

17th February, 1961.

APPENDIX XXIX

Memorandum by the Association of Investment Trusts

The Association of Investment Trusts was formed in the year 1932. The Objects as stated in its Constitution were:—

- "(a) the protection, promotion and advancement of the common interests of its Members and the taking of such measures as in the opinion of the Committee may be conducive to such object and,
- (b) the guidance and assistance of any one or more of its Members where the interests of such Member or Members are or may be affected by any act, omission or default (whether existing, threatened or anticipated) of any person, firm, company, municipality, government or other body of persons corporate or incorporate."

An investment trust is a joint-stock company formed for the collective investment of money subscribed in the form of share capital by its members.

The Association includes among its members almost all the investment trusts whose stocks are quoted on Stock Exchanges in the United Kingdom.

The Association submits the following evidence in response to an invitation contained in a letter dated 15th January, 1960, from the Secretary of the Company Law Committee to the Secretary of the Association of Investments Trusts. The evidence is given under the headings contained in the annex attached to that letter. The questions upon which the Association has no opinion to express have been omitted.

Investment trusts are basically long-term investors and their interests do not differ from those of the investing public. The evidence has been prepared by a Committee from suggestions received after inviting all members of the Association to put forward their views as investors.

1. Incorporation of Companies—Memoranda of Association

- (b) *Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

It is not considered that there should be any restriction in the number of objects included in the Memorandum as it is appreciated that, in the light of experience over a long period of time any attempt to limit the scope of the provisions might hamper a company's activities.

In view of the universality of modern Objects Clauses it is appreciated that a very wide range of activities can be carried out. It is the view of this Association that any substantial change in the nature of the business which the company is, in fact, carrying on should be subject to the consent of shareholders. This point is also made in the answers to questions 5(a) and 5(c).

As any substantial change in the nature of the company's business is of importance to all classes of shareholders, it is suggested that upon any proposal to change the Objects Clause of the Memorandum, including any change in the company's activities as mentioned in the preceding paragraph, preference shareholders should have the same voting rights as they would have on a proposal to wind up the company and that any Article of the company providing otherwise should be invalid. The principle is that shareholders of any class having subscribed for or acquired their shares on the footing that they are investing in a particular kind of business should not, without their consent, be required to continue their investment in some different kind of business.

(d) Shares of no par value

This Association submitted evidence to the Committee on Shares of No Par Value in 1954 and supported a change in the law to permit the issue of shares of no par value. The Association sees no reason to change the views then expressed and which are on record both in written and oral evidence.

3. Classification of Companies

(b) Nature and merits of distinction between exempt and non-exempt private companies (sections 127, 129 of Companies Act, 1948)

It is not considered that there should be any change in the present provisions in regard to exempt and non-exempt private companies.

(c) Unlimited companies and companies limited by guarantee

It is suggested that there should be no change in the present regulations regarding unlimited companies and companies limited by guarantee.

4. Donations by Companies for Charitable and Political Purposes

It is considered that the question of donation by companies for charitable and political purposes raises the important point of principle that the directors have an inherent right to manage. As stated in other parts of this evidence, it is felt strongly that no restriction should be placed on directors' power to manage the company in the way that they honestly believe is in the best interests of shareholders.

It is impossible to define what particular donation or subscription would be in the interests of any particular company as the circumstances of each case would differ. However, as any donation or subscription is made with the shareholders' money, the directors should disclose the facts.

It is therefore recommended that donations and subscriptions should be made at the discretion of the directors but that the total disbursed in any year should be disclosed in the annual accounts.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) Fundamental changes in company's activities

Much thought has been given to the position which arises when proposals are put before shareholders to increase the authorised capital of their company by a substantial amount without any information being given by the board as to the specific purpose for which the additional capital is required. The Association is of the opinion that consideration of the problem should be based on the following two principles:—

- (1) That there should be no attempt to interfere with the powers of directors by seeking to put restrictions on the development of a company by limiting to any definite figure the relationship between the amount of authorised and unissued capital, but
- (2) That it is wrong for the board of a company to permit any substantial change in the control of the company or (as stated above) the nature of its business without referring to shareholders.

These views are held as a matter of principle and it is appreciated that there are circumstances peculiar to each case which require special consideration.

(b) Disposal of undertaking and assets

Shareholders should trust their directors and the disposal of the undertaking and assets should be at the discretion of the directors though normally directors would be

prudent to carry their shareholders with them. The answer to question 6(a) also refers to this subject.

(c) Issue of shares

The issue of shares, in particular of shares for cash, without their first being offered to shareholders is deprecated, but the expansion of a company by acquiring assets by the issue of shares should not be hampered. Any issue of shares, however, which would result in a change of control or a radical alteration of the nature of the business should be subject to the approval of shareholders.

In this connection it is considered that it is for shareholders to consider carefully the discretion which directors are given when a proposal is put forward to increase the authorised capital without stating the purpose for which these shares are required.

Under section 63 (i) of the 1948 Act any increase of a company's share capital beyond its registered capital must be notified to the Registrar of Companies.

It is recommended that this provision should be extended to any increase of the directors' power to borrow (however created or exercised) so that third parties, in their dealings with the company, may be aware of the position.

6. Directors' Duties

(a) Should their duties be stricter and more clearly defined, and if so, in what respects?
and

(b) Are directors generally aware of the legal duties arising from their fiduciary position?

It is considered that generally directors are aware of the responsibilities arising from the fiduciary position existing between themselves and the shareholders. The directors' duties of "care and skill" to manage the affairs of the company in the best interests of shareholders of all classes could, however, be more clearly understood both by directors and by shareholders. Such an understanding would greatly improve the relationship which should exist between the two. Such improved relationship would assist in building up a climate of opinion as to both the responsibilities of directors towards the business and staff and to shareholders and also to the need for shareholders to behave responsibly towards their boards and the company. Encouragement would therefore be given to shareholders to trust their directors and also directors would obtain more support and understanding from their shareholders particularly on such difficult problems as take-over bids.

It is the directors' duty to make the company successful and to keep it so and thus shareholders must be held to include shareholders of all classes both present and future. It cannot be right for directors to act solely in the short-term interests of present shareholders, e.g. to make the Stock Exchange price of shares as high as possible at any particular moment.

To operate a successful company the directors must enter into long-term relationships with many people, e.g. staff (including the payment of pensions), local authorities, trade unions, customers, suppliers, etc. Directors should take every opportunity to remind shareholders of this aspect of directors' responsibilities.

It is considered that in general, directors carry out their duties honestly and in the best interests of the company and its shareholders and that no further legislation should be introduced to restrict their powers as such might well hamper their discretion to direct the business to the best of their ability.

(c) Directors' and officers' dealings in their own companies' shares

The provisions of section 195 (1) 1948 Act ensure that shareholders are in a position to obtain knowledge of any dealings in the company's shares by directors who are responsible to them.

It seems equally important that the directors, to whom the officials of the company are responsible, should also know of any dealings in the company's shares by such officials.

It is therefore suggested that the provisions of the section should be widened to include the holdings of managers and officers of the company within the meaning of the Act.

(e) Should bodies corporate be allowed to be directors?

It is not considered desirable that bodies corporate should be allowed to be directors of public companies.

7. Shares with Restricted or No Voting Rights

It is considered that, in principle, every share of the equity should have an equal vote, whether the shares arise from an issue for cash or from a scrip issue resulting from a capitalisation of either revenue or capital reserves.

It is, however, appreciated that in certain cases there are particular circumstances which would make the issue of non-voting shares justifiable. It is not, therefore, proposed that the issue of equity shares without votes or with restricted votes should be prohibited by law.

There is not complete unanimity of opinion among members of the Association on the subject of non-voting shares. Opinions vary not so much on the principle as upon the validity of some of the exceptions, but it is believed that the great majority of members hold the views expressed in the first two paragraphs of this answer.

It seems wrong in principle that the subscription of risk capital should carry with it no voice in the affairs of the company. Experience has shown that once non-voting shares are in issue further issues of equity capital are almost invariably made in this form, thus resulting in the control of the company remaining vested in the owners of a small proportion of the capital in issue. The perpetuation of such a situation is obviously undesirable.

There are, as is known, many examples of companies which owe their success to the outstanding ability of the family management who control the voting power and investors have been happy to show their faith in such management by subscribing for issues of non-voting shares. However, it is possible that a time may come when the inability to control the management, for instance, by the removal of directors, may preclude outside shareholders from protecting their investment from serious loss.

No solution to this problem has yet been found, but it might well lie with the investing public refusing to take up issues of non-voting shares unless the terms of issue contain provision for protective voting rights in circumstances appropriate to the company in question.

8. The Protection of Minorities

It is considered that the intention of section 210, which is designed to permit a more liberal interpretation of the provisions relating to the protection of minorities, is largely stultified by the necessity of proving that the facts would justify an order for winding-up under section 225 (2).

It is therefore suggested that a member of a company who complains of oppression should be able to apply for relief under section 210 subsection 2 (a) alone.

9. Protection of Special Classes of Shares

It is not considered that this is a subject for legislation. The rights of shareholders are a matter of contract to be contained in the terms of issue. It is for shareholders to decide what conditions are acceptable.

10. Board of Trade Powers to Appoint Inspectors

Whilst we are of the opinion that generally speaking the powers of the Board of Trade as set out in sections 164 and 165 are adequate, it is felt that these powers are sometimes used in too dilatory a manner.

We appreciate that delays on the part of the Board of Trade may be caused by difficulty in attaining the standard of proof required. We appreciate also that companies should be protected against irresponsible applications to the Board of Trade. We would welcome an amendment of the law which would enable the Board of Trade to act, subject to suitable safeguards, on reasonable suspicion. We can think of instances where City opinion would have welcomed earlier action at a time when there was genuine uneasiness about a company (subsequently seen to be only too well-founded) but when its circumstances did not warrant action by the Board of Trade under the present law.

The Association wishes to draw attention to a recent case in which an offer for the shares of a company was made when the report of an inspector appointed by the Board of Trade was pending. No mention of the report was made in the documents accompanying the offer, although these had been submitted to the Board of Trade.

Power should be given to the Board of Trade to prevent the recurrence of such a case.

11. Disclosure of Ownership and Control

(a) Nominee shareholders and debenture holders (including nominee holding companies)

Members of the Association make considerable use of nominee names. Some members have found that the system has administrative advantages and results in a saving in expenses.

Members do not use the system for the purpose of concealing their interests and the Articles of many investment trust companies provide for either the publication of details of their portfolios with the annual report and accounts, or for facilities for their shareholders to inspect the list at the office of the company.

It is recommended that the nominee system be continued, and there seems to be good reason why legislation should not be enacted to make disclosure of beneficial interests compulsory in all cases.

But there are some circumstances in which it is vital for directors to be able to know who the people really are to whom they are responsible. In the case of a take-over bid (for example) it must surely be essential, in the interests of other shareholders, for the directors to be able to call for disclosure of beneficial holdings.

It is considered that directors should have a statutory right at their discretion to call for disclosure by a nominee shareholder of the beneficial interests he represents.

12. Share Transfer and Registration Procedure

The Association strongly supports the simplification of share transfer and registration procedure.

As this problem is the subject of consideration by the Stock Exchange and other bodies closely concerned with the working of the system this Association has no further comment to make at the present time.

13. Multiplicity of Directorships Held by One Individual

It is not considered that this is a subject for legislation. Men differ in their energy, ability to switch from one subject to another, in their speed of working and many other things. Companies differ in the demands made upon the time and energy of their directors and as between one director and another. In neither case could statutory standards apply.

16. Take-over Bids

The Association co-operated in the preparation of "Notes on Amalgamations of British Businesses" and gives general support to the views expressed in that publication.

It is considered that the freedom to develop and expand businesses by the process of amalgamation should not be hampered by restrictive legislation. It is preferable to build up a sound code of conduct in such matters as cases vary so greatly in size and complexity.

It is not proposed in this evidence to restate the principles contained in the Notes on Amalgamations of British Businesses.

Whilst of the opinion that shareholders should trust and support their directors, the information available to shareholders, especially in the case of take-over bids, is often insufficient for them to come to a considered decision as to whether or not they should sell their shares.

Likewise, shareholders in the offering company are sometimes given insufficient information regarding the company for which their directors are bidding to enable them to form a judgment as to the value of the acquisition.

It seems wrong that, while the law and the regulations of the London Stock Exchange require the publication by prospectus of much detailed information before money can be raised from the public by the issue of shares or securities, no such information is required when shares are offered by one company in exchange for the shares (which are money's worth) of another company.

If a take-over bid is made in co-operation with the directors of the company to be taken over, they may be in a position to secure for their shareholders the relevant information. Where the bid is made direct, the shareholders ought to have the relevant information directly from the bidder.

The amount of financial information which should be available to shareholders not only at times when a take-over bid is made is referred to in this evidence in the answer to question 21.

Such additional information would assist in preventing the market price of shares failing to reflect their true worth and thus discouraging take-over bids being made in certain cases where the object is not a genuine amalgamation.

The Association would support any methods which could be suggested for placing before shareholders more information in regard to all shares involved in amalgamations, but would deprecate legislation which could hamper genuine transactions.

17. Issues of Shares to Existing Shareholders

The Association's views in regard to the issue of shares to existing shareholders has been discussed in the answer to question 5(c).

20. Reduction of Capital and Purchase by a Company of its Own Shares

It is considered undesirable that a company be permitted to purchase its own shares. The purchase of ordinary shares by a company would almost certainly lead to abuse. Were a company permitted to purchase its own preference shares out of accumulated profits, this could also lead to abuse and if a part only of the shares in issue were purchased this could well be to the disadvantage of the other holders.

21. Accounts

General. As investors, investment trusts welcomed the provisions of the 1948 Act in regard to consolidated accounts. It is considered, however, that the Act should be revised so as to require the disclosure of further information and, in particular, it is desirable that the following details should be given:—

- (1) Sales and gross turnover figures (except in the case of exempt private companies).

- (2) The names of subsidiary companies which are consolidated.
- (3) The names of companies which are not consolidated if 25 per cent. or more of the share capital is held and, in the case of such companies, details of:—
 - (a) percentage of capital held.
 - (b) total profit of each company.
 - (c) percentage paid out as dividend.
- (4) Directors' valuation of unquoted investments.
- (5) The amount of interest paid on bank loans and other temporary borrowings (other than inter-company loans) to be shown as a separate item. This would indicate to what extent, if any, the company was trading outside its fixed capital.

(a) Revaluation of fixed assets and use of any resulting surplus

In view of the inescapable short-term fluctuations in value of fixed assets it is not thought practicable or desirable that any legislation should be enacted which would make the revaluation of assets compulsory.

(c) Use of pre-acquisition profits of subsidiaries

While unable to put forward any concrete proposals the Association feels that any modification of the existing enactments which would enable companies to amalgamate more simply would be welcomed.

In particular, the regulations under which pre-acquisition profits are frozen in an amalgamation require amendment.

A simplification of the provisions of sections 206 and 208, while still retaining the necessity to hold meetings of creditors and shareholders but avoiding lengthy court procedure, would assist schemes of amalgamation.

(f) Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948

From an investor's point of view it is considered that there is no difference between the position of a bank, assurance or shipping company and any other joint stock company *vis-à-vis* its shareholders. Full disclosure of all information in the case of the former companies would therefore be welcomed.

There may, of course, be other overriding considerations of national importance upon which the Association can offer no opinion.

22. Audit

(b) Duties and responsibilities of auditors

It is suggested that the normal Auditor's Certificate should be in statutory form on the lines of the following:—

"Audited in accordance with section "X" of the Companies Act 196 "

Should the Auditors find it necessary to add some qualification to the certificate this would be more readily noticed if the normal form were amplified.

23. Provisions as to Returns

It is not considered that any useful purpose is served by including in the annual return details of share transfers during the year. Much apparently useless work could be saved by omitting these details and including in the return only the details of shareholdings on the date of the return.

It is suggested that the requirements of Part 2 of the Sixth Schedule to the Act be amended accordingly. Details of dealings by directors, managers and officers of the company should be excluded from the suggested amendment. The answer to question 6(c) refers.

It is also considered that the description of allottees as required by section 52, 1948 Act is unnecessary, particularly as these descriptions are not required in the register of members.

In practice the Registrar of Companies will accept a return of final holders after giving effect to transfers on letter. It would be clearer if the Act specified this and allowed one month from the last date for passing on letter instead of from original allotment.

There would be a saving of work if section 200(4) were amended so as to provide that only the company from whose board a director retires or to which he is newly appointed is required to notify the Registrar of Companies and that other companies of which the individual is a director need only give effect to the change in the next annual return.

Section 200(2)(a) does not appear to require a director who has changed his name or nationality more than once to give details of all his former Christian names, surnames and nationalities. It is believed that the section, as at present worded, would enable an individual to cloak his original identity and to achieve what is, in fact, anonymity. It is suggested that the wording of the section should be amended to cover this point.

24. Company and Business Names

The Association gives full support to the Board of Trade in refusing to permit the registration of names which might be misleading to the general public.

In particular it is considered that stringent qualifications should be required for the inclusion of the word "Bank" in the title of any company operating in this country.

26. Internal Management and Administration

It is suggested that section 141 of the 1948 Act be amended so as to provide that the notice required for all meetings of all classes of shareholders and security holders should be standardised at 21 days and that there should be two classes of resolution only, viz., Ordinary Resolutions and Special Resolutions.

29. Any other matters within the Terms of Reference

It is recommended that in the general interest some control over advertising for deposits should be introduced.

Some investment trusts which issue terminable debentures and accept deposits might be affected by any enactment which might be made. It is therefore stressed that care should be taken not to restrict genuine activities.

In general the Association considers that the existing Act is working well and requires little amendment.

Any improvements which might be introduced should be designed to add to the information required to be disclosed in company accounts. This would assist shareholders to understand the affairs of the companies in which they have invested.

It is strongly urged that the law should not be altered in cases when there is doubt as to whether legislation should be introduced.

6th May, 1960.

APPENDIX XXX

Memorandum by Mr. S. I. Fairbairn

Unit Trusts, "Open End Mutual Funds" and Reduction of Capital and Purchase by a Company of its own Shares

I. Name

Although opinions may differ about what's in a name, it is probably wise to avoid a misnomer which is what the term Unit Trust is. In the early days of these trusts they were called Fixed Trusts because the portfolio was composed of a fixed unit of investment—20 Courtauld shares, 30 Imperial Tobacco Co. shares, etc.—or a multiple thereof. When the fixed form of trust was abandoned the word "fixed" fell out of the name and the word "unit" was substituted with the idea of embracing both fixed and flexible trusts, albeit, of course, quite inappropriately. Before deciding on a better name we might do well to wait and see what further developments the near future may bring; but I would say that it should certainly include the word "investment" and might take the form of "investment fund" so qualified as to indicate the characteristic of facility of growth and cancellation of units or shares in issue.

2. Most desirable form of this kind of Mutual Investment Fund and the proper roles of the parties

The form of control of Unit Trusts has naturally been dictated by the form which this type of mutual investment fund has taken, namely, a tripartite trust, embracing a custodian trustee ("the Trustee"), a managing trustee ("the Managers") and the beneficiaries ("the Unitholders"). Whether, in the light of experience, this form is the best possible is open to question: it almost certainly causes additional expense as compared with company form; and it is, of course, the investor who in the long run has to foot the Bill for all expense.

The trust form (which enables beneficiaries to come in and go out at asset value, practically speaking, in any amount at any time) as opposed to the company form was adopted largely because of the desire to achieve the highest degree of marketability of the beneficiary's holding, in sharp contrast to the notoriously poor market for shares of investment companies (inappropriately called investment trusts). It is this feature of marketability combined with the absence of gearing (which inevitably goes with it⁽¹⁾), which provides the only substantial difference between unit trusts and investment companies. And it is this feature which confers on unit trusts what may become their main claim to social importance in the national economy, for it makes possible equity savings plans into which savers can place as much or as little as they like, whenever they like (one such plan accepts as little as 5s. a time) and have their dividends accumulated. This is not feasible by means of any other investment medium so far conceived.

The trust form, however, has led to administrative inconveniences arising from the essential fact that some beneficiaries can be joining and others leaving the trust at all times. From the very beginning this awkwardness induced the fiscal authorities to regard unitholders for some purposes as though they were shareholders in a company and not beneficiaries of a trust: income has always been deemed to become the unitholder's income when paid out to him or, in the case of accumulation, when credited to him and not, as it would be under ordinary trust law, when it arises in the hands of

(1) An attempt at gearing a unit trust was made in the early days of the movement—about 1938. This was an exception which proved the rule: after the unhappy experiences of its first lease of life it was continued in ungeared form.

the Trustees; and now it is proposed in the 1960 Finance Bill that unit trusts should be taxed in some, but not all, other respects as companies and, amongst other things, be subject to profits tax. The resulting mixture is administratively uneconomical. A large measure of simplification and economy might be achieved if these funds could be cast in company form, as they can be and in fact mostly are in the U.S.A. It would seem that all that is required to make this legally possible is legislation enabling shares to be bought back by such a company so that the size of the fund in company form can shrink as well as grow as easily and smoothly as in trust form. An ungeared investment company would seem to be a particularly suitable subject for what is contemplated in item No. 20 because of the nature of its assets and comparative absence of liabilities, which are, of course, what make it possible to have an indisputably fair price. It might be thought right to require Articles confining investments to quoted securities with a limit to the proportion in the securities of any one company etc., as is the practice in Unit Trust deeds. By this and other methods it should be possible to assure the investor of at least as much protection as he now gets in a Unit Trust.

In any event the tripartite form is not logically necessary. The division of the fiduciary functions between a custodian and a manager is only desirable if it can be assumed that the custodian will always be trustworthy, whereas the manager is sometimes not. Whatever may be thought of the latter proposition, the requirements in the Act concerning the Trustees, namely, that it must be a corporation registered in the U.K. with an issued capital of £500,000 of which at least £250,000 has been paid up, are no guarantee of trustworthiness. So far in fact no trust has been launched without a first class trustee; and it is unlikely that any company not of sufficient repute in itself would attempt to launch one without invoking the respectability of a first class trustee. But for a company of repute to have to employ a second causes unnecessary expense. It would be simpler and more economical to have the functions of custodianship and management primarily vested in one and the same trustee, or, if these funds should become companies, in a board of directors, as it is in the case of any existing investment company.

If company form were adopted, then besides the increase in administrative convenience and economy there would be a gain in protection of the investor. The trust form has enabled, and in the earliest "fixed" form required, managers to act as principals in the purchase and sale of the trust's underlying securities and in the issue and realisation of units. This invidious "dual role" of the managers was the centre of the criticism in the Anderson Report published in July, 1936—Cmd. 5259—see paragraphs 58, 59 and 61—from which I quote as follows:—

- "The Manager of a Unit Trust . . . attracts buyers of units by offering the service of himself and the Trustee as two confidential agents, the one claiming to be skilled in technique of investment, the other to enjoy general trust; . . ."
- "To anyone who studies Unit Trusts, it is obvious that the Manager does, in addition, conduct an active business as a principal and cannot avoid making either a profit or a loss when he buys securities in anticipation of public demand and sells them later in the form of units on the basis of the price ruling when that demand becomes effective . . ."
- "We are impressed with the practical difficulty that someone must decide what is the correct price of the underlying securities at a particular moment on which the price of units is based—and for this delicate decision the client relies upon his confidential agent the Manager . . ."

As soon as the fixed form of trust gave place to the flexible this was no longer necessary; nevertheless most management companies adhered to it, although Municipal and General (M. & G.) did not—see copy of letter attached (Annex A). Whatever the motives of those managers who persisted in acting as principals, there has recently been a growing awareness of its undesirability and a majority of the managers would welcome relief from this invidious position. The establishment of

company form would ensure that managers adopting it acted only as agents in all transactions in underlying securities and in units: it would be inconceivable for a board of directors of an investment company to form themselves into a syndicate to deal in the underlying securities or to make a practice of buying and selling all shares of the company dealt in whether on their first issue or subsequently. In the U.S.A. Managers of Mutual Funds are prohibited by law and regulations from acting as principals except for long-term investment.

3. Protection for Unitholders

(a) The establishment of a management fund (see paragraph 5 of the First Schedule to the Prevention of Fraud (Investments) Act, 1958) should not be required. This tends to increase the preliminary charge which for the following reasons is the less desirable part of the total disclosed charges (an annual or semi-annual being the other). Since the preliminary charge is not amortized its effect is not fully reflected in the figure for yield. It can bear unfairly heavily on a unitholder forced by unexpected circumstances to realize shortly after investing, and on a unitholder coming in towards the end of the life of a trust which is not extended; this unfairness is of course avoided by a pay-as-you-go semi-annual charge.

A management fund will only be useful to ensure the continuation of a Trust which is not paying its way out of annual charge; since the right of the managers to terminate a trust if uneconomically small is recognized, that would not seem to be necessary.

(b) Whatever the ultimate form of these funds, trust or company, the managers should as far as possible be freed from acting as principals. It follows that they should not be required to buy back units. The protection to unitholders contemplated at the end of paragraph 1 of the above-mentioned First Schedule could be as well provided by requiring managers to procure as agents the appropriate amount from trust property.

(c) Managers should be prohibited from paying commissions to investment agents such as Stockbrokers, Solicitors and Accountants. This practice has led (i) to investors being deceived into thinking that they get agency services free (one group used to advertise their prices as "free of commission"), and (ii) to agents having their advice warped, so that it is not given with only the client's interest in mind. Moreover, this practice forces investors to pay for an agent even when they do not employ one, in which case the managers either retain the commission or put the business through their chosen broker who does practically nothing for the investor.

4. Summary

I would therefore suggest:

- (1) Consideration be given to enabling this investment medium to be organized in company form.
- (2) The fiduciary functions be economized into a minimum of persons, whatever the form.
- (3) Managers, in whatever form, should act only as agents in transactions in underlying securities and in units. (If this suggestion were adopted it would be desirable for units of the trust form to be dealt in on Stock Exchanges in order to give investors a narrow margin between bid and offered prices. This raises no difficulty: M. & G. Units are already dealt in on Stock Exchanges. Alternatively this dealing might be done for account of the trust; this should in practice result in a regular yearly profit for the trust, whatever the theoretical possibility of making a loss: this is borne out by our 29 years' experience through good and bad times. Units of company form would *ex hypothesi* be dealt in for account of the company. It might be as well to have Stock Exchange dealings to supplement the market in both cases, trust and company.)

(4) Abolition of management funds.

(5) Managers, in whatever form, should not be allowed to pay commissions to investment agents in respect of purchases and sales of units. They should, however, continue to be allowed to employ their own agents provided they are disclosed as such, like the "Man from the Pru".

31st May, 1960.

ANNEX A

Extract from "The Times", Monday, January 25th, 1937

MANAGEMENT OF UNIT TRUSTS

Mr. George Booth's Suggestions

TO THE EDITOR OF "THE TIMES"

Sir,—As legislation on unit trusts is pending, your readers may be interested in my views as chairman of Municipal and General Securities Company, Limited, the company which has had the longest experience of management of such trusts in this country.

In general I feel confident that unit trusts can be given a form which will make them a useful part in our national investment structure. To achieve this, however, legislation must in my opinion go beyond the recommendations of the Board of Trade Departmental Committee on the point which, more than any other, clearly exercised the mind of the Committee. In criticizing the dual role of unit trust management companies the report says: "In the fixed trusts and some flexible trusts the management company may derive considerable trading profits from buying the underlying securities at lower prices than those on which the price of the units is based when sold to the public." And again: "The temptation to the management company to select the method most advantageous to itself for fixing prices cannot be disregarded, and it is suggested that the management company, being in a quasi-fiduciary position, should not be subjected to such temptation."

Now the gravamen of this part of the Committee's criticism is that, in so far as the management company can in connexion with the creation of sub-units make a profit at the expense of its clients over and above the published service charge, its interests are in conflict with those of its clients. The Committee would seem to have been of opinion that no solution exists; and I noticed that the deputy chairman of the council of the Unit Trusts Association was reported in your issue of November 18th as saying that no one had ever suggested an alternative to the method criticized by the Board of Trade Committee.

Now, Sir, so far as open fixed trusts are concerned no solution has as yet been found. We learnt in the course of managing our four fixed trusts that this difficulty was inherent. We took all steps possible to protect our clients' interests, but were only finally relieved of what seems to be an insoluble problem when we closed them. We believe that failing the discovery of a satisfactory solution consideration should be given to the advisability of closing fixed trusts.

It is, however, the fact that several of the flexible unit trusts, including all those sponsored by my company since it originated the first of this type of trust in the year 1934, have worked on a principle which completely eliminates the difficulty.

That principle may shortly be stated by saying that the amount paid by the purchaser of a sub-unit, after deduction only of the agreed preliminary charge, is paid directly to

the trustees, and invested in their names for account of the fund. Apart from the agreed preliminary charge, the managers are remunerated solely by an annual charge based on the value of the trust. There is therefore no conflict between the fiduciary responsibilities of the managers and their pecuniary interests. The sole interest of the managers is to retain and increase the business of the trust by demonstrating their capabilities in the investment markets on their clients' behalf.

This procedure of our "municipal and general" flexible trusts entirely answers the criticism made by the Committee, and I venture to hope that the legislation now pending may be framed with a fuller knowledge of the facts and possibilities of the situation.

All that seems necessary, so far as flexible trusts are concerned, is a provision that the net proceeds of sale of new units, after deduction of the agreed preliminary charge, be paid to the trustees and invested for account of the fund.

I am, Sir, yours faithfully,

GEORGE M. BOOTH, Chairman.

Municipal and General Securities Company,
Limited.

9, Cloak Lane, E.C.4, January 22nd.

Supplementary Memorandum by Mr. S. I. Fairbairn

Unit Trust Block Offers

1. *What is misleading about block offers?*

It is of the very nature of Unit Trusts that units are always on tap in practically unlimited amounts at a price based on the replacement value of the underlying securities plus a preliminary charge. Similarly, units can always be encashed at a price based on the realisation value of the underlying securities. Each of these two prices, which we will call the "replacement" or "true" price in the former case and the "realisation" price in the latter, is, of course, liable to vary from day to day with variations in the value of the underlying securities. Almost always the managers (and for some trusts the Stock Exchange as well) will make bid and offered prices for reasonable amounts of units such that at least one and perhaps both of these prices fall inside the spread set by the "replacement" and "realisation" prices. This could be put in concrete advertisement form as follows: "Units are always on offer in any amount at the replacement price of the day. Today's replacement price is A shillings and for reasonable amounts of units the price is X shillings—at which the yield is Y per cent." (When a trust is growing A and X will coincide and the words "and for reasonable amounts of units the price is X shillings" will drop out.)

So-called block offers pervert this natural way of propagating units by advertising a specified large number of units on offer on specified price terms to hold good during a given short period. This creates a sense of a fleeting advantageous opportunity which lures investors into units. It has led to talk about "getting in on the ground floor"; and investors have even been known to stag block offers. The Association of Unit Trust Managers in its evidence refers in this context to a criticism of block offers creating "a false impression" and does nothing to refute this criticism.

In order not to violate the Board of Trade requirement about a maximum price the offer is usually at the specified price or the replacement price of the day, whichever is the lower. In some offers the specified price has been as much as 5 per cent. over

the "true" price (which fact is not disclosed). Readers, of course, think the price specified must have some significance and when they get an allotment they will at first be misled into thinking that they have been well treated to be allotted units much cheaper: they will not have realised that the specified price, like the specified number, is "hocus pocus", to borrow a phrase from Lord Piercy's evidence.

2. *Distinction between unit trust and company issues*

By making analogy with the issue of shares by a company, some people have been disposed to think that the use of a specified number of units and a specified price should be all right in a Unit Trust issue. But the analogy is false.

In the case of a company a known total of shares issued or to be issued and a specified price are the factors essential for calculating what investors are being asked to pay for the disclosed net assets and the disclosed earnings, and therefore expectation of income. The number of shares can also convey additional useful information as, for example, about the probable marketability of the shares. None of this is applicable to a Unit Trust, where (1) a variation in the number of units, upwards or downwards, is accompanied by an exactly corresponding variation in the assets, and marketability is guaranteed irrespective of the number of units by the power to expand or contract the number in issue and the corresponding amount of assets; and where (2) the price is not determined by bargaining between vendor and buyer but by strict reference to the market value of the underlying securities. The "true" price, honestly calculated, tells that whole story. A combination of a specified number of units and a specified price, "true" or otherwise, can tell no more, and if the price is not "true" it tells less.

The "hocus pocus" quality of a specified number was well illustrated by an offer made a little over a year ago: 2,000,000 units were offered and 15,000,000 were allotted.

3. *The defence claimed for block offers*

Not all block offers follow the same pattern; some may be considered less objectionable than others, but all tend to create a false impression. The defence advanced for all block offers is that although they are objectionable managers cannot live without them; therefore they may be permitted because the end in this case justifies the means.

To begin with, it is in fact untrue that managers cannot live without block offers. Some managers have lived all their unit trust lives without them; others have lived most of their lives without them. Furthermore, even those who subscribe to the doctrine that in some cases the end may justify the means would, I think, on close consideration not feel that in this case the end justifies the means.

The means consists of consciously creating a false impression—hocus pocus. The end may be thought of in two ways: (1) to make a profit for the managers and trustee; (2) to make and serve investors. The (unproved) need to use this device to make a profit cannot be thought to justify *hocus pocus*. If (2) could be said to amount to making for responsible investors, it might find favour with many people on the sociological grounds of advancing a responsible society. In fact it probably does the opposite. To make responsible investors out of folk comparatively ignorant of investment is something which calls for patient and persistent education. Every advertisement which does anything to pervert the fundamental facts about an investment makes the task harder for those who are trying to achieve this end.

ANNEX

Minimum disclosure in block offers to prevent investors from being misled

(a) It should be stated in bold type that units are always available at the replacement price of the day, which may be more, or less, than the specified price.

(b) Any particular price of units only has significance by relation to the "true" price which should be stated in the advertisement as prominently as the "specified" price, and the advertisement should also state the names of newspapers in which the true price will be published on every subsequent day while the offer is open, during which time the "true" price may of course vary.

(c) If managers reserve the right to refuse to allot at the specified price in the event of a rise in the "true" price, the relevant facts should be stated in the advertisement. (That, of course, would be just the time when it would be advantageous to applicants to receive an allotment at the specified price.)

(d) If the managers intend to allot as many units as may be applied for, regardless of the "specified" number, this fact should be stated.

(e) Block offer advertisements should state where units are coming from. If the managers on the date of the offer own units, the number of such units and their average cost to the managers should be disclosed.

It would be reasonable to require in addition a statement by the managers similar to that required to be given by directors of a company under Appendix 34 of the Rules and Regulations of the Stock Exchange (see paragraph 49).

None of this information would be embarrassing from considerations of space nor, for a genuine offer, otherwise.

10th February, 1961.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
ELEVENTH DAY

Friday, 13th January, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. L. BROWN, F.I.A.

PROFESSOR L. C. B. GOWER, M.B.E.
(*Questions 3634 to 3972 only*)

MR. W. H. LAWSON, C.B.E., F.C.A.
(*Questions 3634 to 3838 only*)

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D. (*Questions 3634 to 3838 only*)

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON (*Questions
3839 to 4052 only*)

MR. C. H. SCOTT

MR. R. SMITH

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. ALFRED READ, MR. P. L. FLEMING, MR. J. GODFREY, MR. A. E. S. MENZIES
and MR. A. T. PURSE *called and examined*

3634. *Chairman:* Gentlemen, thank you for coming here this morning and for your very interesting memorandum. For the purposes of our record I would like to get down on the note your descriptions correctly. You, Mr. Read, I understand are a member of the Council of the Institute of Directors and you are Chairman of the Institute's Company Law Committee?—*Mr. Read:* That is right, Sir.

3635. You, Mr. Fleming, and Mr. Godfrey, Mr. Menzies and Mr. Purse are all members of the Institute's Company Law Committee?—That is right, Sir.

3636. I understand the Institute was incorporated by Royal Charter as long ago as 1906. I do not know if you would like briefly, Mr. Read, to tell us something of the Institute's work?—1906, yes, Sir, that is right. It was rejuvenated in 1948, and it has since progressed until now we have in excess of 36,000 members. Those directors who are members—you have to be a director of a company to be

a member—consist of directors of public and private companies all over the United Kingdom and we also have branches in Rhodesia, in South Africa, Australia, New Zealand and Gibraltar.

I would further like to explain that we are speaking in the name of the Council of the Institute; the members of the Council are the elected representatives of the 36,000 Fellows, and all of them are chairmen or directors of companies covering a wide cross section of industry and commerce. Our members are engaged in diverse industrial and commercial occupations, and their personal experiences and particular skills are as varied as their companies' activities. We sought the views of all our members in the United Kingdom on matters of direct importance to them, and while careful note was taken of what they said in reply to a questionnaire which we sent them and which was based on that issued by your Committee, the recommendations made by us do not necessarily reflect all the views they have expressed.

The Council, in making its recommendations, is mainly concerned with the smooth, honest and efficient working from the practical point of view of private industry and commerce. I might add here that it is our considered view that the Companies Act, 1948, has in the main worked extremely well, and only in a few respects do we feel that it needs amendment. We have endeavoured to cover these in our memorandum as well as a number of matters where we feel the present law might be improved.

3637. Thank you. We have all read and profited by your memorandum. It is not necessary for us to go through it with you paragraph by paragraph, but we will ask your views on any particular point on which it seems to us you might clarify it further.—Yes, Sir.

3638. I think we might begin with your view as to the *ultra vires* doctrine which is heading 1(b) of the Committee's questionnaire. Your suggestion for dealing with the *ultra vires* rule is in effect in accordance with the recommendations of the Cohen Committee?—Yes, Sir.

3639. You recommend that as regards third parties a company should have the same powers as an individual notwithstanding anything omitted from its memorandum of association, and accordingly as regards third parties the *ultra vires* doctrine should be abolished; then you say in recommendation (iv) under this heading: "notwithstanding the abolition of the *ultra vires* doctrine as regards third parties the directors shall be liable to the company for any loss caused to the company by any act or thing done or suffered by the company not within the objects of the memorandum of association unless the company in general meeting shall have authorised or ratified such act or thing". That is to say the third party would be entitled to assume that the company had all the powers of a natural person and the provisions of the memorandum as to objects would merely be in the nature of provisions regulating the powers exercisable by the directors. That is substantially your view?—*Mr. Purse*: That is correct, Sir.

3640. What would happen if a director was seeking to enter into a transaction with a third party which was not within the objects stated in the memorandum and the company became aware that a director was doing this—would you say that the company should be entitled to move for an injunction against the director before an agreement had been concluded?—I think that would follow, Sir. What we are anxious to avoid is the situation where the third party is regarded as being put on inquiry as to whether this matter is *intra vires* (which under the amendment we propose would become a matter of internal organisation in the company) before concluding the transaction. We regard it as right that his position should be in order unless he has some express knowledge that the director is, in fact, exceeding his authority.

3641. What would you call express knowledge? The memorandum of association as the law stands at present is a public document; everyone has knowledge of its contents theoretically although nobody does in practice.—Under the amendment we propose the memorandum would no longer be a public document in that sense, because so far as the third party was concerned, although the particular transaction was not authorised by the memorandum, he would not know whether in fact the matter had been dealt with internally by appropriate resolution in general meeting, and we regard it as right that he should be entitled to assume that is so unless he has reason to believe to the contrary.

3642. He would not be entitled to go on and conclude a bargain with a director after he knew—if he did ever come to know—that it was beyond the director's power?—I should say not, Sir. We have not directed particular attention to that, but it would seem to follow he would be dealing with an agent whom he knew was not authorised to carry out that transaction.

3643. So that if the company stepped in before there was a concluded agreement and perhaps went to the length of starting proceedings to restrain the agreement being entered into, then the third party would lose his immunity, would he?—I would say so, yes.

3644. I see. Then you say in your recommendation (ii) under this heading that with a view to shortening the objects clause contained in the company's memorandum of association, certain standard subsidiary objects should be set out in a schedule to the Act?—Yes.

3645. You would not want that provision, would you, if your view as to the abolition of the *ultra vires* rule were adopted?—I accept it would not have quite so much importance, but we think it would be a convenience as being a set of objects which would apply as between the director and the shareholders automatically unless they were expressly excluded.

3646. Then what I am leading up to is this. Would not this schedule of subsidiary objects be better placed in the articles of association rather than in the Act or in the memorandum of association?—That may be so, Sir, but just as one has a standard form of articles of association, Table A, it might be a matter of convenience to have a standard form of ancillary objects which can be used in the same way.

3647. One way of doing it would be to put them in Table A?—Yes, Sir.

3648. Then you say in one part of your memorandum that there ought to be the maximum freedom to alter the objects, and in another that the objects should be alterable without restriction. Do you mean by that that the specific cases in which the objects can be altered under section 5 should be done away with?—The object of our recommendation, Sir, was that the present rule whereby you can alter your objects for certain specified purposes should be widened so that one is not restricted to those specified purposes.

3649. Then the company would simply be given power under your revised section 5 to alter its memorandum with respect to its objects quite generally, and not only for the purposes set out in section 5(1)?—That is so, Sir.

Mr. Read: We are not recommending the repeal of section 5(2).

3650. You mean the right of a minority to object?—Yes.

3651. Has it occurred to you to consider the effect on companies incorporated by licence of the Board of Trade without the word "limited" which your recommendations as to the *ultra vires* rule might have?—Mr. Purse: We have not considered that, Sir.

3652. It would need watching, would it not, otherwise a company might unwittingly cease to qualify for the exemption and perhaps incur pains and penalties—so you would agree that would be a point?—Yes, Sir.

3653. Then you recommend that rights attaching to shares and specified in the company's memorandum of association should be alterable in the same manner and to the same extent as if such rights were specified in the company's articles of association. That is your view, is it? You disregard the fact that the rights are attached by memorandum and make them alterable as if they were simply attached by the articles?—Yes, Sir. Our thinking on this is if—as is the case, I think, in certain old companies, but I doubt whether it applies very much in companies formed in recent years—the rights are attached in the memorandum, it is very, very difficult indeed to alter those rights. Indeed it might be said that that was the object of putting them into the memorandum. But we think it is wrong that these rights should be fixed for all time in this manner because circumstances change and it is imposing too rigid a capital structure on any company to be limited in this way.

3654. The point against it is the one that you have taken yourself. That is to say that the rights may have been attached by the memorandum in order to make them as far as possible unalterable. What is the answer to that?—I think the only answer would be the question of public policy.

Mr. Menzies: If you wish certain rights to be unalterable they could be made class rights. You would have a class meeting of those particular shareholders before their rights were altered in any way. On the one hand they could be altered by special resolution if they were included in the articles of association; but if you wish to provide that they cannot be

altered to the detriment of those shareholders, they could be made class rights.

3655. You think that the ordinary method of altering class rights usually followed—the method whereby if a class's rights are affected it has to approve by specified majority at a separate meeting of that class—gives sufficient protection to shareholders in the situation we are discussing?—As a rule articles require a 75 per cent. majority vote at a class meeting.

3656. Of course the form of these memoranda and articles is capable of infinite variety. I remember seeing a form quite often, at any rate of an old company, under which the rights were attached by the memorandum, and the memorandum went on to say that the rights attached to these shares should be alterable in the manner prescribed by the articles of association registered therewith and not otherwise; so that one generally got a power of alteration in that way. I do not at the moment recollect seeing a memorandum with special rights attached which did not have some provision for alteration; although there are such cases I do not believe they are very common.—I believe they exist under old memoranda of association.

3657. Yes. The tendency has been to shorten the capital clause in the memorandum, and simply say the capital is £x divided into y shares of so much each. That is the modern form?—Yes, Sir.

3658. So this legislation would really concern a diminishing number, probably, of shareholders?—Yes.

3659. But still I think we have your submission on that. Then there is heading 5 (a) as to the need for prior approval by the company in general meeting of any fundamental changes in a company's activities. I gather your view about that is that it is really ruled out by practical difficulties, and in particular difficulties in defining "fundamental". And your practical difficulties include cases in which there has been a fundamental change but not overnight, a fundamental change which has been brought about over a long period.—*Mr. Read:* Yes.

3660. Have you any other practical difficulties which you would like to

mention?—*Mr. Purse:* I think we have no other points than those you have just made.

3661. As to the meaning of "fundamental" I agree that there may be marginal cases in which it is difficult to say whether the alteration is fundamental or not, but would it not be possible as a rule in the vast majority of cases to say of a particular alteration either it is or it is not fundamental?—I think what would happen would be that every board of directors would play safe if there was a rule of that kind. I think one would find there would be a tendency to go to the shareholders on every change—to err on the side of caution which would be natural—and therefore the development of business in the way that it ought to develop might be delayed and hampered by the necessity of constantly calling general meetings.

3662. I see. But of course fundamental changes are not likely to happen so very often, are they?—No, Sir, that is true.

3663. You may exchange your rubber plantation for a hotel once, but you are not likely to do it over and over again in the course of a year, are you?—No, Sir. Of course we regard it as we say here as extremely important that no fundamental change should take place without the consent of the shareholders. The point we make concerns the practical effect and the definition of a legal rule to that effect.

3664. You suggest furthermore a strengthened form of directors' annual report under section 157, and you say that matters such as this should be stated at the latest to the shareholders in the next directors' annual report—that is your view?—Yes, unless of course there was a really substantial reason why that should not be done.

3665. Yes, the proviso in your memorandum, is: "unless such disclosure would in the directors' opinion be harmful to the company's interests"—which would give the directors a let-out in some circumstances.—Yes, Sir.

3666. Section 157 postulates a report with a similar saving provision, and has been criticised on the ground that the

inclusion of a saving provision which operates at the discretion of the directors deprives a report on such matters of most of its force.—I know that has been suggested, Sir, but I doubt whether a board of directors would in fact suppress this information unless there were very good reasons for doing so. One has to balance here the relative interests of the business and the desirability of making the fullest disclosure possible—which is not always easy, of course.

3667. And in your view most directors would be anxious to disclose the information unless there were very good reasons to the contrary. The man who wanted to hide something when it ought to be disclosed would be a comparative rarity, is that right?—Yes, Sir.

3668. Then passing to the next heading 5 (b), the exercise of powers of a company by directors in regard to the disposal of the company's undertaking and assets. In that case as I understand your memorandum you think there should be prior approval by the company in general meeting?—Yes, Sir.

3669. Why do you say so in that case and not in the case of a fundamental change in the company's activities?—The practical objections to it do not arise here in our view to the same extent as they do in the latter case. This is something which could be provided for and, incidentally, is provided for in the South African Companies Act, and in the form that we propose it we believe it would be workable and a desirable amendment to make.

3670. And you recommend "that the Companies Act, 1948, be amended so as to provide that, notwithstanding anything contained in a company's articles of association, the directors shall not have power to dispose of the whole or substantially the whole (say 75 per cent.) of the company's undertaking or assets, except to the company's subsidiary or holding company or another subsidiary of the company's holding company, without the consent of the shareholders in general meeting." You think that that would work satisfactorily without giving rise to too much doubt as to the proportion, which indeed you prescribe, where it is less

than the whole?—We give 75 per cent. as an example to show that we think it should be quantified in some way so as to import that element of certainty into the circumstances in which approval must be obtained.

3671. Supposing a company's sole asset consisted of a very large property, and it was its practice periodically to sell properties it owned and invest in others. You would have to rule out a transaction of that sort from your requirement for prior consent even though it embraced practically the whole of the company's assets?—We have not considered that, but it would seem right to make an exception in such cases.

Mr. Fleming: I wonder, Sir, whether that would follow? It could be said that the undertaking of a company of that sort was the business of buying and selling these assets. It is not as if the shareholders assumed they were going to hold the assets for ever: there is a slight distinction. The undertaking or assets of a company of the sort you mentioned would be the business of buying and selling such assets, so that really to qualify for our proposed requirement it would mean they were going to give up the whole of their goodwill and connections.

3672. One always speaks of a company's undertaking, but when I have sat down and tried to define it in words I have always found it very difficult. Still, that is your suggestion which you put forward as providing a workable formula, with of course any modification which might seem necessary on further investigation.—Yes.

3673. Then the next one is heading 5 (c) concerning the issue of shares by directors, and you express the view that any new issue of shares should be offered in the first instance to the members *pro rata*. That is the general proposition. Would you confine it to additional shares created by resolution for increase of capital, or would you include shares forming part of the original authorised capital with which the company was incorporated?—I think we had both in mind, Sir.

3674. I would have thought that was what you wished, but I would like to raise

this point. Would it not be very difficult to find in the very early history of some companies the moment at which one could begin offering the shares, to be issued for cash, to the members?—*Mr. Menzies*: I think, Sir, if you have a very few members when you commence the company and you have only part of your share capital issued and you wanted to issue some share capital elsewhere, you would go to those original shareholders or the shareholders at the time and seek their approval in general meeting.

3675. I was thinking, you see, that in all cases you start off with seven or more individuals.—Yes.

3676. It cannot be intended that large blocks of share capital would be unloaded on those individuals, can it? Should not one fix some point, the statutory meeting or some other point in time, from which such a provision should begin to operate?—I think there the position would be that the seven original subscribers would pass a resolution giving the directors authority to issue further share capital to others; they would give express authority to the directors to issue in a specified period a further amount of the company's authorised share capital.

3677. Then you would intend your *pro rata* rule to apply to all issues of shares for cash beginning with, I suppose, any shares representing a surplus to the shares required for issue on the original formation of the company?—Yes.

3678. And then any shares subsequently created would also be subject to the *pro rata* rule?—If they exceeded 20 per cent. of the capital.

3679. Then you would have, I suppose, assuming for the sake of argument that the majority of directors are rascals, to put something in to prevent the issue of shares in dribbles so that they never reached the 20 per cent. as regards any one transaction?—The directors have to issue shares in the best interests of the company, and if they were issuing them to themselves—and I am not suggesting that they would—merely to gain control I would have thought that was perhaps not in the interests of the company.

3680. I was not suggesting that they would issue them to themselves; I was

suggesting they might issue shares amounting to 10 per cent. or 15 per cent. on one day and then issue a further amount another day so that neither parcel of shares reached the required minimum for bringing into operation the *pro rata* rule.—I think that could be avoided, Sir, by placing a time limit on it.

3681. You might extend your rule expressly to cover a series of transactions, the total of which would cause the 20 per cent. to be exceeded—something of that sort?—Yes.

3682. Then there is this difficulty that has been raised on this question of *pro rata* issue to members: that it is common practice when an increase of capital is authorised for power to be given to the directors to deal with the shares as they think fit. There is almost invariably such a power in respect of the initial capital. What would you say about that? Supposing there has been a meeting at which the shareholders have agreed that the unissued shares of the company or some of them shall be at the disposal of the directors, would you regard that as ousting the *pro rata* rule once and for all, or would you give the shareholders a further opportunity of considering the matter in general meeting?—I think the shareholders are the owners of the business and if they trust their hoard and grant that authority to the board they do so with their eyes open.

3683. Having done it they cannot afterwards complain?—We feel that is the position, or should be the position.

3684. One must reach a point where even a shareholder is bound by his own actions?—I think so. There is a present tendency on increases of authorised share capital which would normally be at the disposal of the directors, for them to indicate to their shareholders that they will not issue that capital so as to affect the control of the company without prior reference to the shareholders.

3685. Yes, I see. I think you have really answered this, but is it definitely your view that this *pro rata* rule as we have been calling it should be imposed by the Act, or do you put it as a proper rule which the directors should follow

and which ought to be included in any well drawn set of articles?—*Mr. Fleming*: What we were concerned with was to see that that sort of procedure, which we consider to be the proper procedure, was generally carried out, whether it was compulsorily put in articles or in the Companies Act does not seem to me to make much difference.

3686. Except of course that you can alter your articles and you cannot alter the Act?—*Mr. Menzies*: The purpose perhaps would be defeated if it was made optional for inclusion in the articles because the present position would still obtain, and it would be omitted from articles of association.

3687. You can alter your articles, of course.—And, therefore, we feel it should have statutory effect.

Mr. Read: You can only alter your articles in general meeting, of course.

3688. I think some effect might be achieved, perhaps a cumulative effect, by including provisions of this sort in Table A. If you did that and had provisions in the Act to the effect that these particular provisions were to be included in the registered articles, and remain in the articles unless the company by special resolution otherwise provided, you might possibly reach a kind of half-way house.—*Mr. Menzies*: It would have moral persuasion, but there are very few public quoted companies—in fact none perhaps—which merely adopt Table A as their articles of association.

3689. There are not, I entirely agree, but you would have to include articles about these matters—perhaps fundamental changes in activities, disposal of the undertaking and assets and *pro rata* issue of shares for cash—in Table A in the case of a company registered with Table A, and you would qualify its power of altering its articles by saying it could not alter these particular articles except by special resolution, and that this special resolution could not be proposed for some time—say in the case of a public company before the date of the statutory meeting or something of that sort. Where

a company did not adopt Table A or adopted it with modifications, one could have a similar provision in the Act that any articles should include these particular articles, and the company would have a similar power of repealing those articles by special resolution, but again a date would have to be fixed.—*Mr. Read*: And that would be in the Act?

3690. That would be in the Act. It sounds a little complicated, but it did occur to me that some method of that sort might be adopted, so that existing companies' articles should be deemed to contain these provisions unless and until they excluded them by special resolution; which they could do at their next annual general meeting.—If I may say so, I think that would be a very good solution.

3691. It looks as if it might have possibilities; I would not put it any higher than that. The next point is section 195, which is the register of the directors' share dealings. As to that it has been suggested that a summary of each director's dealings during a given year should be included with and form part of the directors' annual report to the shareholders. The effect of that would be that each shareholder would have sent to him a summary of the directors' purchases and sales of shares and the financial result to them one way or another. That has been suggested; I just want to know whether you think it is a reasonable suggestion or not.—

Mr. Purse: We have proposed that the register of directors' shareholdings should be open to shareholders at all times and we would have thought that that would meet the point behind the suggestion you have just put to us. Turning to your suggestion, although we in our Committee have not considered it, it would seem in line with our own proposals. It is a different way of giving publicity to something which we see no particular objection to.

3692. Of course it would be one more bit of paper for the secretary to see about, to get printed and published.—*Mr. Fleming*: We have not devoted our attention to this particular point and you can only get an impromptu personal

reaction in the circumstances. I think it is impracticable, and rather allied to these presumption of guilt clauses which the Institute of Directors has been fighting in a great many cases—the implication is that directors are fooling about with the shares unless they can prove the contrary.

3693. You think if the register is kept open all the year round like the register of members, that should give enquiring shareholders all the information they can reasonably expect?—Certainly.

3694. Yes, I see. Then I think the next one—again I think it is something that you have not dealt with—concerns section 185 which is the provision as to the age limit of directors. I would just like your general view—and if you do not like to answer it off-hand say so—whether the provisions about that in the Act are effective, and whether you think they could be improved.—*Mr. Read*: We have not really considered that point, Sir.

3695. Perhaps it is not fair to ask you about it.—Some companies contract out, but quite a number of companies follow the provisions.

3696. I think the suggestion is that by following a rather complicated drill regularly year by year, this question of retirement over the age limit is simply got over with no particular advantage to anyone.—Not in any company of which I am a director—that is not so.

3697. Very well, then we had better pass from that, I think. Then you deal with voteless shares which is heading 7 of the Committee's questionnaire, and your view is that such shares should not be prohibited by law, but should be clearly designated as such—that is to say designated as shares which do not carry any votes, and you further suggest that the holders of such shares should be entitled to speak at general meetings, and broadly that the rights attaching to such shares should not be alterable in any circumstances without the consent of the majority of the holders. Those I think are, put very shortly, your suggestions. What would you say to this further

suggestion which has been made by some witnesses? It is that holders of voteless shares should be given by statute voting rights in certain circumstances, for example, winding up, change of objects, failure to pay dividends over a period: that is to say they would be given *mutatis mutandis* the rights of voting often given to preference shareholders who are not generally eligible to vote. Do you think that would be reasonable?—I am doubtful whether voteless ordinary shareholders should be given a right to vote on failure to pay a dividend.

3698. I agree that the analogy of failure to pay dividend for three years or whatever it may be in the case of a preference share hardly applies to a voteless ordinary share. I suppose it might be said because they are not entitled to dividend at any fixed rate, the inclusion of that might require reconsideration. But it is a general idea to the effect that it might not really give the voting shareholders any cause of complaint if the voteless ones were given votes in strictly limited cases. Whether that is feasible or not I do not know, but the suggestion has been made and I would value your view on it. If you think it is a bad suggestion tell us so. We do not hold any brief for it.—*Mr. Purse*: It is difficult to conceive of circumstances when this would be of value, because the cases in which a shareholder exercises his vote are in any case limited to some extent—e.g., on a special resolution, a resolution for winding up and a resolution on the election of a director, etc. To give voteless shares votes in the circumstances you outline would seem very near to giving them general voting rights apart from certain special cases. That is the difficulty as I see it.

3699. It would come too close to enfranchisement, which of course would depart from the bargain made by the voting shareholders that they alone should be entitled to vote?—That would seem so.

3700. Then there is heading 8, protection of minorities. Many witnesses have made the same suggestion as you have that the test of winding up under the just and equitable rule should be dropped from

section 210. What would be your view of this further suggestion that there might be included in the section, by way of illustration only, instances of conduct to be regarded as oppressive, such as the taking of excessive remuneration and failing to distribute a reasonable part of the profits of the company by way of dividend?—*Mr. Menzies*: We think, Sir, that if you leave it in general terms for a decision of the Court as to whether or not there is oppression it would be more satisfactory. It is not easy to define excessive remuneration because it must depend on the circumstances of each case, and one would then have to attach definitions to the examples which were given. Whereas a wide discretion of the Court, we feel, to apply in varying circumstances would be more satisfactory.

3701. Would it be satisfactory, because it does impose a very heavy burden on the Court? So often these statutory provisions come down to saying that the Court has to do whatever is reasonable and so forth; the thing is put to them with no further guidance than that. I entirely agree that this is a section which should be kept as general as possible, but it has been suggested that these specific instances might give the Court a line without restricting its general power. I gather you are not much impressed by this suggestion?—We would prefer, Sir, to leave it in wide terms, not in any way restricting the powers of the Court.

3702. You are content with the section, are you, the just and equitable condition being omitted?—Yes, Sir, we are.

3703. Passing to another aspect of section 210, we have been told that one of the main difficulties facing a minority shareholder who thinks he is being oppressed is that he cannot obtain the information needed to make out a *prima facie* case for inspection or for a petition under section 210. I take it that there would be serious objections to allowing a minority any automatic right of access to the books of the company in order to make out a case against the directors or fellow shareholders? I take it you would agree that that would be a very serious step?—*Mr. Read*: Very serious.

3704. Then what would you say to a suggested enlargement of the provisions as regards Board of Trade inspections to enable the Board of Trade to make a private investigation?—I think we do suggest that, do we not? We do make a suggestion as regards the Board of Trade exercising greater powers, but it is in a different connection. But I do not see why it should not be applied to this section.

3705. I think the trouble is at the moment as the law now stands the Board of Trade is unable, or feels itself unable, to proceed to appoint an inspector who could examine books unless a *prima facie* case has been made out. I think that is the view they take of the matter, and the complaint against that is that it means that the inspection machinery works so slowly and is so cumbersome to get into action, so to speak, that really something more expeditious is required.—*Mr. Menzies*: The Board of Trade already have powers under section 165 and we did discuss this together as a committee, and our feeling was that the Board of Trade should exercise those powers more freely, and that if they do not have the staff or facilities to do so, then steps should be taken to assist them—perhaps by greater employment of outside professional people to make an investigation.

Mr. Read: I might tell you, Sir, that one of the members of our committee is a former head of the particular department of the Board of Trade which deals with companies. He has been a very useful member of our committee—naturally he did not feel he could come here today—but we have been very largely guided by his great experience, particularly in regard to the 1948 Act.

3706. I think the objections to the Board of Trade inspection procedure are twofold. In the first place they work too slowly, and in the second place inspections involve a certain amount of publicity, and it cannot do a company any good that it should become known that it is being inspected, so that one wants to get speed and absence of publicity.—If that company is behaving oppressively, Sir, there is no reason why there should not be publicity.

3707. Yes, but the company is saying it is not being oppressive, while the

minority shareholders are asserting that it is.—The Board of Trade could decide that.

3708. But not until they have heard both sides, you see, that is British justice; that is the difficulty. It may be rather unfair to take you out of what you have actually dealt with in your memorandum, but one does not often get the opportunity of conferring with an institute representing so many directors, and it is a valuable opportunity which I feel should not be wasted.—I quite appreciate that, Sir.

3709. Then we have had another suggestion that it might be possible to provide that any application to the Court under section 210, in its early stages at all events, should be heard *in camera*, and the complaining party should then be allowed to produce his evidence which would be by affidavit I take it, and then provide—unless indeed the rules provide for it already—that if in the opinion of the Court the applicant had made out a case for investigation—that would not necessarily amount to a *prima facie* case against the company—then the Court could make an order for investigation of the books.—*Mr. Menzies*: The Board of Trade would not be a party to that?

3710. The Board of Trade would not be a party to that. It is not necessary under section 210 that it should be.—It would merely be proceedings between the company or its directors and the oppressed minority?

3711. Yes.—And it would perhaps be a fishing action.

3712. The Judge would have to make up his mind whether it was a genuine case calling for investigation or whether it was a fishing expedition. I do not think the complainant could expect to succeed every time, but I should have thought he might succeed under procedure of that sort although at the moment he could not make out what amounted strictly to a *prima facie* case. That is just a suggestion, there may be nothing in it.—It does seem a satisfactory one, Sir. But there is the problem that shareholders might then invoke section 210 against directors and the company too frequently.

3713. Yes, if it is too easy they will all be wanting to.—Yes, and a disgruntled shareholder might exercise considerable influence at annual general meetings if he threatened the board to commence proceedings under section 210; we feel a director should not be subjected to threatening influences of that nature in dealing with the business of the company.

Chairman: The costs would to some extent act as a deterrent, unless indeed you could get legal aid for proceedings like this—I do not know. Then the next point I have is the question of multiplicity of directorships held by the same person. That is heading 13. We have had some quite convincing answers about that, how in the modern business world it is very often necessary and desirable that a man should be a director of many concerns, but arising out of that there is the point that a director may often find himself in two camps. For instance, supposing he is a director of a company which owns properties and he is also a director of a company which wants to rent those properties. The question may arise what is a proper rent, and what I would like to know is whether the Institute of Directors ever gets requests for advice in circumstances of that sort. For example, the director who found himself in two camps might ask you whether you thought the rent should be fixed by an independent valuer and whether your Chairman or President would be kind enough to appoint one to decide the question. This type of point, I think, particularly interests Mrs. Naylor, so I will ask her to put any questions she has about this kind of situation.

3714. *Mrs. Naylor*: My interest really falls into two parts, Mr. Read. One is to what extent the Institute acts as an adviser in the same way as perhaps the President of the Institute of Chartered Accountants is prepared to advise accountants who have difficulties or problems to solve.—*Mr. Read*: We would if asked.

3715. Do you think it would happen frequently?—*Mr. Menzies*: I understand from the Secretary that problems like this do arise, not so much referring

matters to the Institute as arbitrators. But members seek advice very often on their colleagues' or other directors' remuneration—directors on the boards of several companies in a group—and they do seek the views of the Institute on many occasions as to what the Institute consider to be fair—what view the Institute would take on a particular matter. The Institute has a fund of experience in similar cases and is able to help members in that way. But they do not actually act as arbitrators, which I think was the point you were mentioning.

3716. No, I was enquiring rather whether professional advice on problems would be forthcoming. Do you regard yourselves as a professional, or quasi-professional, body?—*Mr. Fleming*: We certainly regard it as our duty to give advice if asked for it.

Mr. Menzies: There is considerable correspondence, I understand, between the Institute and its members on their problems, and I believe the Institute does help the members to a substantial extent. If necessary they are referred to a professional firm, such as accountants or solicitors.

3717. I am also interested in practical examples of problems that must arise. For example, where there is a management company of which the directors are the same as those of the operating company with which it has a management contract, do you think that that is invariably a satisfactory arrangement? Do you think that in such cases the shareholders should not perhaps be more fully informed of the nature of the remuneration of the management company? One gets examples, I think, in three main fields—shipping companies, plantation companies and also in the theatre world.—*Mr. Read*: I have come across it in the case of shipping companies, but I have had no experience of the theatrical world.

3718. Do you think the law should be changed? That is really the burden of my question.—*Mr. Menzies*: In regard to disclosure in the accounts?

3719. Yes, in the annual report or accounts?—*Mr. Godfrey*: Although I have been in practice as an accountant

for a long time I have not come across these things—my work is in other directions—but I would think there is probably a case for greater disclosure.

3720. *Mr. Lawson*: Could disclosure be in the register of directors' shareholdings, something of that sort, rather than in the annual accounts? You could possibly give more detail in that.—*Mr. Read*: You get in the register of shareholdings particulars of the shares a director holds in the operating company and of sales of those shares. If he happens to be a member of the management company, too, presumably those should be included. His remuneration is disclosed in the aggregate.

3721. The director would have to disclose his interest to the board, would he not? I wonder whether it would be practical for the minutes of those board meetings, or some summary of them to be recorded in the register of directors' holdings, which is available to shareholders? Would that meet the situation better than putting too much in the annual accounts?—I do not think you want to clutter the annual accounts too much.

3722. *Mrs. Naylor*: Under the Investment Company Act in the United States I believe that such information as the fees paid, and presumably other forms of remuneration, by an operating company to any concern which gives advice or other services has to be disclosed in the accounts of the operating company. That particularly relates to investment trusts. Do you think that a similar obligation might apply to ordinary industrial companies in this country?—*Mr. Purse*: I am just wondering how far it is not already covered by the obligation to disclose directors' remuneration in relation to the management of the company from whatever source that remuneration may come?

3723. But if it comes through shareholdings in a management company with which the operating company has a management contract, would there not be difficulties?—*Mr. Menzies*: You are asking for personal views? I would have thought any dividends a director received were his own private affair.

3724. Even though the dividends had been earned as a result of a management contract with a company of which he was a director?—We assume that the director would be acting properly in being a shareholder of the management company.

3725. If we assumed that we need not have a Companies Act at all.—What in effect you are saying is that you suspect that directors could without disclosure obtain remuneration in the guise of a dividend which, in fact, they ought to receive as remuneration which would be disclosed within the accounts of the operating company?

3726. Not precisely that. It is rather that a director who is negotiating a contract with a management company in which he has a considerable interest has a dual capacity and responsibility. The first question is whether it is easy for him to discharge that dual responsibility, and the second question is should he not report to the shareholders the way in which he has discharged it?—*Mr. Read*: I think the implication of what we say in our memorandum about multiplicity of directorships is that the director concerned should be fully aware of his legal duties to all the companies of which he is a director.

3727. Yes.—*Mr. Fleming*: I think, Madam, that this business of wearing two hats or even three is in fact much less difficult than might be imagined. It is difficult to argue the thing out logically, but that is the case. I have no personal experience of this management business, but if you are going to insist that the directors shall disclose what their directorships bring them in not only in the shape of direct remuneration but in indirect profits from some other association, I do not see where you are going to end. It is clear that the management company and the investment company are only two hats, but there are a multiplicity of hats in a great many cases. It is extremely difficult to see where to draw the line.

3728. To narrow it down, could we say details of management contracts should be reported to the shareholders?—That seems not an unreasonable suggestion as long as it stops there.

3729. *Mrs. Naylor*: It is in management companies that my interest particularly lies.

Mr. Mackinnon: You might get at that by providing in the Act that directors have to disclose their remuneration from all sources; that should stop the possibility of directors proceeding to disguise their remuneration by setting up a management company for that purpose.

Mrs. Naylor: That is very helpful.

Mr. Mackinnon: And I think you would probably agree with that in principle?—Yes.

3730. *Mr. Lawson*: Is there not another separate point? A director must, of course, disclose to his board any transaction between that company and another company in which he is interested.—*Mr. Read*: If the contract comes before the board and is material.

3731. *Mr. Lawson*: I was wondering whether *Mrs. Naylor* was not getting at that separate point—not merely the question of remuneration of a director, but whether the shareholders should not know about such interests.

Mrs. Naylor: At present as far as such a contract is concerned it has to be reported to the board but not to the shareholders.—*Mr. Menzies*: If he is a director, his other directorships would appear on the return at Bush House.

3732. If you know the name of the management company.—No, the name of the director.

Professor Gower: The shareholder will possibly not know anything about this at all.

3733. *Mr. Watson*: Also there is the possibility that the management firm concerned is a partnership in which the director of the operating company is a partner.—Is it proper for a director to be a partner in a firm and also to be a director of a company with which that partnership enters into a contract? And it follows from that, can a director wear six or twelve hats? I understand in practice it does work satisfactorily.

Mr. Read: It may be for the benefit of the company. It is his job, his duty, to influence contracts if he can to the company of which he is a director.

3734. It is sufficient that, when his firm is being contracted with, his own personal interest in that firm having been disclosed, he takes no part in the negotiations?—It may be that he might take part if he is authorised by the board to do so. They would be fully aware of his interest in the other concern. A company in which I am interested had an engineering works in South Wales which made its own contracts as regards purchases with various other companies, and we did not think that it was necessary that a director of the parent company should go down to South Wales to find out details of such contracts made by the engineering works. So that a director of the parent company might have no knowledge whatever of contracts made by the engineering works with other companies in which the director also had an interest. But if the contracts came before the board of the parent company then he declares his interest.

Mr. Menzies: The normal high standard of conduct expected by a board from its executive directors and officers should guide them in dealing with the company's contracts in which they have a material interest.

3735. *Mrs. Naylor:* That is a statement of belief and expectation. But our problem is to make it enforceable.—*Mr. Purse:* I think in the majority of cases those high standards prevail.

3736. *Mrs. Naylor:* Certainly, I quite agree. Do you not think in a minority it might be there is a conflict of interest—which might be met by disclosing the interest to the shareholders in the operating company?

Professor Gower: The South African and the Indian Acts contain provisions whereby declarations of interest made to the board of directors can become available to the shareholders. Would you regard that as a reasonable safeguard? At the moment there is provision merely for disclosure to the board.—*Mr. Read:* No, I do not think so. I think it is sufficient if directors disclose their interest

to their colleagues on the board. The board is responsible for the direction and management. They have to see that their officials and executives are honest people, and I do not think that if you started disclosing contracts to the shareholders it would always be to the advantage of the company concerned.

3737. I do not think that in South Africa and India they go as far as requiring disclosure of the details of the contracts—merely disclosure of declarations of interest.—How are you going to do that? In the directors' report?

3738. I am trying to remember the details. I think in the Indian Act they maintain a special register of declarations of interest. In the South African Act it has to be reported—I think I am right in saying—at each annual general meeting, but I am speaking from memory.—*Mr. Fleming:* Is it not available for inspection at each annual general meeting in South Africa?

Professor Gower: It may be that—I think that is what it is.

3739. *Mrs. Naylor:* One last point. I think you will more clearly understand the nature of my problem if you visualise not one director reporting an interest to his colleagues but the majority of the board of the operating company also being the majority and controlling shareholders in the management company, so that reporting to the board does not really mean a great deal.—*Mr. Read:* Are there many instances of that?

3740. I imagine it is common, is it not, in plantation and shipping companies?—In shipping companies I think it may be fairly common. I have no knowledge of plantation companies. Shipping companies may have a management company, and I think under the Indian Act, for example, the problem of management companies is a very difficult one.

3741. *Mr. Scott:* Is your view that disclosure by a director of an interest would apply to all directors, in the case put by *Mrs. Naylor*? Supposing there was a partnership or a firm in which four of the directors of the company were all interested, would that apply to all four of

them? Is it your view that the provisions of article 84 of Table A really cover the situation under which you may remember directors are required to disclose their interest to the other directors and not to vote on any transaction in which they are interested in that way?—It depends how many directors there are, whether there is an independent quorum.

3742. It would of course depend upon there being an independent quorum, but the correct answer would be then that if there were not enough directors remaining independent then the transaction would have to be ratified by the shareholders?—That might be so, but I think there is very often an article included in modern articles of association which deals with that very point.

3743. Article 84 of Table A is a fairly standard form, I think, and I do not think it is usually made more or less stringent in public company articles today. It seems that it covers the ground in considerable detail, and I should have thought if it was applied impartially to all companies it would probably meet most of Mrs. Naylor's point.—It is already there?

3744. Yes. Applying its provisions for instance to the management company which controls the operations of the shipping company, when that contract was first entered into it would have had to be ratified by an independent quorum of the board or the shareholders. Admittedly the contract probably runs for a long time and new shareholders come along and perhaps are not aware of it.—I have read with great interest the reports of the proceedings of this Committee and I understand you have had before you the General Council of British Shipping; did you put this point to them?

3745. *Chairman*: They came before us in order to deal very largely with the question of secret reserves, and if I remember rightly I think their evidence was in fact confined almost entirely to that point. The point you are seeking to make is this, is it not, that we ought not in anything we say here today, in the absence of a particular class of companies, to—as it were—pass any strictures on their methods?—Yes, Sir.

3746. I would entirely concur with that.—I think shipping companies are honestly run like the majority of companies in this country.

Mr. Menzies: I think it would be a solution if the director had to disclose his interest in the manner required by article 84 and if he was unable to vote there would have to be an independent quorum on his board and, failing that, the matter would have to be put to the shareholders.

Mr. Mackinnon: Except that in fact practically every public company has already got article 84, and as I understand it Mrs. Naylor is questioning whether the result in some of those companies is satisfactory.

3747. *Professor Gower*: One reason may be the proviso in article 84 (4).—Perhaps also paragraph 2 (d) should be amended to alter the provision in regard to shares so that if he were a shareholder he would be precluded from voting.

3748. Yes. It is a fact that the net effect of 84 (2) (d) and 84 (4) means that in fact directors can vote on these things and be counted in the quorum, not withstanding their interest, is that not right?—Yes.

Mr. Read: Unless you have some provision like that how are you going to carry on business?

3749. *Mr. Mackinnon*: That is the real difficulty in this case, it is a question of degree. You have to have 84 (2) (d) really to make the business workable; if you knocked it out altogether you would practically stop all business of a public company, where the directors' interests are scattered over a wide area. Take for instance a bank or something like that.—I have seen a document prepared in respect of a director of one group of companies in which there is a close-printed list of companies which runs to about six or ten pages, and the director simply says: "I am interested in these companies".

3750. *Professor Gower*: Would it be reasonable do you think if this were amended so as to provide that an interest merely as a holder of say less than 1 per cent. of the shares or debentures of a public company should not be regarded as a material interest?—The word "material" is used in a number of places

in the present Act, but it does not appear in section 199, and since a director may make a disclosure once a year some of the names on his list may be outdated within a month.

3751. Surely another weakness of section 199 is that it presupposes that all contracts will come before the board of directors, and in fact they do not?—They do not. I instanced earlier that point in the case of the engineering works. If that engineering works has a separate board those contracts would come before that board, but not before the parent's board.

3752. *Chairman*: Passing on from that, Mr. Read, you mentioned a gentleman who produced a list of companies covering whole sheets of paper; that reminds me of the question of the holding company and subsidiary. A point which has been debated a good deal in our meetings is whether a holding company should be required to disclose in its accounts or accompanying documents the names and main activities of its subsidiary and associated companies. What would be your view on such a requirement as that?—I should be against it, Sir; for instance, a company that trades largely abroad may very often have two subsidiary companies, and both put in a quotation for a certain contract, and the other party concerned would say: "We will not give it to that one this year, we will give it to this other one". But if he knows they are both under the same hat he might give it to somebody else altogether. I think it would be wrong to be forced to disclose that certain companies were subsidiary or associated.

3753. Would your view be the same if say the auditors of the company were given power to agree to the omission of insignificant companies, that is to say companies not large enough or far enough advanced to affect the position of the holding company to any material extent? That would be one saving, and another giving the Board of Trade a general dispensing power in cases in which they were satisfied that the disclosure would be against the interests of the company? Those would be considerable qualifications of the provision. Do you think it

would still be objectionable?—I think possibly it might, Sir.

3754. You would prefer to drop any idea of that kind?—I would. Actually I think most companies in their chairman's statement do say something about their subsidiary companies and their operations during the year, to give the shareholders as full information as possible, but there is this danger in setting out the names of all subsidiary or associated companies, in connection with trading abroad particularly.

3755. I see. Then one should just mention the question of take-over bids which, of course, has loomed very large. When your memorandum was issued I do not think the new regulations made by the Board of Trade had come into force?—*Mr. Fleming*: I wonder whether, Sir, before you put any specific question, we could tell you what it was we had in mind in our whole approach to this question? The way we looked at it was this, that the vast bulk of business amalgamations are between small private businesses, where there is a director/shareholder relationship which is purely personal, and we have been to a great deal of trouble to suggest nothing which would have any impact on them whatever. The next category we had in mind is where two like-minded boards of directors are agreed that they would work better together rather than separately. From our observation in cases of that sort, the shareholder has been treated with all the consideration due to an owner, and the facts have been put fairly and squarely in front of him. In fact, our suggestions are really only a codification of the best practice that is generally adopted in those cases. But what was worrying us was the third category of amalgamations, the category to which the name of take-over bids is peculiarly applicable. We are thinking of the cases where a bid is resented or obstructed or a bid which elicits counter bids, or the bid which is accompanied by a sort of veiled threat that the directors will be made to look foolish if they do not play, or a secret promise that they will be better off if they do, or—a rather important case—a bid which is couched in the form of an

ultimatum with a time limit which does not give the directors time to consider it properly. In that third category we felt that the directors of the company which is the subject of the bid are forced into an impossible situation, and the directors of the bidding company might find themselves in a situation which they would prefer to avoid. The Companies Act deals mainly with the legal duties of directors to their shareholders, but they have also got duties to their employees, commercial duties to their customers, and natural duties to themselves. Therefore, you can get a position in which the directors have got to take a decision on all those duties, knowing the decision will be irrevocable, to take it in a context with which they are probably quite unfamiliar, and without time for thought, opportunity of consultation or even access to advice. We feel in cases we know about in this category that that is intolerably onerous on directors, and must, therefore, end up by being bad for the shareholders and everyone else who depend on the directors to protect their interest. Consequently we framed our suggestions simply to ensure that the procedure to be adopted in all cases is more or less the procedure that is already adopted among the more respectable and responsible members of the business community, with the main object of trying to reduce the whole temperature and tempo of the operation so as to give directors a chance to think. I thought I ought just to say that that was what we had in mind.

3756. Yes. I was not proposing to go into it in detail. The question I intended to put was whether you regard the new regulations issued by the Board of Trade as broadly speaking acceptable as a code to govern these take-over bids?—We had gone a good long way in our thinking before those regulations came out, and we feel that they are quite unexceptionable for the purpose for which they are intended, which is to regulate the relationship between licensed dealers and the public. We do not think ours appreciably differ except that ours are drafted with a different object in view.

Mr. Menzies: Our feeling was that they should apply not only to licensed

dealers but also to exempt dealers and to any person who makes a take-over bid.

3757. Yes. I was only referring to the content of the regulations. I assumed that so far as they are adopted suitable legislative arrangements would be made to ensure that they applied all round.—Yes. In broad terms we approve the contents of the Board of Trade regulations. There were one or two points of detail with which we did not agree but they are not important enough to trouble the Committee with.

3758. Then the next matter I have to raise is section 54 of the Act, the section which was designed to prohibit financing by a company of purchases of its own shares. I do not know if any of you have any views about that section, which I think has been criticised by a good many people. If you are not prepared to deal with that we can pass from it.—*Mr. Read:* No, Sir, we have no comments on that.

3759. Then there is just one more small point, as to section 201; I think you are in favour of abolishing it altogether?—Yes.

3760. You do say in your recommendations that section 201 of the Companies Act should be repealed, though "if it is thought that there is some value in retaining its provision in respect of private companies, that it be limited in its application to those companies". But apart from private companies you really regard section 201 as an obsolete provision which was designed to meet wartime difficulties in the 1914 war?—Yes, that is so, Sir.

3761. But as regards the smaller companies, which are mainly private companies, you do acknowledge I think that there might be some value in it?—*Mr. Menzies:* Yes, Sir. When a partnership has formed itself into a private company to gain the advantages of incorporation and limited liability, to a great extent the personalities, the partners or directors concerned, are more important to the members of the public dealing with them perhaps than particulars of the company's capital. Therefore, in private companies where a more personal relationship is involved in dealings with the

public we thought it could quite usefully be retained.

3762. It is more likely that the identity of your correspondent might be difficult to discover in the case of a small private company than it would in the case of a large corporation?—Yes.

3763. But on the whole you would be in favour of abolition of the section?—That was our feeling, yes.

Chairman: I think Mr. Lawson has some accountancy questions which he would like to ask, and I will leave those to him.

3764. *Mr. Lawson:* Your memorandum does raise some very important accountancy points, and they are rather technical and rather difficult, so that you may find my questions a little lengthy. You say that companies should not be required by law to revalue their fixed assets in their accounts, but there is nothing to prevent a board from incorporating revalued figures in the accounts should they consider this the proper course to adopt in the circumstances. You say it is possible to imagine cases where, after providing for taxation computed by reference to a depreciation allowance based on original costs—and that, of course, is the case as regards taxation—and after charging depreciation calculated by reference to current value, nothing would remain for shareholders. When assets are written up and the irrevocable step is taken of capitalising the resulting surplus, it becomes necessary, does it not, to provide depreciation on current values, and this you would say might have serious consequences for the company. That is the starting point, is it not?—*Mr. Godfrey:* That is so.

3765. Presumably it is for this reason amongst others that the Institute of Chartered Accountants in their evidence recommend that a surplus arising on the revaluation of fixed assets should not be available for distribution either in cash or in shares. You on the other hand suggest that the surplus should not be available for distribution in cash but should be available for a bonus issue of shares. In view of the adverse con-

sequences which could follow for ordinary shareholders, and possibly for preference shareholders, can it really be said that in every single case directors should be allowed to use an unrealised surplus of this kind for an issue of bonus shares?—Sir, Mr. Lawson has raised a number of questions in one. As a start I must make it clear that I am not authorised by the Institute of Chartered Accountants to say what they had in mind in their memorandum. There was one small point in what Mr. Lawson said. He used the expression "distribution in cash or shares"—the memorandum by the Institute of Chartered Accountants referred to "distribution in cash or specie", and there is a difference there. I would think that specie does not mean shares of the company. However, the reason why one normally says that the surplus on revaluation of fixed assets is not distributable is because there is a well-known rule that one would regard it as a capital surplus, and that capital surpluses are only distributable if they are realised and if certain other conditions are satisfied. This is a case where the surplus is not realised, and therefore I think it rules out distribution in cash or specie. Specie, as I say, I take not to include shares of the company. You make the point—the point is made in our memorandum, and you refer to it—that a company could get into serious difficulties if it capitalised its surplus. I can see no reason for the law prohibiting it from taking action like that. There are many other things which directors can do which could be very foolish, and directors presumably before they embark on any action have regard to all the circumstances, and take advice as necessary. I do not think there is any case for the law preventing them from doing something which may be foolish. I do not believe you can distinguish between justifiable and unjustifiable cases. Nor should a company be prohibited from revaluing its assets in its books if it wants to—but neither should it be forced to. That is a matter which should be left entirely to the discretion of the directors to do what they think proper. If they think the proper course is to indicate current valuation by way of a note, then I think they should be able to do that.

3766. Have you any views as to the type of valuation which should be permitted? We have had suggestions which cover a tremendous range of possible methods of valuation, including even the amounts for which the assets are insured. Should there not be some limit on the methods which should be permitted or some indication of them?—I would think it was almost impossible to be specific, because one does know from practice that if you go to several professional valuers, you may get several different valuations.

Mr. Lawson: That is also a point that is made against writing up assets in the books, that it is difficult to get one figure.

3767. *Mr. Mackinnon:* It is true there is a distinction between distributing unrealised capital appreciation in cash and using it to pay out shares in a sense, because in the one view the company parts with something in the first case and it parts with nothing in the second. But of course the theory of the Companies Act is that in exchange for paid-up shares the company gets as it were from an outsider either cash or an equivalent consideration other than cash, and that surely must be basic to the conception of using the revaluation. I therefore found a little difficulty myself in seeing why you draw such a distinction between the two cases. Supposing you do use the surplus to issue paid-up capital, you could in fact follow that in a matter of months by a reduction of capital, and by this indirect method you would in fact be redistributing the surplus that you had found on revaluation.—I suppose that is theoretically possible, but of course you would still have to find the money to distribute.

3768. I suppose your evidence is based upon the assumption that an unrealised capital appreciation could not legally be distributed in cash? You were making that legal assumption?—Yes.

3769. *Mr. Lawson:* Turning to a different subject, you are on common ground with many witnesses in recommending that the position arising out of the case of *Henry Head & Co. v. Ropner Holdings Ltd.* should be clarified. You state that where assets are acquired in exchange for shares the board of the acquiring company should make a *bona fide* estimate of the

value of the assets acquired, and if they form the view that there is a surplus value compared with the nominal value of the shares issued, that surplus should be placed to the credit of a share premium account. When you talk about the value of the assets acquired, do you include goodwill, or are you thinking purely in terms of the tangible assets?—If goodwill is an asset of a company, in my view it should be included for this purpose.

3770. There are of course quite a number of companies who incline to want to include only the value of the tangible assets. You think they are really wrong?—I think as a starting point they must be wrong.

3771. Am I right in thinking then that you wish to make no distinction between the acquisition of an asset for shares and an acquisition for cash? In both cases the asset should be included in the balance sheet of the purchasing company at its full value; that is your general proposition?—For this particular purpose, yes, I would agree. There are distinctions between purchasing for shares or for cash in other connections, but not for this purpose.

3772. You then refer to the extremely difficult question of the use that may be made by a holding company of pre-acquisition profits of subsidiaries. As I understand it your point is that when a new holding company is set up to acquire the shares of two or more other companies, the effect of the present provisions of the Companies Act is that all pre-acquisition reserves of both companies are frozen, so that the new company has no buffer to assist it if trading difficulties are experienced in the early days of the merger. That is a case we all come across very frequently. Thus shareholders of the new enterprise might be deprived of dividends which they could have received out of accumulated balances if the two companies had continued to operate independently. Is it your view that there is a genuine demand for some kind of relief in respect of these cases?—It is my belief that there is a demand for it, and that directors would welcome it.

3773. To take that point a stage further: have you had in your experience

of amalgamations any cases where after the merger hardship has actually been suffered by reason of the fact that pre-acquisition profits of both companies concerned were frozen and could not be used for payment of dividends by the holding company?—I must admit in my experience I have not known it arise, but I do know of one case which arose not very long ago where the directors were really concerned at the possibility of this situation arising.

3774. We have heard that from other witnesses, and it is certainly my own personal experience too, that people are apprehensive at the time of a merger that they will get into this difficulty, but in fact under trading conditions as they have been recently the actual case is comparatively rare?—That is so. The case I referred to concerned insurance companies, and the transactions took place early in the year. As the Committee will know, insurance results are very uncertain, and the directors were certainly very worried about the possibility of adverse results.

3775. Following that up, presumably it would be convenient for any company formed to take over an existing unincorporated business to have a buffer to enable it to pay dividends in its early years and if trading proved to be unsatisfactory. In your view is it possible to draw a clear distinction between that kind of case and the larger amalgamations of existing public companies, which are of course what you have in mind in your evidence?—I would have thought that there was quite a clear distinction. I would not have thought there was any call for such relief in the case of a company which had taken over an unincorporated business, which I suppose would be in the form of a partnership or a sole trader, and where the shareholders in the new company would be exactly the same as the owners of the business beforehand. I would have thought there was no call there for relief, because had the old business continued as a partnership or a sole trader, running at a loss, the shareholders would be in no worse position than the shareholders of a company which starts off with no profit.

3776. I suppose one could carry the cases a stage further and consider where the unincorporated business was formed into a limited company for the purpose of issuing shares to the public; it would be convenient, would it not, particularly as regards the issue of preference shares, if they had some kind of buffer in that case?—I must agree that it would be a convenience in a case like that.

3777. The case nowadays arises, not very frequently of course, where the small trader forms himself into a public company?—Yes, I would have thought it was comparatively rare. Generally they become incorporated and then carry on for a number of years as a private company.

3778. I think in theory it may be difficult to make the distinction between that case and the merger of existing public companies?—Yes.

3779. A somewhat similar situation may arise—this is a much more common case—when existing companies buy the entire share capital of another company. The consequences may not be so severe as in the earlier case that I put to you, because only the reserves of the acquired company are frozen. The acquiring company may therefore still have some buffer, but it will be a proportionately smaller buffer in relation to the number of shares outstanding after the merger. Would you wish to see reserves of the acquired company freed to some extent in this kind of case?—I do not think the fact that the buffer, as you have termed it, is reduced by reason of having some additional shares issued is in itself a reason for seeking relief. There may be other reasons, but I am a little doubtful about that particular reason.

3780. But do you think that if the law were amended so as to free some of these pre-acquisition reserves, that should be confined only to the case of a holding company buying other companies or should it be extended to mergers of existing companies?—I find it difficult to distinguish between the two.

3781. I thought that would probably be your answer. Turning now to the form of relief, you suggest first that it

should be beyond doubt that the payment by a subsidiary to its holding company of a dividend out of pre-acquisition profits is not illegal. That is of course the generally accepted opinion, is it not?—I entirely agree, but I did hear it suggested on one occasion that there was something wrong with that proposition. But I would say the majority of business men take the view that there is nothing wrong with it, and in most cases think nothing of it.

3782. Then you say where upon a reconstruction or amalgamation shareholders remain substantially the same, revenue reserves should remain as such notwithstanding the reconstruction or amalgamation. Would you be good enough to clarify this suggestion in the following respects: what do you mean by an amalgamation as distinct from an acquisition? Do you mean only the case referred to in your evidence where a new holding company is being formed to acquire two or more existing companies? What is the position if the holding company at a later date acquires one or more additional subsidiary companies? Would you not also regard that as an amalgamation? I think you have answered that latter point already: you would so regard it, would you not?—I think one has to. I agree when you start it is awfully difficult to think of proper definitions of these things.

3783. Have you in mind that there should be any relationship in the size of the two amalgamating companies? If a company with a capital of £1 million acquires the entire share capital of a company with £1,000, is that an amalgamation?—I cannot see any difference in principle in that. As a practical matter of course it is generally quite unimportant.

3784. It is not always so, because the acquiring company may have relatively small revenue reserves, and you may have a much smaller company which has a big reserve, but your answer is that there should be no distinction based on the relative size of the companies?—I do not believe there should be.

3785. Have you in mind that, in order to obtain the relief you propose, the holding company should acquire or offer to acquire the whole of the shares of the

other company or companies concerned, or would some lower percentage be sufficient, 90 per cent., 75 per cent. or 51 per cent., for example?—I find it very difficult to make any distinction so long as the subsidiary/holding company relationship is established, and I think in the case of less than complete amalgamation one would have to give relief on a *pro rata* basis.

3786. Of course the Gedge Committee on no par value shares, although admitting that they were going outside their terms of reference, did recommend that something should be done in this type of case; they limited it to amalgamations which came under section 55 of the Finance Act, 1927, as amended, which I think relates to acquisitions of 90 per cent. or more; I do not know whether you knew that?—I had forgotten it, I must admit.

3787. It appears from your evidence that you are thinking only of the case where there is an exchange of shares and the shareholders remain virtually the same after the reconstruction or amalgamation as before it. Why do you draw a distinction between an amalgamation effected wholly by an exchange of shares and one which is effected wholly or partly by a payment in cash?—I think if I can deal first with the question of wholly shares or wholly cash; there is an essential difference there. If the company purchases shares in another one for cash some part of its substance goes right outside, it is lost for ever to the company, whereas if it buys for shares nothing goes outside and the assets of the two companies are preserved. I think there is a distinction there which is quite clear. There is more difficulty when the consideration is partly for shares and partly for cash, as of course is frequently the case, and I think there one would have to say that one could only obtain relief—if the Committee does decide that something should be done—in a case where the part which was represented by cash was relatively small, so that it was mainly a share consideration.

3788. You would fix some arbitrary percentage?—One would have to fix some arbitrary percentage.

3789. There is the case where the consideration is wholly for cash, but the

acquiring company might raise the cash by a new issue of capital to its own shareholders. You would still draw the line and say issues for cash are one thing and issues for shares are another?—That is the way of our present thinking.

3790. Turning to the mechanics of the operation, you give the following example in your evidence: "In the simple case where company A pays, say, £200,000 for the whole of the shares in company B (share capital £100,000 and revenue reserves £100,000, together represented by net current assets of £200,000) the total purchase consideration of £200,000 paid by company A is clearly represented by the £200,000 net current assets in company B. If then company B declares a dividend of £100,000 out of its revenue reserves and pays that amount to company A, the net assets of company B become diminished to £100,000 and it would seem to be desirable for company A to apply the dividend in writing down the value of the shares acquired". Your wording is that it is desirable for company A to do that, but it really would be absolutely essential, would it not, because otherwise the shareholding in company B would be over-valued?—I would entirely agree, Mr. Lawson; my wording was unfortunately chosen there.

3791. I just wanted to get that point quite clear. Am I not right in thinking that in practice there is only one practical source, other than the dividend from company B itself, from which such writing down could be made, namely, the share premium account of the company, and that is at present not allowed; that is to say, if you want to use pre-acquisition profits of a subsidiary company the only way you can do it is first of all to write down the book value of your investment in that company in your parent company's books, and there is only one source from which that can be done and that is the share premium account? Is that right?—I have been doing a certain amount of arithmetic on this thing, and that is the conclusion I have come to, that however you set about it that is really where you finish up.

3792. It is where I ended up, I was rather surprised to end there, I do not

know whether you were. But I am glad we both came to the same conclusion. In other words, the accountancy aspect of the problem appears to be this: assets acquired should be stated in the balance sheet at the full value and any surplus value as compared with the nominal value of shares issued should be placed to a share premium account?—I agree.

3793. Then the suggestion which you are making with regard to pre-acquisition profits can be carried through only if an exception is made to that rule, in that either in this type of case no share premium account is created despite the general rule, and the asset acquired is thus valued below its cost, or alternatively that the share premium account is created but is allowed to be used for writing down the value of the shares in the subsidiary company to the extent that pre-acquisition profits are received as dividend by the holding company.—I must say that my thinking has led me to that kind of result and of the alternatives which you pose I prefer the second one. I do not like starting off by doing something which basically seems wrong.

3794. I think the second one would be right, because you do not need to do the writing down until you take the step of bringing the dividends in.—Exactly.

3795. Then an important part of the problem we have to consider is the extent to which the present requirement, that the share premium account should be treated as share capital, might be relaxed in order to facilitate the use of pre-acquisition profits on mergers and amalgamations.—I think that is right.

3796. I suppose the minimum alteration required would be to allow the share premium account to be used to write down the book value of shares in subsidiary companies?—That would appear to meet the need which we have been talking about. There are of course other things which one might do. It is not apparently clear whether you can write off against share premium account stamp duty on an increase of capital.

3797. Would you allow share premium account to be used to write down any goodwill?—I think there might be a case for that too.

3798. It does mean of course if you do that that you lose sight of these items in looking at a balance sheet as an account of stewardship, the directors have had money, they have spent it on goodwill, it is lost without trace if you allow this to be written off, is it not? In the United States and Canada—you would know more about this than I do—I think they go further still and at any rate in the case of no par value shares some part of the paid-in capital may be distributed as dividends, is that not so?—I must admit I have no experience of that.

3799. I believe it is so.—I have no doubt you are right.

3800. You would not want to see that?—No, I would not.

3801. If some way could be found out of these difficulties would you think it reasonable that the shareholders of both the companies concerned in the merger should approve the arrangement by a special resolution or something of that kind?—I would entirely agree, because quite obviously if anything on these lines is found to be practicable the Committee will be concerned with safeguards, and I would have thought this was a safeguard in that it gave publicity to those directly concerned as to what was going on.

Chairman: Has anyone got any further questions on the accountancy aspect? Then if nobody has got any questions on that are there any other questions directed to other points which have been raised in the course of discussion?

3802. *Mr. Brown:* I am interested in your written evidence on non-voting shares, and I would like to ask whether the reference to the practice of issuing these being objectionable represents the views of the Institute of Directors? Are they in favour of non-voting shares or do they think they are objectionable?—*Mr. Read:* We could say, Sir, that we do not like them but we do not see how, unless you go to the full extent of the Indian Companies Act and say there shall only be ordinary or preference shares, you can prevent them.

3803. But to the extent that it was possible to make this practice more difficult or limit the practice, you would

think that would be a good thing?—I do not know about more difficult. I do not think the Institutional investors generally like them, and that in itself tends to limit the issue of such shares; but we do instance a case where there was no alternative, in order to re-finance.

3804. I was going to refer to that case, but I personally do not see that there was no alternative. I would have thought advisers could have found alternatives, but it is not worth discussing that now. But on the whole you do think the practice is objectionable?—I would not go so far as saying it was objectionable. Personally I do not like them.

Mr. Purse: I agree with Mr. Read.

Mr. Fleming: We have no collective view as to whether we like them or not. Mr. Read says he does not like them. I have a slight distaste for them, but at the same time it is difficult for me to push that too far, because I buy them in great quantities, very often from the insurance companies who do not want them, so how can one give a collective view on this?

3805. I was merely asking you to amplify the first paragraph of your memorandum on this subject. You refer to the Institute's views and objections, and you say that so far as the holders of voteless shares are barred from voting at general meetings it is a valid point of view that they are objectionable in that that conflicts with the feeling which is generally held that the members who run the most risk should have the power of ultimate control over the affairs of their company. I was asking whether I am right in interpreting that to mean that on the whole the Institute thinks voteless shares are objectionable?—*Mr. Read:* I would not go so far as to say they are objectionable.

Mr. Fleming: But may we have this quoted right? We do not say we regard them as objectionable, we say: "In the intervening years opinion has been growing that equity shares which do not carry full voting rights at all general meetings are objectionable".

3806. But you do go on to say: "To the extent that non-voting shareholders are barred from voting at general meetings

of their company, this, the Institute submits, is a valid point of view". Presumably that means you agree with it?—*Mr. Read*: Yes, to that extent.

3807. That of course is the extent that matters. Could I ask a question which has not been mentioned before, and that is on the exemption of private companies. I understand the Institute have as members many directors of private companies and exempt private companies?—It certainly does, a very great number, but we have not considered that. We are quite prepared if you want us to do so to submit a supplementary memorandum on exempt private companies.

3808. The evidence we have already had presented to us in many cases is to the effect that exempt private companies having the privilege of limited liability should be required to file accounts. You would not wish to express any views on that?—I would not want to express any opinion on that.

3809. *Professor Gower*: How would the Institute react to the suggestion that directors' remuneration in whatever form should require confirmation by the company in general meeting?—I do not think personally that that should be required: it is already disclosed in the accounts.

3810. The global figure is disclosed.—Yes, and I think that the global figure is all that should be required.

3811. It is slightly anomalous, is it not, that at the moment you may get a company in general meeting solemnly resolving that the directors' fees should be £500 per annum each, and then the directors themselves go away and vote themselves long-term agreements of £5,000 per annum each?—*Mr. Menzies*: How can a company employ directors, and executive directors, if you cannot tell them what you are going to pay them? If you want a new managing director and you advertise for one and say: "I hope to give you so much remuneration. I must call an extraordinary general meeting of my 10,000 shareholders before I engage you and obtain their approval of your terms of service". Personally I do not think in practice it would be workable.

Mr. Read: Neither do I.

3812. It is the law in Western Australia, and even more strongly it is the law in India.—*Mr. Menzies*: Does every director then have a basic irreducible remuneration, and is it the extra remuneration which is voted by the shareholders at the general meeting? They do in Australia have a minimum basic wage which applies to secretaries and probably to lawyers as well.

3813. You do not like it, in other words?—No.

Mr. Read: In these days of high taxation it is sometimes very difficult to get the man you want unless you do pay him very highly.

3814. *Mr. Scott*: In your memorandum I understand you recommend that the *ultra vires* doctrine should not apply to third parties at all, is that right?—*Mr. Purse*: That is so.

3815. So that would mean a third party even if he expressly knew that a particular transaction in which he was engaged, whether it was the purchase or sale of an asset, was for an object that was not authorised so far as the internal regulations of the company were concerned, he could nevertheless go ahead with it and be fully protected?—That is not our view—we think that a third party with express notice should not be protected.

3816. Express notice opens the whole question again, does it not? I hoped you were going to say that the answer was yes, he could go ahead even with express notice, but once you accept that a third party is bound by notice do you not get straight away back to the position as it is today?—I think not, because at present he must depend upon the terms of the memorandum of association. He is bound by knowledge of those, whereas under our proposals the transaction might have been authorised by a resolution in general meeting.

3817. I think you did say that the memorandum of association would not be a public document as at present, but if the company in question has a large number of shareholders, 10,000 or so, the

third party might be a shareholder himself; there must be some means by which that document would be in fact a public document, it could not be concealed, and I think in many cases the third party would almost inevitably have notice of the memorandum, indeed, he might consider it prudent to ask for it, and I think in that case you get back straight away to the position we are in today?—*Mr. Menzies*: Our views are that we want to get away from the present position and protect members of the public. We want to get away from that so that anyone can deal with a company and he will not find that he is an unpaid creditor because the transaction was *ultra vires*.

3818. I think a lot of the evidence we have had supports that view, and I was trying to analyse your suggestions for meeting it so far as the third party was concerned, because I think if you do enshrine in a memorandum of association certain objects and possibly powers by which the directors are bound so far as their shareholders are concerned, you do open the door to the question of notice of that document being given to the third party.—Exactly.

3819. You do not see any difficulty then in your attempt to protect third parties dealing with a company if you still preserve the principle that he is affected by notice, whether it is express or implied might be difficult to decide?—*Mr. Purse*: I must admit that our recommendations do not deal expressly with the question of notice.

3820. I thought they did really, because in your recommendation (iii) under heading 1 (b) you say: "That as regards third parties a company shall have the same powers as an individual notwithstanding anything omitted from its memorandum of association, and accordingly as regards third parties the *ultra vires* doctrine be abolished".—Yes, but if the third party is aware or has noticed that the transaction has not been approved by the shareholders, he should not be protected.

3821. In that case you would not be abolishing the *ultra vires* doctrine.—Yes, the company should be able to exercise the same powers as an individual, and the third party should not suffer, although a transaction might be *ultra*

vires or outside the express memorandum of association. But we felt there must be some deterrent on directors otherwise they would disregard memoranda of association entirely and do entirely what they wanted.

3822. Could you not envisage a situation where third parties could deal with the directors entirely without reference to any document at all, and it was only the shareholders who could restrain the directors and call them to account for any transaction which they had done outside the terms of their authority?—That is what our recommendation (iv) is designed to do really.

3823. But I thought it was weakened a little by your saying a third party would be affected by notice.—*Mr. Menzies*: I agree with Mr. Scott, you cannot have it both ways.

3824. *Professor Gower*: Is there not perhaps a confusion? Under the present law a third party is affected with notice of the limitations imposed by the memorandum on the company's powers. That would disappear, I understand. On the other hand you might still get a situation in which an officer of a company was acting outside his authority, and surely if the third party actually knew that then he should be affected?—*Mr. Purse*: That really puts the question as it presented itself to me, if I may say so.

3825. *Mr. Mackinnon*: But if anybody can stop a director dealing with a third party on the grounds that the transaction is outside the powers delegated by the company to the director in the memorandum, the third party will be driven to enquire into the memorandum. If we are seeking to abolish the *ultra vires* rule we shall only bring it back by the back door unless we also provide that a third party is not affected by any restrictions on the director in the memorandum.—Yes.

3826. On the question of the issue of shares being at the disposal of the directors—and the suggestion is that they should not be free to issue more than 20 per cent. of the issued equity capital, except *pro rata* to existing shareholders, without the prior consent of the shareholders—do you apply that only to the

issue of equity shares for cash or would you apply it for example to issues of shares on the acquisition of a business, on the take-over of another company?—Yes, both.

3827. So they could not make an offer of the company's shares to acquire the shares of another company without getting the consent of the shareholders?—*Mr. Menzies*: If the issue exceeds 20 per cent.

3828. But up to 20 per cent. you would allow it?—*Mr. Fleming*: We suggest the figure of 20 per cent. as a reasonable dividing line.

3829. In your recommendations about take-over bids, you suggest: "No offer may be made in relation to a take-over bid in respect of any class of securities unless it is made to all holders of securities of that class". If a company had, say, 47 per cent. of the share capital of another company, the remaining 53 per cent. being held outside, your proposal would prevent that company saying to one shareholder: "We will buy your 3½ per cent. interest", is that right? It could not increase its holding beyond 50 per cent. without offering to all.—We limit our proposal to offers made in relation to a take-over bid.

3830. Yes, but the case I have put to you would be a take-over bid because you have defined a take-over bid as one which would result in the acquiring company having more than 51 per cent. of the votes. If the company owns let us say 47 per cent., it is in your definition a take-over bid if it makes an offer which results in it having 51 per cent.—No, we suggest here that the definition should be so drawn as not to cover market dealings or acquisitions, and it seems to me if I want to buy 3 or 4 per cent. which you hold I can just come and ask for them.

3831. So the company could always make small purchases in the market or privately and thereby increase its holding to 51 per cent.?—Yes.

3832. But your memorandum says: "No offer may be made in relation to a take-over bid in respect of any class of securities unless it is made to all holders of securities of that class". It would be

an offer, would it not, if they got in touch with their friends?—What we are trying to do is to prevent people only circularising certain of the shareholders. We thought if anyone wants to make an offer for the shares of the company, every shareholder ought to have an equal chance of disposing of his shares to the offeror.

3833. I understand the principle. I was thinking it could easily happen in practice that a company gradually increased its holding to 51 per cent.—*Mr. Menzies*: There is no objection to that, provided it does not issue circulars to only a few of the shareholders. I would not have thought we would want to prevent two private individuals or companies getting together and buying and selling shares between themselves in the same way as one buys a property or anything else. It is the circular to a small section of the shareholders, and not to all the shareholders, with a view to acquiring their shares which this was designed to cover.

3834. *Mrs. Naylor*: How many letters do you have to write in order for it to become a circular? Would it be a take-over bid if they wrote to six people?—If it was with a view to obtaining control and they did not know those people, I would have thought it was, but I express my personal view.

Mr. Fleming: I think so. I think writing to people you do not know out of the blue would have to be considered a circular.

3835. *Mr. Scott*: I think you can recognise a circular when you see it, but there could be borderline cases, could there not?—Yes.

3836. *Professor Gower*: Suppose the bid was confined to shares owned by the directors for which the bidder paid a handsome premium?—*Mr. Menzies*: If you buy shares direct from your friends without going through the market, it should not be an offence, in the same way that you can buy the shares on the market and give yourself control in that way. We admit that it is a difficult definition.

3837. *Mr. Smith*: Concerning charitable and political contributions, the Institute wants companies to retain their own

discretion to make such donations in the interests of their company's business, but would you see any objection to disclosure of these contributions in the annual accounts to shareholders?—*Mr. Read:* Companies must make payments and do things for the benefit of their business, and among those things there may be the making of payments to particular bodies which may be charitable, political or anything else. So long as it is for the company's benefit, directly or indirectly, directors should have freedom to make those payments. So far as disclosure is concerned, we think it is wrong in principle. If disclosure of such contributions, why not of expenditure on advertising? And then so far as political purposes are concerned—and I think you may be particularly concerned with that aspect, Mr. Smith—there is the difficulty of defining what is a political purpose. It is well known that we, as an Institute, are in favour of private enterprise, which we think is vital to this country's interests. If a company wants to fight any particular aspect of that matter we think it is

entitled to use the necessary funds to do so. I think every director has regard to the fact that he is dealing with shareholder's money when he makes a charitable or any other contribution. But if you have disclosure in the aggregate, companies would perhaps be under pressure to identify payments on request from shareholders. That is our view.

3838. *Chairman:* Well, gentlemen, that concludes the questions we have to ask you.—I would like to add one thing, Sir—that on foreign companies there is a very good section, section 348, in the New South Wales Companies Bill, which covers our written evidence on this point. May I leave a copy of that section with you?

Chairman: If you would, that would be most helpful. Then, gentlemen, it only remains for me to express once more the thanks of the Committee to you all for coming and giving us so much time this morning and also for your very helpful memorandum. Thank you very much.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

MR. E. G. HARDMAN, MR. W. F. TALBOT, MR. G. N. GABELL and MR. J. F. PHILLIPS
called and examined

3839. *Chairman:* Good afternoon, gentlemen. As an introduction may I mention the following particulars? You, Mr. Hardman, are a past-president of the Chartered Institute of Secretaries and member of the Law and Parliamentary Committee. Mr. Talbot is a member of the Council of the Institute and Chairman of its Law and Parliamentary Committee. Mr. Gabell is a member of the Council of the Institute and of its Law and Parliamentary Committee and Mr. Phillips is the Secretary of the Institute?—*Mr. Hardman:* That is correct.

3840. We have had your careful and very full memorandum for which we are greatly obliged. It deals, among other things, with a great many matters of comparative detail and we do not propose to trouble you by going through all those,

but we shall confine our questions to the more important matters on which it seems to us you might be able to help us further.

The first point concerns your suggestion that in the case of both public and private companies the minimum number of members should be three. Some witnesses have gone in the other direction and suggested in the case of a wholly owned subsidiary company that it should not be necessary to have more than one member. What would be your views on that?—*Mr. Talbot:* We feel basically that a corporation aggregate should consist of at least three persons. We feel that difficulties might arise in connection with companies with only one member as regards the quorum. We feel that some matters could be abused if one person had the right to act entirely on his own without

consultation with anyone else. The basic principle is that a company is a corporation aggregate.

3841. That, if I may say so, is the conventional view.—Yes.

3842. But, of course, practical considerations are urged on the other side and it is said that in the case of a wholly owned subsidiary there is almost by definition only one member and it is all very artificial and unnecessary to go through the formality of producing a second member.—*Mr. Hardman*: As you know, the majority of companies are private companies and on formation where you have only two members you may well have differences of opinion arising and therefore three in the case of a private company is quite important from that point of view. I do agree, of course, in the case of a wholly owned subsidiary perhaps other matters might apply, but broadly speaking I think we must keep this in mind that the majority of our companies are private and three is the better number when holding meetings and carrying through the statutory obligations of the company.

3843. Might not a minimum number of three be inconvenient in the quite common case of the husband and wife partnership or the two brothers' partnership converted into a private company?—In my experience where that applies sometimes you get disagreement and very often it is almost impossible to have a meeting, whereas if you have three there is a chance of getting two together at a meeting, and of reaching a decision.

3844. You can get two together at a meeting and if there are three you can get a result on voting instead of deadlock?—Exactly, Sir.

3845. That is certainly a possibility that should be looked into. The minimum of seven which is the time-honoured minimum prescribed for a public company since 1862 and before seems to be based on a conception that this is the minimum number of people who could reasonably prefer incorporation rather than carrying on business themselves as partners?—Yes.

3846. That seems to have been the underlying idea but you say that it is

unnecessary to have more than three whether the company is public or private?—Yes.

3847. I see. Then you recommend that the power at present given to a minority to apply to the Courts for cancellation of an alteration of objects should be removed. Have you any knowledge of the extent to which that power has been used since 1948?—*Mr. Talbot*: In my experience it has not been used. The difficulty underlying this is the fact that we are obliged to file special resolutions within 15 days and yet 21 days must elapse before the resolution can be effective to give time for the minority to make its voice heard. Personally I have had no experience of minorities exercising their right under that section.

3848. Why do you want to abolish it even though it is dormant?—Really from the practical point of view. You will appreciate that a lot of our points are based on irritations that arise from practice, the application of the law as distinct from the law itself. Here is one of the cases, where we have to file special resolutions within 15 days and we cannot give effect to them for 21 days. If anybody did object that sets that resolution aside and it does not have effect. We feel it is a rather cumbersome procedure.

3849. Supposing the times were altered to make the thing more practical would you see anything wrong with it in principle?—I can see nothing wrong personally. I think it would partly meet our case.

Mr. Hardman: I think that alteration as respects the timing of filing of both documents, both the special resolution plus the printed memorandum might meet the case. If that were done I would have no objection. On the other hand we must remember that the resolution is passed as a special resolution therefore it is passed by a 75 per cent. majority.

3850. The theory underlying the power, I suppose is, that a shareholder ought to be entitled to object to an alteration in the objects of the company which may make it an entirely different concern from the enterprise in which he invested his money. It is put that his rights are then

being interfered with in a way in which the wishes of the majority of the company and the special resolution passed by the company as a whole should not be effective without the agreement of the Court. —Is it true to say that one could alter the main object of the company? Fresh resolutions as a rule simply extend the objects. But we are concerned with the practical difficulties of the present arrangement.

3851. It is a question of the times at which the various steps are to be taken, and these are too short to make the thing effective, that is really what it comes to. Then passing to another matter, you said in paragraph 11 of your evidence that in the light of experience in North America since 1953 you wished to withdraw your earlier recommendation to the Gedge Committee that the issue of no par value preference shares should be permitted. Could you elaborate that?—*Mr. Talbot*: Yes, we understand from our friends in North America that difficulties have arisen when the shares come up for redemption or repayment in establishing exactly the price at which the preference shares are to be redeemed. Is it the price at which they were issued? I do not think I can go any further than that.

3852. The essence of a preference share is that it is preferential as regards some amount.—Yes, what is that amount? Unless the matter is clearly covered in the terms of issue there may be difficulty, and even so other considerations which were not thought of at the time of issue of the preference shares may arise which affect their relationship to the equity; they may bear unfairly on the equity.

3853. One might also say, might one not, the no par value equity share meets the attack on the conventional share of nominal value, that the public or shareholders may be misled when they get a dividend expressed as a percentage of the nominal value.—Yes, certainly.

3854. So far as preference shares are concerned they never were exposed to that attack because you had a fixed sum and fixed rate of dividend or interest on them?—Yes.

3855. So one of the great reasons alleged for adopting the no par value plan does not apply to preference shares?—It does not apply to preference shares and difficulties have arisen on redemption.

3856. *Professor Gower*: I do not see how they can arise on redemption since presumably the terms on which they are to be redeemed must be stated. Have you in mind the difficulties which arise when a company exercises its power to buy its own shares?—That is a consideration in America. We have in mind the position when the company, in so far as it can do under North American law, gets rid of its preference shares by paying them off, even though the company is still a going concern. It is in those circumstances that these difficulties have arisen, as to what price they should be redeemed or paid off.

3857. *Mr. Watson*: Is it not the thing in practice in the United States of America for preference shares to have a declared redemption value?—A lot of them have, but there are apparently some that do not.

3858. And in those circumstances is it not a supposition that they are repayable at some parity, say \$50 or \$100?—I am sorry, Sir, I really cannot answer that question. I can only tell you the difficulties that have actually arisen and been reported to us.

3859. I should have thought before shares were issued among the published details of their rights and privileges would be their ultimate redemption value?—No.

3860. You have found that is not so?—One can visualise, for example, that the price of the share on the market might be very much higher than the redemption price.

Mrs. Naylor: But that happens with par value shares too, does it not?

3861. *Mr. Watson*: The value in the market would depend, would it not, on the value of the preference dividend and whether it was redeemable by the company at a certain time; if it were non-redeemable and interest rates fell the shares would rise in value?—Yes.

3862. And that presents a difficulty, does it?—So we understand, yes.

3863. The same situation exists in this country, does it not? When interest rates have been low, 8 per cent. preference shares, which could not be paid off except on liquidation of the company, have stood at very high value?—Yes.

Mr. Phillips: We have not had a great deal of evidence on this issue ourselves. Our view is based, one must confess, on hearsay to some extent from our correspondents in North America. The Institute, I think, was mostly impressed by the view that the advantages of no par value shares—the desirability of authorising by legislation the issue of no par value shares—were much more important in the public interest in the case of the equity than in the case of preference shares. Accordingly we were not really concerned to pursue further the idea of extending the scope of the principle of no par value to preference shares. It was from that negative point of view rather than anything else that we were concerned to withdraw our original suggestion.

3864. *Chairman:* I follow. We pass to a different matter. The Committee has received a very considerable volume of evidence in favour of abolishing the present special privileges accorded to the exempt private company. We gather from your memorandum, I think under paragraph 15, that you are not suggesting such an abolition?—*Mr. Talbot:* That is correct, Sir. There was a diversity of views on this question but the majority view was that no drastic change should be recommended.

Mr. Hardman: It is the case, is it not, that these companies are very private concerns, and we have seen evidence, at least suggestions, coming forward that perhaps accounts should be filed in future. Is that strictly fair when they are purely private companies; why should information be divulged to competitors? I think myself that the division of companies at the moment is quite good. Where you have any other connection whatever in the company, where shares are not beneficially held by the registered owner, then it ceases to be exempt. I think there is a strong case to be made out for the retention of this particular type of company.

3865. Speaking from recollection I believe almost 80 per cent. of private companies are exempt private companies and one is also told—I have not got any detailed information about it—that this category of exempt private company does include some very large concerns indeed. —That is so. But nevertheless, surely there is the principle that where you have a purely family company and every share beneficially held by the registered holders without any interference at all from outside, the privilege should be granted to that company to retain its privacy.

3866. The Cohen Committee, in order to direct these privileges to the people who in their view should have them, did bring in, in what is the seventh schedule to the Act, some extraordinarily complicated requirements.—Yes; the basic requirements were that there should be no interference with the board and that the complete beneficial ownership should be in the people who were members of the company. I think the retention of this form of company is quite important for the business of this country, and from my experience of formation of private companies stretching now over many years, people jealously guard their interests and do not want any other information divulged to competitors, particularly in given areas.

3867. On the other hand, they do enjoy the benefit of limited liability, do they not?—Yes, but they have obligations too. Exempt private companies must fulfil their obligations as well as deriving benefit. I think personally, that in the case of the smaller, purely private, company these exemptions are welcomed by the general trading population.

3868. Of course, it depends which side of the fence you are on. But we have had evidence from various bodies in the nature of trade protection societies and there is one concern which insures credit worthiness who say that their work would be greatly facilitated if they could get particulars of the people whose credit worthiness was in question by simply going to Bush House and looking up their file.—I read that with great interest but at the same time that is one section, surely,

of one part of our trading organisation. There are other methods by which they can find out the credit worthiness of the people concerned in an exempt private company.

3869. Of course they can go to the person and say we are not going to extend any credit to you unless you produce your balance sheet, I agree. But it would be rather a more painless process if they could just go to Bush House and find the information they wanted on the file.—*Mr. Phillips*: I think the view of the Institute on this issue was based primarily on practical considerations, and the fact that so far as we are aware no real hardship or abuse, no harm or damage to the public interest in our view has arisen from the present classification of companies. There may be arguments for and against continuing the privileges available to exempt private companies but we have no evidence before us at any rate to show that the present position is contrary to public interest. Accordingly, because of the convenience of the existing procedure we would like to recommend on balance the continuation of the existing legislation.

3870. You say in effect the onus of proving the need for an alteration in the law rests on those proposing it and the case has not been made out?—I wish I had been able to express it in those terms, yes.

3871. What are the practical considerations in favour of preserving this special kind of company?—*Mr. Talbot*: Mainly the saving of work, that is what it amounts to.

3872. Of course, they have got to keep accounts, have they not?—Most certainly.

3873. And the accounts have to be audited?—Certainly, but you would not publish them necessarily as a separate document.

3874. Given the necessity for accounts and given the necessity for audit what is there against filing, that is not an expensive process, is it?—No. I think the objection to filing is really the disclosure it makes in the case of people who want

to preserve a certain amount of secrecy in their operations.

3875. Just to deal with the three main exemptions, the first is the right to appoint unqualified auditors. Do you think that desirable?—*Mr. Hardman*: No, certainly not.

Mr. Talbot: As a matter of fact we were approached by the Institute of Chartered Accountants some three or four years back. That Institute asked whether we would support the contention that exempt private companies should be brought under the same conditions in this respect as other companies, that the auditors should be qualified. A small sub-committee of our Institute was set up and we concurred with that view.

3876. It may be we have all been pushing at an open door because I gather the results so far received of a sample enquiry carried out on behalf of this Committee indicates that at least 86 per cent. of all exempt private companies do employ qualified auditors.—Yes.

3877. Then we have dealt with the right not to file accounts, and the consideration there is that of privacy?—Mainly, yes.

3878. Then there is the right to make loans to directors which is denied to every other company. Do you see any reason for preserving that?—Only again because in the nature of these small businesses it can be a reasonable thing to do. I see no harm in it.

3879. A person dealing with a company which turned out to be unable to pay its debts might feel a little aggrieved if he found that the assets of the company had all gone in the form of loans to directors when he came to get his payment?—I cannot deny that.

3880. That is a consideration, is it not?—It certainly is.

3881. Can you suggest any reason why this power to make loans to directors was accorded to the exempt private company?—No, Sir, other than the nature of the company envisaged at the time, the small family business. That is a very real consideration, Sir.

3882. It is a convenience, no doubt, to the members of the company that they

should be able to make loans to directors who probably would be the same as the members of the small company.—Yes. If they were trading as individuals they could dissipate their money in some other ways.

3883. There are only too many ways of dissipating one's money.—The very fact that a family forms a company does not really affect the creditor position. If they did not form a company and traded as Smith & Son, if they were intent on not paying their bills they would not pay them.

3884. But there is no reason why this Committee or the legislation should point the way?—No.

3885. *Mrs. Naylor:* Of course private companies do have a limited liability?—Exactly.

3886. *Chairman:* The next point is quite a different one again and concerns section 195, the register of directors' share holdings. You say in effect that you doubt the desirability of that provision. Could you amplify your objection to it?—Yes, Sir, the section was mainly designed to curtail the activities of a director who was possibly taking advantage of inside information in order to deal in the company's shares and so make a personal profit for himself. I think that was the idea behind the Cohen Committee's recommendations. Our view is to a great extent that the person who is intent on doing that kind of thing will do it anyway through nominees. Section 195 does act as a brake to the person who may be on the borderline, if I make myself clear: a person who might not do it when he sees he has to disclose it. The person who does not care will do it in any case. So we think there is cause to retain the section but we think it ought to be eased a lot. I can speak with personal experience of a company which has 67 wholly owned subsidiaries; the holding company has the bulk of the shares and one director holds one share of each subsidiary as nominee. We have to maintain a register of directors' shareholdings for each subsidiary in each of which must be recorded the shares which the director holds in the parent company. We think this is unnecessary and serves no useful purpose. We also feel there is an enforced disclosure in

certain circumstances of information not connected with or of interest to the company. For example, a director may be a trustee of a trust and he has to declare details of that trust which is nothing to do with the company at all. Perhaps for personal reasons not connected with the company he does not want to disclose it. Strictly speaking he should. We feel there should be some easing of the section, especially with regard to wholly owned subsidiaries.

3887. You really favour an easing of the provisions of the section rather than abolishing it altogether, is that right?—I think that summarises our views.

Mr. Hardman: The easing of it in the case particularly of the wholly owned subsidiary. Information is duplicated time after time which we feel is quite unnecessary in the case of the holding company. We favour the retention of the section but the easing of the work of it in the case of wholly owned subsidiaries.

Mr. Talbot: And we do say we doubt the usefulness of the section for the reason I have already given that the man who intends to take advantage of inside information will do so through nominees without disclosing it to the company and the company has no means whatever of enforcing disclosure.

3888. The terms of the section are fairly wide and it looks to me that they do include nominees.—The section does cover nominee holdings but the director must disclose his action. We say a director who is intent on defrauding the company or taking advantage of inside information for his own benefit is the very man not to disclose it and there is no means to force him to do so.

3889. For reasons of that kind it cannot be made fully effective?—No.

3890. You say, further, in some cases it involves really quite a considerable amount of work?—In the case of wholly owned subsidiaries, yes, where you have to maintain separate registers.

3891. You think the section which you do not like ought to be simplified so that the requirement does not apply in the case of wholly owned subsidiaries?—Exactly

Sir. If it is to be retained at all, and we are doubtful as to its value, then relief should be given and the section should not apply to wholly owned subsidiaries.

3892. Your next one is a curious little point which as I understand it is this: as regards the register of directors you raise a point whether section 200 (9) (a), which contains that wonderful definition of a director as a person in accordance with whose instructions a director is accustomed to act, makes a holding company a director of a subsidiary company for the purposes of the register.—It has been interpreted that way on legal advice.

3893. Can it be that it was intended by section 200 (9) (a) to make the holding company a director because of the mere fact that it is a majority shareholder of the subsidiary company. If so it would also cover a majority shareholder, however acquiescent, of a company because if he does exercise his voting powers he can make directors do what he wants?—We do not think it was intended that it should but there have been cases where it has been interpreted in that way.

3894. The next point is on the next section, section 201, publication of directors' names and so forth, and as to that you say that it should either be abolished or be applicable in all appropriate documents and not merely those sent to persons in any part of Her Majesty's Dominions. Would there be any merit in extending this provision so as to make it necessary to give particulars on documents sent outside Her Majesty's Dominions?—*Mr. Phillips*: It seemed to us that you should extend section 201 to cover the case of companies which were formed at any time, registered at any time, and secondly, that if protection were needed for people in Her Majesty's Dominions it might equally be needed for people who were resident in foreign countries and to whom it was important that they should know the nationality and the directors of the company. Should, for instance, the section cease to apply if South Africa becomes a Republic outside the British Commonwealth or not? It seemed to us that it was inconsistent and incomplete. We do not advocate the retention of the section, as you know, but

if it is to be retained we do think that it should be made comprehensive and apply uniformly to everybody.

3895. I was wondering whether if it was extended to all parts of the world a company might not be harmed in some way by disclosing these particulars in some foreign countries?—We really had not considered that possibility. I suppose if somebody in a foreign country wanted to ascertain the identity of directors in a particular company he could do so without a lot of difficulty.

3896. By merely asking an agent in London?—Exactly.

Mr. Talbot: Behind our ideas in regard to this section was the fact that a lot of the shell companies that have been taken over and used for other purposes were formed before 1916, particularly rubber companies; those shell companies have been used by persons in order to carry on some other business entirely remote—very often in property—without disclosing their names so that the person dealing with the company has no knowledge from the notepaper who the directors are.

3897. These are people resident abroad?—Resident here, not necessarily British nationals. But the whole point is that these rubber companies and other companies formed before 1916 have been taken over and used for totally different purposes and at the same time have taken advantage of not disclosing names of directors on their notepaper. It is admitted that third parties can always find out in other ways who the directors are even if they cannot get it from the notepaper.

3898. That looks as though the provisions of Section 201 if they had applied to these pre-1916 Companies would have served a useful purpose. That is not a very good basis on which to found a plea for abolishing the section?—It is going to be very difficult for many companies. There are many arguments relative to the publication of directors' names. Where there are several directors it would be very inconvenient and might conceivably take up the whole front page of a letter.

3899. A company might have to attach something like a telephone directory to

its letters?—Exactly. Therefore we feel that is not reasonable; but if the Committee think it is reasonable that these names should be retained on notepaper then the section should apply to all companies whenever registered.

3900. *Professor Gower*: From your practical experience do any companies in fact keep separate notepaper for use when writing abroad?—Not in my experience.

3901. *Chairman*: That needs tidying up.—We feel that. It is really a tidying up suggestion.

3902. I have a note on Section 185 which is the retirement of directors under age limit. Have you considered the provisions relating to that? The question I have in mind is whether you think these provisions designed, I suppose, to secure retirement of directors at a reasonable age are effective and if not whether you think anything ought to be done to make them more effective than they are at present?—We have had no suggestions that they are not effective. Various people have expressed their views as to whether they are necessary but we would rather not express a view in that regard because it is really a political question from many points of view. We have not found any difficulty in regard to the working of that section, and none has been expressed to us.

Mr. Phillips: I think really the Institute feels it is scarcely a matter which comes within its province.

3903. It is rather a delicate matter?—Yes. The secretary might often have a view. Sometimes it is not tactful to express it.

3904. Then my next point is your concern over the growing use of fancy names such as special director or executive director; these terms being used to describe a person with less than the full powers of a director but who merits some honorary recognition of his long service, something of that sort, really?

—*Mr. Talbot*: Yes. His name may or may not be shown on the notepaper but very often in dealing with third parties he produces his business card and the person dealing with him, unless he knows the structure of the company, thinks he is

dealing with a man who is a director properly so called of the company who has power to bind the company accordingly: this practice is growing and we think it might be dangerous.

3905. *Mr. Brown*: You would not object to the use of the word executive director to describe someone who has all the responsibilities of the director?—No. The difficulties arise from his limitation. He has not even the right to attend board meetings except when called. If he is not able to accept the liabilities of a director he should not hold out to a third party that he has directorial powers.

3906. *Chairman*: Would you agree it might be rather difficult as a matter of legislation? Do you think there would be any future in a legislative provision to the effect that anyone who is designated by one of these names which includes the word "director" with the connivance of the company shall be deemed to have all the powers of a director to bind a company in dealing with a third party?—Yes.

Mr. Gabell: I think, Mr. Chairman, there is some distinction to be made between using the word *director* in relation to a function, such as director of research or a director of a commercial function, and using the expression special director or executive director. In the former case I do not think there is any suggestion that that man is a member of the board of the company. Where he calls himself an executive director the common understanding of that is that he is a full time, salaried member of the board, and it is a misuse of the expression if he is not. So I should have thought that to have ruled out the word director from a name altogether could be an unnecessary restriction upon titles.

3907. Yes, I see.—Sometimes you have special directors or executive directors whose titles imply membership of the board but who are in fact a special class of executives created in the articles of association. People dealing with the company do not normally know that provision in the articles.

3908. Supposing you have Director (Contracts), Director (Research), which

side of the line would those be?—I appreciate it would be quite difficult to make a hard and fast line. But there are instances where there could be no doubt that the function described did not imply directorship of a company; that I should have thought should be permitted.

Chairman: This one looks as if it is going to turn out on further investigation rather more difficult than it at first appears.

3909. *Mr. Brown:* Would it not be simple to alter the other name to research manager and adopt the suggestion that director is limited to those who are full members of the board?—I do not think the expression manager necessarily carries the same understanding.

3910. *Mrs. Naylor:* Controller sounds much grander.

Chairman: Comptroller is a splendid name.—*Mr. Phillips:* On this issue, as you will observe from the paragraphs in our memorandum dealing with the matter, whereas with other paragraphs we have attempted a positive proposal, in this case we feel bound to confine ourselves merely to record the development of this practice which we rather deprecate. We do not suggest it is practicable satisfactorily to legislate against it. We merely wanted to record our feeling in the matter. We recognise the difficulties of choice of appropriate terms and of legislation generally in a matter of this kind but we did want to bring before you our view that we deprecate this development.

3911. *Mr. Scott:* Would you apply it also to the local directors of banks, for example?—That is an aspect we have not considered and there are all sorts of organisations the chief executive officer of which is called director without directorial powers in the company sense. We have not extended our thinking to that at all. This is confined to the case of the special or executive director of the ordinary trading company.

3912. *Chairman:* It is rather a case of then everybody is somebody, nobody is anybody. You might find yourself contracting with the commissionaire who is director (doors).—Yes.

3913. So far as we have got it looks as if it would be a difficult matter to legislate on this but you have recorded your objections to the present position.—I think by implication, Sir, we have indicated too our recognition of the difficulty of legislating against it.

3914. Have you met with any actual cases where somebody was deceived to his detriment through this practice?—

Mr. Talbot: I heard a case in reverse, if I may mention it. A company with which I am associated has several subsidiaries and executive directors are appointed to those subsidiaries. They are the technical executives who carry on the day-to-day work of the subsidiary—it is a contracting company. These technical executives have conferences and negotiate with local government authorities in connection with building contracts and town planning schemes. The company wished, for administrative reasons, to change its policy regarding the appointment of executives as executive directors but was unable to do so because of the impression already created in the minds of third parties who had had dealings with them. In regard to the executive directors themselves, to alter their status might imply as regards third parties and members of the staff of the company concerned, that they had been demoted or lost prestige, which was not the case.

3915. The next point I have concerns non-voting shares about which as, of course, you know, there has been considerable controversy of late and you make a novel suggestion. I use that word in the sense that it is one that our fairly numerous other witnesses have not produced, that the holders of non-voting shares should be entitled to apply to the Court in certain circumstances and be given such right of voting on the particular matter, as I understand it, as the Court shall think fit.—*Mr. Phillips:* Yes. The Institute has, in formulating this idea, as it were, proceeded on the basic assumption that in the ultimate resort it is the owners of the equity capital who should decide the destiny of the company, however indirect their degree of control may be. We did not want to support the various other propositions which have, of course, been canvassed for prohibiting

non-voting shares, enfranchising them, paying compensation and the like, because we could not really see how justice could be done as between voting and non-voting shareholders by any of these devices. And so we conceived the idea that it would be right to give the Court the power to confer upon non-voting shareholders, in specified circumstances which were carefully worked out, the right to participate in the decision on the future of the company. In other words, it is a sort of protection of the majority by comparison with the protection of minorities which is dealt with elsewhere in the Companies Act.

3916. The difficulty I feel about this is what voting power should the Court in a proper case accord to the holders of the non-voting shares?—We have said in our memorandum, and I hope you have not felt it was burking this rather obvious difficulty, that the Court should have the right to confer such voting power as would seem just and equitable. We thought that the Court would unquestionably have the capacity to reach a just and equitable conclusion. We feel that the instrument must be flexible, particularly in the case of a complicated capital structure where there are several classes of shares of different nominal value. We thought it would not be impossible for the Court, which has to do so many things which are just and equitable, to work out a scheme in an individual case. I do not think we apprehend this is a provision which would have to be resorted to very often. Its very existence might help to avoid the necessity of action under it but if and when it had to be used we felt that the Court would be able, without great difficulty, to devise a scheme of voting power applicable to these cases which would be fair.

3917. This would mean that the Court could decide which way a meeting was going to go?—In effect by conferring voting power accordingly. But it would not know at that time. All that would be done is that, say, 15 per cent. of the non-voting shareholders would apply to the Court and make out a *prima facie* case to the satisfaction of the Court that their interests were being adversely affected and deliberately so by the voting shareholders on a particular issue. The Court would

merely say that there should be a meeting at which they should have votes on this issue.

3918. Given the desirability of the suggestion, in other respects would it not be best for the Court to give the non-voting shareholders the same rate of voting per share as was enjoyed by the voting ones?—Yes.

3919. Would that not be better so that each individual had the same voting power measured by reference to the nominal value of his holding in the ordinary way?—That is what we had in mind when we spoke of the case of a complicated capital structure. We were thinking of A shares of £1, B shares of 5s. and in those circumstances the Court could declare that there should be a vote for each £1 nominal value, as it were.

3920. I think that would be almost unworkable. Because there are many kinds of cases in which a Court summons a meeting but then the issue depends on the vote of the meeting and I think a Court would be very reluctant to dictate indirectly what the result of the meeting was going to be.—I realise we may have misled the Committee a little bit by referring to the power of the Court to allocate votes but we were only thinking in the terms which you have indicated to us that it should be directly related to the nominal value of the shares; it was only in the sort of cases I have quoted where comparison is between £1 and 5s. shares, that the Court could declare that every £1 share should have four votes as compared with one vote per 5s. share. We did not think that the Court should be asked so to weight the votes as to secure a given result.

3921. *Mrs. Naylor*: In practice the feeling against voteless equity shares has arisen in connection with take-over bids because the people making the offer for the remaining shares have left non-voting shares out in the cold. How do you think your proposal would affect the price offered for the non-voting shares if the offeror had to calculate the voting strength the present non-voting shares might have in future, unknown circumstances?—

Mr. Hardman: If an occasion arose under those circumstances surely the offeror

would know of this provision and therefore he would know that all shares probably on that occasion would carry equal voting rights and therefore he would have to pay the same price for all.

3922. The circumstances would not arise necessarily on the occasion of taking-over, but in some unforeseen circumstances in the future.—*Mr. Phillips*: I would have thought that the introduction into legislation of a provision on the lines which we have suggested would generally cause a slight increase in the value of non-voting shares, but not a considerable increase because no one could foresee at the time of an offeror making a take-over bid that the time might come that the non-voting shareholders would go to the Court to prevent it.

3923. *Chairman*: As I understand it your proposal would not involve the Court in weakening the position of the voting shareholders simply on a matter of business?—Quite so.

3924. Some project which they consider to be in the best interests of the company even though there might be two views about it? In such case as that the Court would say it was for the company to manage its own affairs?—Yes.

3925. But if the voting shareholders were proposing to take over the assets of the company and make them available to another company or project in which they were interested then you would get into different realms altogether and the Court might well say the non-voting shares should vote on that?—That is exactly the point.

Mr. Talbot: It would also act as a brake to a take-over bidder who simply wanted to acquire the voting shares which might be a small part of the equity, but by so doing he acquires assets of great value over and above what he has had to pay for those voting shares.

3926. I think that is as far as we can carry that argument. Then we pass to section 210, protection of minorities, and you say in your paragraph 58 that you think that in view of the relatively recent decisions of the Courts any amendment of section 210 might tend to restrict rather than to extend its scope?—Yes, Sir.

3927. I assume you are referring to the *Meyer* and *Harmer* cases?—Yes. We thought that in those two cases the Courts had interpreted this section very broadly and further, we thought that if we tried to tamper with that section we might restrict the Court's freedom of interpretation. However, we feel it should be made quite clear that the reference in section 210 (1) to "the affairs of the company being conducted in a manner oppressive . . ." should not only apply to a continuing process but to any one incident. The section, as at present drafted, rather implies it has got to be a continuous process.

3928. I am gratified with what you say about the effect on the section of those decisions of the Courts because it so happens I was a party to one of them myself. But do you not agree really that this section would be strengthened in favour of the oppressed minority if the requirements as to winding up were omitted? That is the amendment generally proposed by people who have discussed this.—We should certainly support that.

3929. I think that would improve the position, would it not?—Yes.

3930. You see each case depends on its own facts and in another case the Court might hold that a case most nearly resembling one of these recent cases fell just on the wrong side owing to the winding up requirement.—Yes, if requirements as to winding up were omitted that would strengthen the section.

3931. Then you suggest the extension of section 210, as I understand it, to meet cases where the rights of debenture-holders are being varied?—Yes.

3932. Do you think that that could really appropriately be introduced into the section which deals with squabbles between shareholders? Do the same considerations really apply in the case of debenture-holders?—Probably not, Sir, but we think they should be protected in much the same way.

3933. Would that not suggest an adaptation of section 72, variation of shareholders' rights, to make it fit the case of debenture holders?—Yes.

3934. It would be more at home somewhere there?—Certainly, that is very true.

3935. In one way or another you would like to see an oppressed minority of debenture-holders protected in the same way?—Yes.

3936. Then in paragraph 67—this is quite a different matter I am passing to now—you suggest it should be made compulsory for a company to register evidence of satisfaction of a charge?—Certainly.

3937. The Registrar in the Companies' Court gave evidence before us the other day and he said he saw no reason why this should be made compulsory, thus producing another potential offence and another matter on which the overworked Board of Trade would have to chase up delinquents and his view was that it should be left to the company. If the company has any sense it will take the charge off the file and if it does not it is just making itself appear worse off than it is. Would you have any comment on that line of reasoning?—We do not think that is really a strong line. Anyone inspecting a file which is not complete gets a completely misinformed idea as to the company's indebtedness.

3938. I suppose you would say that if a compromise was suggested the companies' creditors might inspect the file and say "this company has freehold property which is mortgaged up to the hilt" when really the charge had been paid off?—*Mr. Phillips*: Exactly, it would be completely misleading.

3939. It does look as though that perhaps required a little consideration, though, of course, it is not a very important point really. It could easily be made compulsory but one has to consider the burden on the administration of company law and each one of these requirements adds another matter which somebody has to look after. I do not know that we can.—*Mr. Hardman*: Surely the position is that certain charges have to be registered and, to be logical, for the benefit of creditors they should be removed when they are satisfied. That is all. We are not pressing it.

Mr. Talbot: At the moment evidence of satisfaction is just filed and if you look at the file in order to ascertain the position you have to marry up the two documents whereas if one party is satisfied there is no reason why the charge should not be taken off the file.

3940. I think we have your point on that now. It is the sort of matter on which I should have thought that the official view as to any difficulties of administration might carry some weight but otherwise I follow the force of your suggestions. Then you say in your paragraph 68 that you would like to see a penalty imposed on people who have failed to render a statement of affairs to a receiver. It seems on a close examination of section 373 (5) that that is provided for: "If any person without reasonable excuse makes default in complying with the requirements of this section, he shall be liable to a fine not exceeding £10 for every day during which the default continues". That applies to the submission of a statement of affairs.—*Mr. Phillips*: I think the feeling about this was that the receiver was not in the position to require or call for the submission, that is all.

3941. Then if it was made obligatory on the individual to render a statement of affairs by an order directing him to do so made by the Court on an application by the receiver, that would meet your case?—*Mr. Talbot*: That would meet our case. At the present moment he cannot force a creditor to provide this information.

3942. If he had the right to apply to the Court, an order could be made and the person in default could be attached or committed for breach of the Court's order?—We have had the case where one of our members in connection with this matter has repeatedly tried to get this statement without success and, of course, he is being repeatedly pressed by the Board of Trade to make a return, which he cannot do and he has no power whatsoever to force the issue.

3943. The Court order would meet your case?—Yes.

3944. The next one relates to so-called take-over bids and I think that the Board

of Trade's new regulations were issued after you had compiled your memorandum?—Yes, and we concur with everything that is provided there.

3945. You think broadly speaking that those regulations really meet the case?—Most certainly, yes. There is one additional point which we have raised in paragraph 75 and which is not covered by the Board of Trade's regulations.

3946. You want some special provisions as to disclosure of nominee holdings in connection with take-over bids?—Yes.

3947. I think the Board of Trade regulations and various other suggested schemes require the man making the take-over bid to disclose his identity but you go rather further than that in your paragraph 75.—We do because at this stage there is no take-over bid, a person is acquiring shares and building up his holding with a view to acquiring the company. The board realises there has been activity in the shares; they cannot understand the reason. They see shares changing hands and building up in one particular nominee account and there is nothing they can do about it. They cannot enquire as to who is operating and therefore we suggest when that state of affairs exists that the companies should have the right to submit a case to the Board of Trade so that the Board of Trade can enquire as to the position. That is actually the point.

3948. I appreciate that point and actually I think it has been covered possibly at a different point in our questionnaire where we have asked for views about disclosure of ownership of nominee holdings.—*Mr. Phillips:* We raised the point in this part of our memorandum deliberately because we did not feel we could advance the case for general disclosure of ownership of nominee holdings, and it was a question really that could only be considered properly in the context of acquisition of control of the company by stealth.

3949. *Mr. Smith:* Would it not be better, if you could overcome the practical difficulties of enforceability, to oppose the nominee system altogether?—*Mr. Talbot:* No, I do not think so, with

respect. We are only concerned in a case where it is quite obvious from the dealings that are taking place in the company's shares that a lot of shares are going into one pocket or one account. The directors want to get behind that account and they ask the Board of Trade to investigate to find out who is trying to acquire control. That is they have to satisfy the Board of Trade that there is a case for investigation. We are not suggesting that the company should in all cases have the right to enquire behind shares that happen to be in the hands of the nominees, because we feel, that apart from questions of take-over, there is a case for the nominee system.

3950. I implied from your paragraph 61 that the only difficulty about disclosure was that it was impracticable to enforce such provisions.—*Mr. Phillips:* It does give that general impression but if I may supplement what Mr. Talbot said, I think we would also like to record our view that there are proper and useful cases in which shares are held in the names of nominees; one thinks of trustees, of personal representatives, all sorts of cases, in which it is perfectly proper for shares to be in the names of nominees. We did in paragraph 61 express the general view that it was not really practicable in our view to attempt to tackle all unworthy cases by dealing with every case of nominee shareholding, because there is such an infinite variety of circumstances; but we do think there is one set of circumstances in which an attempt should be made and that is the case mentioned in paragraph 75, the acquisition of control of the company by stealth.

3951. *Mr. Richardson:* Could I ask what the prescribed percentage referred to in your paragraph 75 would be?—*Mr. Talbot:* If this was accepted we were going to leave it to the Committee to decide.

3952. *Chairman:* It is an extraordinarily difficult subject.—I wonder whether a percentage need be stated? After all the company has to make its case to the Board of Trade and the Board of Trade would decide whether the beneficial owners of 15, 20 or 30 per cent. of the

issued capital in any particular set of circumstances should be required to disclose their interests.

Mr. Richardson: Yes, thank you very much.

3953. *Mr. Brown:* How do you visualise the Board of Trade acting in those circumstances? It agrees there is a *prima facie* case for disclosure. What does it do? Instruct all shareholders to make some return or what?—It would be one shareholder, would it not? It really would show itself up when one account in your register was building up.

3954. Clearly if that was so anyone who wished to hide his actions would use ten nominees.—Yes, there are ways round but again any unusual activities in a company's shares would become apparent and put the directors on their guard. It is hard to envisage all circumstances but the directors would have to make a case to the Board of Trade, that is the essence of our proposal.

3955. I am clear on that. I am not clear what happens afterwards.—*Mr. Phillips:* We did not work this out in detail. I think we felt that if the Board of Trade had the power to make an order for disclosure it would have to be uniformly applicable to all shareholders of that company. We felt it would not serve the purpose to pick on one shareholder because that could so easily be evaded in the way suggested.

3956. *Mr. Smith:* Did you give thought to the penalties for default?—No.

Mr. Smith: They would presumably be imposed by the Board of Trade.

3957. *Professor Gower:* The Board of Trade already have powers under section 172 and 173 to do much of this kind of thing. You want something less elaborate, do you, instead of appointing an inspector to carry out enquiries, you want the Board of Trade to make an order so that the company can somehow get the information?—Yes; it is an order upon the shareholders of that company to disclose to the directors the true beneficial ownership of their shares, that is all.

3958. *Chairman:* My next question relates to your paragraph 80, in which

you very briefly say that there is no reason for the application of section 54 to an unlimited company, and as section 54 concerns the financing by a company of the acquisition of its own shares, that seems a very reasonable suggestion with reference to unlimited companies.—*Mr. Talbot:* Yes.

3959. Have you any other comments about section 54? It is not a very popular section.—We have not.

3960. In your paragraph 81 you recommend that the Board of Trade should be empowered in certain circumstances to relax the restrictions in section 56 so as to permit a proportion of the share premium account to be used for wider purposes than is at present allowed. Can you give any examples of your wider purposes?—*Mr. Gabell:* What we had in mind here arose where a holding company is to be formed to effect a merger and the people concerned in the merger, the shareholders, become shareholders in the holding company. The effect could be, as I understand it, that what were free reserves would become to a degree frozen in the share premium account of the holding company. The results of that seem to us to be to the detriment of the holding company's future operations.

3961. That is a point which was discussed at some length this morning, it so happens, and I think it was suggested the share premium account produced as a result of such amalgamations might be allowed to be used to write down the value of the shares acquired, which is, I think, another example of what cannot be done with it at the moment.—Yes.

3962. Are there any other wider purposes you have in mind?—No; I was thinking on the broad lines that it was an unfortunate thing to freeze reserves that might otherwise be available.

3963. What is suggested is contracting out of section 56 in special cases?—Yes.

Chairman: Those are all the questions I had in mind to ask you gentlemen, but I expect my colleagues will have a question or two.

3964. *Mr. Richardson*: You would like such reserves to be made completely free for distribution or for any other purpose?—In principle.

3965. You would feel the same whether the merger were effected by one company becoming the holding company of the other or by setting up a new holding company which takes over the shares of the two existing companies. The difficulty in both cases is that the assets thus acquired represent share capital in the hands of the holding company and this prevents the distribution of what were formerly free reserves.—Yes.

3966. *Mr. Watson*: I have one question about the age limit for directors. I wonder if you would tell us in your experience how often have these provisions been avoided by a company?—I do not think very largely. I know of companies that have contracted out. I think my experience would be that this is a salutary provision in the law. There is nothing to prevent a director having passed seventy being re-elected after giving notice of his age. In fact that is done all the time.

Mr. Talbot: I would agree with Mr. Gabell.

Mr. Phillips: As an Institute I do not think we have taken any particular view; it is really a personal view which you are seeking at the moment rather than that of the Institute as a whole.

3967. Do you know of any cases where a director may have been director of a company for many years, it may have been his sole means of income, and under the operation of this section he has to retire at 70. Are there no cases of hardship arising?—*Mr. Gabell*: He can be re-elected.

3968. *Mr. Scott*: In paragraph 12 of your memorandum you refer to the evidence you gave to the Gedge Committee suggesting that any further issues of shares for cash in the case of no par value shares should be offered *pro rata*. You have now modified that, limiting it to apply to equity issues for cash and not

shares issued for the acquisition of a business. Is that correct?—*Mr. Talbot*: Yes.

3969. I wonder whether you would extend that principle only to no par value shares or whether you would extend it to all equity shares. Is the point particularly applicable to no par value shares?—In our statement we do specify that they should be issued *pro rata*. We may wish to issue shares, whether of no par value or otherwise, for acquiring another business and we want to be able to do that; if you have, in all cases to offer new shares *pro rata* to the existing shareholders you cannot use them to acquire a new business.

Mr. Phillips: There is one point there; we have not modified the views expressed. That statement which has just been made was made to the Gedge Committee.

3970. I quite see that. You are really recommending that any issues of capital for cash should be made *pro rata* to the shareholders. If you want to issue shares for the acquisition of a business for a consideration other than cash, would you suggest any limit on the number of new shares which might be issued without prior consent of the shareholders?—No. The position is exactly the same whether no par value shares are involved or not. If the directors thought fit they could issue them at a premium or otherwise.

3971. *Mr. Althaus*: With regard to disclosure of ownership and control, would it be your experience that the element of surprise is occasionally achieved by delayed lodging of transfers; that is understood to be a device whereby the acquisition of considerable blocks of shares is sometimes concealed for a considerable time?—We certainly had not considered that.

3972. It is not within your experience?—No.

Chairman: Those are all the questions we have been able to think of for the purpose of getting your assistance, and we are very grateful to you for coming here this afternoon and giving us so much of your time and being so helpful. Thank you very much indeed.

(The witnesses withdrew)

MR. E. S. FAY, Q.C., called and examined

3973. *Chairman*: We are very much obliged to you for coming here this evening to help us. To complete our record, you are Mr. E. S. Fay, one of Her Majesty's Counsel, and in 1958 you were appointed as an Inspector by the Board of Trade into the affairs of General, London & Urban Properties, Ltd.—That is so.

Chairman: Thank you. Now I think Mrs. Naylor would like to ask you some questions on your experience as Inspector.

3974. *Mrs. Naylor*: I am very grateful to the Chairman for letting me start because I am one of your biggest fans as far as your report is concerned, which came out some months ago. I gather you feel it is preferable to have two inspectors, a chartered accountant as well as a lawyer? —Yes, in this class of case. I feel the difficulty often is, and certainly was in this case, that no one knew when the matter was first mooted just what was going to be involved. It is not uncommon I understand for a chartered accountant to be appointed also as a co-inspector, and I assume if the Board of Trade had known the magnitude of this inquiry that might well have been their course.

3975. I think you are right; but as it was you had an assistant from the Accountant Division of the Board of Trade.—Yes.

3976. One of the advantages of having an accountant as co-inspector is his office organisation.—That is an important consideration for a barrister.

3977. But has not the Board of Trade got any office organisation?—Yes, indeed; and I made use of Mr. Deacon's services unmercifully. The Board of Trade, for example, copied documents for me, and on one occasion I had facsimile documents made from a file which I had to return to the lender; and they produced the analysis of the figures and so forth in proper form. But I feel that in an investigation of this sort it is rather important that the investigator should have at his elbow the help of a secretariat, and it is not a matter which barristers' chambers are equipped in the ordinary way to deal with.

3978. I realise that. Apart from providing secretarial assistance, how useful would it have been if you had had people who could have done some of the leg work?—Mr. Deacon—I do not want to stigmatise him as being a leg man—did an immense amount of the more dreary parts of the work and produced admirable summaries for me. I do not think I have any complaint on that score. What I feel is that a chartered accountant who is used to auditing and whose clerks are used to auditing would probably be better than a civil servant in proposing lines of enquiry in matters which might need further investigation. I do not wish anything I should say to reflect on Mr. Deacon, whose services were literally invaluable.

3979. You pay tribute to him in your memorandum.—But his day-to-day work is not that of an auditor and not that of an ordinary investigator, as I understand it. I had to take decisions as to what line to pursue, and I am quite sure it would have been a lot easier for two inspectors to decide among themselves and then for one of them to detail persons in his office to follow a particular line.

3980. What about the actual writing of letters?—That imposed a certain strain on the clerk's office in my chambers, but we coped with it. The Bar, I am afraid, are largely old-fashioned in secretarial matters, not all offices have typists, my chambers have no typist. The junior male clerk does the typing very efficiently but he does not take shorthand.

3981. Could you help us on a more general subject, about the timing of these inspections? Do you think, from what you discovered, from what you have heard, that it would have been possible in your case for the inspector to have been appointed at an earlier stage?—I find it very difficult to answer that without documents with me which I have not brought. What happened before I was appointed I only know from the dates of the letters which were handed to me. My recollection is that a considerable time did elapse, but I have no means of knowing what use was made of that time, so I do not think I can usefully assist you on that.

3982. This inspection took a long time; all inspections take many months.—I am very much aware of the time my investigation took. I think for some of the delay I must be held personally responsible, because barristers in practice have their briefs to attend to and there were occasions when I had to take myself off this work for a month at a time sometimes in order to deal with a case which was of some substantial import. That is where two inspectors could achieve greater continuity.

3983. Still even with two inspectors the time taken for inspection is very considerable.—Yes, I have no experience apart from my own case, but from what I hear, yes.

3984. When these reports are published they generally say when the inspector was appointed, and it is generally a year or more.—Yes.

3985. Would you say there is anything to be said for the Board of Trade equipping itself so that it could do more of its investigations itself?—That raises a very large question of principle. My feeling, rightly or wrongly, was that the Board of Trade were anxious, as an administrative matter, not to concern themselves in the undertaking of the investigations, which they regarded as being an independent matter. One way of dealing with this sort of question is to have it done departmentally. That would be the other extreme.

3986. The Board of Trade then would not have the advantage of professional people expert in their own professional field?—No, they would not have in that event.

3987. On this question of independence you raise, at the end of your memorandum, the problem of combining detective work with the quasi-judicial function of assessing the evidence and reaching conclusions.—Yes; I did that because it struck me forcibly at the outset when I was appointed and had to consider what my job was that it was very different in character from the class of inquiry I had been used to either as an advocate or indeed as the conductor of the inquiry. My experience in the latter respect is limited, but I have in fact held a couple of inquiries into aircraft

accidents, a field very far removed from this. But the object broadly speaking was to ascertain facts, as it is here, and there it is completely severed from the various departments' activity.

3988. Do you think the system adopted for company investigations could lead to injustice to people whose activities are being investigated?—As I said, I do not think I am qualified to judge this because one likes to do a job as well as one can. I tried to be impartial; I tried to hold the scales evenly. I formed an adverse view about one person, which may appear in my report, in the course of my investigations. I hope I was not influenced by that in any way. One cannot tell really, at least a person conducting an inquiry is hardly in a position to tell. I feel there is a possibility, not of one's interest intervening, but of the psychological aspect of one's own application to the facts. As an advocate one finds oneself identifying oneself with the case, and that phenomenon affects investigators as well and if they have discovered something I suppose they are likely to be affected in that way. I was conscious of the necessity to consciously hold the scales even because of this factor.

3989. Can you think of any alternative method of investigation? I think in the United States they do try to separate the functions of investigator and assessor although both come under the same organisation of the Securities and Exchange Commission?—I am not familiar with their procedure but it is a procedure we are familiar with in other contexts in this country which I think works well in those contexts. It is a factor which struck me coming fresh to this class of investigation, perhaps more so than many others, because my practice has not brought me a great deal into touch with Company Law until this case.

3990. To go now to a totally different subject; you say the minor theme in your report is the question of protecting minority debenture-holders?—Yes.

3991. Could you develop that?—I do not know whether I can say a great deal more than I have said in my report. It is clear that debenture holders in a company of the class I was dealing with have no ready market for their securities. I

understand in practice if a debenture-holder in any such company wants to realise his security, and of course it is a problem which usually arises upon a death because the executor or administrator wants to get the estate wound up and to realise securities of this kind, the practice is to approach the secretary of the company and see if the secretary knows anyone in the market, and if so at what price, and then it is a matter of bargaining. But that phenomenon was in this case made use of in the way which I have quoted in my report, and what struck me forcibly was that the company in question was in arrears with debenture interest. No debenture-holder, because of the smallness of the individual holdings by and large, took any private proceedings to obtain back interest, and the fact that the interest was so far overdue was one of the factors used to depress the price. I came rather with the common law approach and rather naively asked why was there not a debenture-holder in the circumstances who would bring a county court action for the interest which was overdue.

3992. *Chairman*: Having got a judgment they could then proceed to wind the company up.—Yes, I suppose they could, but none of them tried. If any of the debenture-holders had done that I imagine the company would have paid up fairly quickly.

3993. *Mrs. Naylor*: Why do you think they did not try? Just ignorance of their rights?—It is very difficult for me to speculate. They are represented in many cases by trustee organisations such as the Public Trustee, who held a number of these debentures, and none of them as far as I know took proceedings.

3994. *Mr. Watson*: Were the debenture-holders getting the annual reports?—That I do not know. I do not suppose they were entitled to them.

3995. *Mr. Brown*: There was no actual trustee for the debentures?—No.

3996. He would have had grounds for action.—Yes.

3997. *Mrs. Naylor*: Perhaps that is the solution to the problem of what should be done, that there should always be a

trustee.—Yes. I felt it was a problem of some importance, because as you know my investigation disclosed that there was a continuous selling of debentures in the companies, not only the subsidiary I was investigating but also an allied company, and the background of that is in my report. But the money of these investors was clearly not readily available, and such professional advisers as they were concerned with did not seem to think it was worth taking proceedings.

3998. It is a curious situation. You say you have not had much to do with Company Law, and I am wondering whether it is fair to ask you if you think directors generally, not in the case you were investigating, if directors generally are aware of the duties arising from their fiduciary position?—How far a director is in a fiduciary position is a matter which exercised me in the course of this investigation and again I have no great experience outside this investigation. These directors I am quite satisfied were not.

3999. They were not aware?—Either they were not aware, or if they were aware they were not disposed to follow the path which the awareness would lead them to.

4000. That is a very different point.—I should have thought, as a newspaper reader, that directors were not fully aware of the fiduciary nature of their position, but I do not think I ought to venture an opinion on that.

4001. Do you think it might be useful if directors' duties were more clearly defined—I am not thinking of the Companies Act—perhaps if papers giving some guidance generally were issued by the Board of Trade?—I am not sure a statement which is not a statement of law would be of any great utility; but, again speaking with great diffidence, as a member of the common law Bar I should have thought some more specific indication of the duties of directors might well appear as part of the law.

4002. Would you think that transactions in directors' shares should be reported to the shareholders at the annual general meeting?—That is a technical matter which I am not sure I ought to

venture an opinion about. It is noteworthy of course in this case that what caused those who asked for the investigation to make their application was a transaction in shares which was not known to them until they saw in a balance sheet that the company had lost its subsidiary. They deduced that from the accounts when they were produced. If the sale had not been of the majority interest and had not turned the subsidiary into not being a subsidiary there would not have been an inquiry.

4003. I take it from your experience in this investigation that you would feel companies should only issue shares for cash to existing shareholders *pro rata*?—I am not sure I want to venture an opinion on that. I am bound to say this. I was struck by the conflict of interests there must often be in the director's mind between his activities as a director and his activities as an individual. And the whole of this case really turns upon the individual concerned carrying on a parallel business and engaging in transactions between himself and his company, with the results that I have indicated.

4004. Are the disadvantages of that to some extent mitigated if full disclosure is made to the shareholders?—Yes, that may well be so. Again I speak with great diffidence, but it seemed to me that a great deal of what was done was a matter which could have been checked as being contrary to the law if the facts had been known, and indeed one reason why I must be very careful is that there is still an action pending between the new owners of the company and the old based upon misfeasances or actions contrary to the law in one way or another. To that extent it may be it is not the law that is deficient so much as the machinery of giving information.

4005. Can you think of any way in which the machinery could be improved?—No, I do not think so. I have not addressed my mind to it and I do not think a snap view would be very useful.

4006. *Chairman*: Mr. Fay, going on the evidence so far received, there is one broad conclusion which follows the initiation of an inquiry by the Board of Trade, and that is the adverse publicity and the

effect it has on the standing and credit of the company.—Yes.

4007. Do you think it would be possible in certain cases that the Board of Trade should have a certain right of investigation in private, that is to say with no publication of the fact of the appointment of an inspector and indeed no formal appointment of an inspector at all?—Yes, I should have thought that would be a useful part of the Board of Trade's proceedings. The adverse publicity arising from the appointment of an inspector stems, I suppose, partly from its association in the public mind with cases of bad frauds such as there have been inquiries into in the past, and of course it does indicate that there has been a complaint under the section to the Board of Trade.

4008. *Mr. Richardson*: That is the general thing before they institute an inquiry.—Quite.

4009. *Chairman*: That indeed is the chief drawback to these inspections. So long as they are going to be made public the Board of Trade quite rightly refrain from action until there is something approximating to a *prima facie* case made out.—Yes. The alternative, I suppose, is some sort of continuous right to investigate any company whenever thought fit, on complaint or otherwise.

4010. That might be regarded as an unwarranted invasion of the liberty of the subject.—Yes.

4011. On the other hand if everyone was exposed to it there would be no stigma.—That is certainly true.

4012. That possibility I think is perhaps worth pursuing, but it is difficult to envisage exactly the relationship between the Board of Trade and the company being made the subject of this form of enquiry.—Yes, and I suppose it is open to considerable objection in many classes of business where a great deal depends upon secrecy, the effect that such an enquiry would have on the operations of the company even if it was only within four walls. One can see the objections, practical and theoretical, from the point of view of the principle of the liberty of the individual.

4013. Probably the best and most effective way of investigating the affairs of

a company is to wind it up. Could anything have been done about winding up in the case in which you were concerned?—I do not know that anyone wanted it wound up.

4014. That might damage both sides. —Yes. Indeed, there was a move to wind up General, London & Urban Properties Ltd., really as a counter-move to the opposition to the accounts when the shareholders found out about the loss of the subsidiary—I mentioned it somewhere in my report, that there was a proposal that the company be wound up. But I do not think myself that was a serious proposal and I certainly did not get the impression that anyone seriously wanted that company wound up. And a move to wind up would again affect the company.

4015. And might destroy the bone of contention?—Yes.

4016. I do not know if we can carry that much further. You have mentioned in your memorandum a number of points in which the law is left somewhat in doubt. For example, you say you took the view that it was the secretary's obligation under section 167 (1) of the Act to give all assistance which he was reasonably able to give, including a duty to furnish information in writing.—I have the passage and I remember the point. It was one which I had to consider when I started on the course of asking for information by correspondence. It seemed to me a sensible course to take, but a power which is not in terms given to inspectors.

4017. That would easily be remedied by amendment.—Yes, indeed; as I think I suggest in my memorandum.

4018. Then after that you say: "Under 167 (3) an officer may be brought before the Court for refusal to answer questions, but it is not clear to me whether this is limited to the questions put during the examination on oath referred to in the preceding subsection." That again would be a matter for amendment of the law. —Yes, it seems to me it might be so limited because although subsection (3) refers to the refusal to answer any questions, it does follow subsection (2), which refers to examination on oath, and

one would have thought perhaps that the questions referred to in subsection (3) are those which would be put during the course of examination on oath, being supported in that view, perhaps, by the gravity of the offence. It would be a surprising power to confer in the case of informal questions.

4019. Then there is a point about how far the evidence given to an inspector by an individual is available in possible criminal proceedings against him.—Yes.

4020. That arises on section 167 (2): "An inspector may examine on oath the officers and agents of the company or other body corporate in relation to its business, and may administer an oath accordingly." Then (4): "If an inspector thinks it necessary for the purpose of his investigation that a person whom he has no power to examine on oath should be so examined, he may apply to the Court and the Court may if it sees fit order that person to attend and be examined on oath . . .". There are certain restrictions on those powers. It is expressly said there, ". . . and notes of the examination shall be taken down in writing, and shall be read over to or by, and signed by, the person examined, and may thereafter be used in evidence against him." So there is no express statement that the result of the inspector's examination on oath under (2) can be used in evidence against the individual, but there is an express provision in relation to the rather different matters dealt with in subsection (4).—Yes, there is a rather curious distinction between the two.

4021. In that matter would it be your view that it would be reasonable to make all information available in evidence against him?—There are, I suppose, objections again from the viewpoint of the liberty of the subject to using against a man evidence which he has been forced to give. He cannot claim any kind of privilege that it might incriminate him, where his answers are taken down by shorthand writer and given on oath. I rather think—again it is not my province—there are some provisions about this under the Bankruptcy Act.

4022. Which provide for private examination and public examination?—Yes,

and give some kind of security to those who answer the questions.

4023. I am not sure about that. I remember some difficulty about the admissibility of what a bankrupt says at public examination or private examination, but I have not got it clearly in my mind.—It is a departure from the ordinary processes of the criminal law that a man should be required to incriminate himself, and I personally feel it would require some justification to provide that anything a man said, however damaging to him, under compulsory powers should be used against him.

4024. In any case it would be desirable probably to bring those two subsections into line and either make it admissible or not in both cases. As far as I can see there is no special reason for the distinction.—It is noteworthy that in the case of a police officer investigating a crime, he is required to administer a caution to any person he has made up his mind to charge, that he need not answer questions. While in this case where one reaches that stage one still has power to require answers on oath; it is a departure from the general philosophy of the law.

4025. Then you say: "I am in some doubt whether the destruction of documents in order to avoid production is a refusal to produce documents within the terms of section 167 (3)". That might perhaps easily be brought in by amendment and I do not think it would prejudice anybody.—No, it did seem to me that was a matter which might well be dealt with.

4026. Then you say you would like a general provision for the protection of documents whether before or during an investigation. That seems reasonable.—Yes. I speak subject to correction, but there is, is there not, no specific requirement on a company to keep or preserve documents—keep in the sense of preserve, as distinct from keeping books, which is having books which are written up—I do not know whether the word "keep" in that context means "preserve".

4027. I think it means keeping an account by making entries within a reasonable time.—Keeping in the accountancy sense, not in the sense of

preserving; and there is no provision I believe as to the preserving of any documents.

4028. You have also surely got to keep these documents in the latter sense.—Yes, but for how long? It is not expressly provided, is it? In the case I was investigating it was claimed that the company kept practically no correspondence, for example. A letter of course would not be a document which they would have a statutory duty to keep, but one might have thought in the case of a public company at any rate there would be some obligation to preserve for a limited period at any rate, certain records—whether they were formal records, statutory records such as minutes, or whether they were informal records such as correspondence.

4029. It certainly seems reasonable that there should be some such provision, and if not provided for generally, surely it would be reasonable to say that where an investigation of this sort is on foot any material documents must be preserved.—That would seem to me to be a rather important thing in the section.

4030. I suppose it would be possible to provide something on the lines that you must produce the documents you have got, and the ones you have not got you must say when you last had them.—That might, I suppose, in the case of some companies involve very considerable labour.

4031. Probably that sort of provision would break down.—Yes.

4032. Then there is the question of production of documents under section 167(1). The only duty under section 167(1) is to produce, and it would be highly inconvenient to have to attend the company's office every time the books and documents have to be examined and compared. You would then add an obligation to deliver the books to such place as the inspector directed?—Yes, to permit the inspector to retain them as he thought fit.

4033. But the company would have to have access if they were still carrying on their business?—Yes, certainly. That did cause no difficulty in this particular

case but it was a difficulty which I foresaw as possible, arising from the fact that an obligation to produce something does not seem to me to convey with it any obligation to hand over or part with the possession of it.

4034. On the other hand, even though the company were given rights of access, it would be very inconvenient for it if the books were kept away from the office where its business was attended to.—Yes, indeed.

4035. So that it might be right to qualify the inspector's power.—Of course the major books would be parted with anyway for the purposes of the audit, unless the audit were done on the premises. In the case I was concerned in I was told time and again that the books were away from the office at the time of audit.

4036. Then there is the question of extending the power to order an investigation if recommended by the inspector in the case of a company allied to although not a subsidiary of the company. That might be a necessary ancillary power which could be brought in without much difficulty.—Yes, if the Board of Trade were given the power, but not the duty, it would be a matter for their discretion.

4037. You then say; "It is to be observed that section 171 of the Act makes a Report admissible as evidence of opinion; it is perhaps for consideration whether it would be advantageous to make it also admissible as *prima facie* evidence of fact."—Yes; I threw that out because it had arisen as a practical matter in my report. I am not quite clear under what circumstances the opinion of the inspectors could be admissible if at all, but the facts could be admissible evidence, even if the report as it is now is inadmissible.

4038. If it is evidence of the inspector's opinion it carries the matter no further; he has made an inspection and come to the opinion that A.B. is to blame, or whoever it is.—Yes. I cannot conceive what issue in litigation that might be relevant to; but the facts given of course may well be relevant in proceedings and it may or may not be right that that

report should be *prima facie* evidence. That raises rather a large question.

4039. It looks as if it would need some consideration. Have you any other points on this issue? Do you think the legislation might be amended or that an amendment might be considered?—No. The only point I have noted as perhaps worth mentioning is this, that some of the most valuable documents which came to me in the course of the investigation were the transcripts of the shorthand notes of the evidence under oath of those officers or directors who were examined. That document is not part of the report and is not available to anyone as far as I know. I presume it is available to the Board of Trade. I have still got my copies of the transcripts of the shorthand notes of the examinations that I conducted in this case and perhaps the Board of Trade should have them. But it was brought to my mind of course by realisation of the fact that since there is litigation pending the information contained in those transcripts would be of the greatest value to one side at any rate. Therefore it crossed my mind to wonder whether the transcripts might not be among those documents which the Board of Trade might at their discretion make available to interested parties. At the moment I do not think there is any such power. Indeed, I suppose if this pending litigation in my case comes to a head the party interested might well subpoena me *duces tecum* to produce the transcripts. I felt bound to put a good deal of the questions and answers into my report because I realised if I did not do so those questions and answers might never be made known either to the Board of Trade or to members of the company.

4040. Did you feel that the efficacy of your investigation was hampered by the libel laws?—No. I felt that so long as I kept myself straight and did not give anyone any reason to think that I was not behaving properly, I was privileged.

4041. Mr. Watson: You do think it would be an advantage, Mr. Fay, if enquiries could possibly be speeded up?—I felt rather badly about the length of time my enquiry took, and it is not right that any investigation should take that length of time; and I think it is the quicker the better, within reason.

4042. And you think the appointment of a chartered accountant to act jointly with the inspector would be a big help in that?—I mentioned that because I understand it to be a common practice. The Act envisages two inspectors. One of the oddities of this part of the Act is that it sometimes talks about the inspector and sometimes about inspectors in the plural, and it certainly—I hope I am right in saying this—is common to appoint two. Indeed I do not know whether it is more common than not to have two inspectors. I say that because some of my colleagues have conducted inquiries with a chartered accountant as co-inspector.

4043. It is possible for the situation to deteriorate during the investigation, to the disadvantage of those interested parties?—Yes.

4044. Did that happen at all?—That is very difficult to say. I do not think perhaps I ought to answer that, in view of the pending litigation. I think I prefer to let my report speak for itself. Quite a lot went on after the commencement of the inquiry; but I do feel that speed is important in a case of this kind, and if the present structure of independent inspectors unconnected with the Board of Trade is preserved it seems to me that the practice of having two inspectors, one a lawyer and one an accountant, is a satisfactory one.

4045. One further question on that. Do you think the law regards these appointments as essentially of individuals, or can an accountant get somebody else in his own office to do part of the work?—I think that is done. I think when an individual chartered accountant is appointed he makes use of his clerks to go and do the ground work and what one might call the preliminary auditing.

4046. That would have been of great help to you?—Yes, I think that with the help of an accountant's office staff an investigation might be completed more quickly.

4047. *Mr. Richardson:* Taking up from Mr. Watson's point, Mr. Fay, am I right in thinking the quotation for the company remained in being during the period of your investigation?—Yes, up to the last month or so. There was a bid first, I

think, shortly before Christmas. When it became effective I presume the quotation was withdrawn, but I did not follow that.

4048. Did you form any view about the propriety of there being a possibility of a bid at a time when your inspection was proceeding, especially in a case like this where it is very difficult for the shareholders of the company to know the true value of the shares bid for and very difficult for a bidder to say what he thought the value of the shares was? This was a case in which the value could have been very materially altered, depending on the outcome of your investigation?—Yes, it was a question of who knew most, I think, or who had the best hunch, the shareholder who had hung on to his shares or the bidder who might or might not get something worth having. It seems to me undesirable that there should be a bid during an investigation.

4049. Especially since it is difficult for the bidder to gauge the situation which he suspects may exist and may have to remedy if he gets control?—The inwardness of this case—there is a lot of money in it—is simply that in a certain view of the law I suppose General, London & Urban Properties, Ltd., can recover Du Cane Court, which must be worth a great deal of money, and whether or not they can recover it is a question of law. Someone appreciated that uncertainty, I suppose, and made a bid by way of a speculation or gamble. But how a shareholder could decide whether to accept or not, I do not know. He just had not the material. I suppose in practice he said to himself—"I have had these shares a long time, they have not been worth much and have not paid a dividend, and now that I am offered something useful I had better take it."

4050. And of course in practice also he was deprived of the benefit of the advice of the directors, because they were involved in this transaction?—Yes.

4051. *Mrs. Naylor:* Mr. Fay, do you think perhaps the main advantage of a Board of Trade inspection is simply its deterrent effect? Does it ever achieve anything else?—I should have thought it achieved a good deal, factual knowledge which may yet be useful to the members of the company in their decision as to

whether to continue to elect certain directors or not, and what steps to take generally. I should have thought the end product was of value. I have not any doubt in my case. It is the only case I really can speak about, but my report must be of great value to one side in the litigation.

4052. *Chairman:* Mr. Fay, I think those are all the questions we have to put

to you. It only remains for me to thank you very much once again for coming here this afternoon to help us. I am most grateful.—Thank you very much. It has been a pleasure to have come, and if I have been of any assistance I am very glad indeed.

Chairman: You have indeed. Thank you very much.

(The witness withdrew)

APPENDIX XXXI

Memorandum by the Institute of Directors

The Institute of Directors was by letter dated 15th January, 1960, requested by the Secretary of the Company Law Committee to submit its views on a list of subjects, enclosed with such letter, drawn up in accordance with the terms of reference of the Committee appointed by the President of the Board of Trade.

The comments and recommendations of the Institute on certain of the subjects listed, together with its views on certain unlisted subjects within the Committee's terms of reference, are set out in the following Memorandum.

The Institute of Directors was incorporated by Royal Charter in 1906 with the principal object of bringing together Directors of both Public and Private Companies for the purpose of strengthening their position in matters affecting their corporate interests and providing information and guidance on matters connected with the duties and responsibilities of Directors of Companies.

The Institute has a membership in excess of 35,000.

Before dealing in detail with its comments and recommendations the Institute of Directors desires to make the general observation that, in its opinion, the Companies Act of 1948 (the result of an exhaustive examination by the Committee on Company Law Amendment under the Chairmanship of Mr. Justice Cohen, now Lord Cohen) introduced legislation which provided an immense contribution to the advancement of Joint Stock Company enterprise in this country, and indeed during the years since its enactment has on the whole worked admirably.

The Institute circularised its members inviting their views on certain points that are to be considered by Lord Jenkins' Committee. In its conclusions, the Institute paid due regard to the opinions voiced in the replies to this questionnaire, but the recommendations in this Memorandum do not necessarily reflect all the views members have expressed on certain matters.

It should be made quite clear that in its deliberations the Institute, while fully conscious of its duty to its members as individual Directors, has in every case had primary regard to the public interest and the effect of its recommendations on the smooth and efficient working of industry and commerce in this country.

July, 1960.

(1) Incorporation of Companies—Memoranda of Association

(a) *Statutory declaration on incorporation of a company*

RECOMMENDATION

That the statutory declaration required under section 15 of the Companies Act, 1948, serves very little, if any, useful purpose and that this requirement be abolished.

(b) *Objects and ultra vires doctrine*

COMMENT

It is generally accepted that the *ultra vires* doctrine, whatever may have been its original justification, can cause injustice to those dealing with a company because a creditor may find that his claim is invalid by reason of the purpose for which he has supplied goods being outside the powers of the company and the objects contained in the Memorandum of Association. As a matter of practical business expediency it should not be obligatory for persons having normal everyday business dealings with a company (e.g. the supply of goods on credit) to inspect its Memorandum of Association.

So far as third parties are concerned, the Institute favours the recommendation of the Cohen Committee that a company should have the same powers as an individual and that the objects clause should not operate to the detriment of third parties. If directors act *ultra vires* the Memorandum of Association or exceed the powers conferred on them by the Articles of Association they should incur personal liability.

The Institute considers that it is desirable to retain the provision that a company must set out its objects in its Memorandum of Association (either expressly or by reference to a schedule or other document), but considers that there should be the maximum freedom to alter the objects by special resolution.

The way in which objects clauses are drafted at the present time can, in the Institute's view, be criticised on the ground that they contain far too much detail and that economy and clarity would be achieved by enabling the Memorandum to set out only the main objects of the company, and that objects subsidiary to the main objects, such as the power to borrow money, invest, acquire and develop property, to pay pensions to officers, employees, ex-officers and ex-employees and their dependants, and to subscribe to charitable, benevolent, public and useful objects, should be set out in a Schedule to the Act and should apply to all companies which have adopted the Schedule.

A further amendment which the Institute considers desirable relates to the variation of class rights. In some instances, particularly in the case of companies incorporated many years ago, class rights are defined in the Memorandum of Association. This has the effect of making them unalterable (however desirable the alteration may be in the interests of all parties) except by a scheme of arrangement under section 206 of the Companies Act, 1948. It is accordingly considered that where class rights are defined in the Memorandum of Association they should be capable of alteration in the same manner and to the same extent as if such rights were defined in the Articles of Association.

RECOMMENDATIONS

(i) That a company should be at liberty without restriction to alter the objects in its Memorandum of Association by special resolution.

(ii) That with a view to shortening the objects clause contained in a company's Memorandum of Association certain standard subsidiary objects, such as the power to borrow money, invest, acquire and develop property, to pay pensions and to subscribe to charitable, benevolent, public and useful objects, be given in a Schedule to the Companies Act for adoption and inclusion in the objects clause by any company which so decides, by reference merely to such Schedule. (It would still be necessary for a company to specify in detail in the objects clause in its Memorandum of Association the principal business which it intends to carry on and the proposed Schedule would be available for adoption in the same manner as Table A in regard to Articles of Association.)

(iii) That as regards third parties a company shall have the same powers as an individual notwithstanding anything omitted from its Memorandum of Association, and accordingly as regards third parties the *ultra vires* doctrine be abolished.

(iv) That, notwithstanding the abolition of the *ultra vires* doctrine as regards third parties, the directors shall be liable to the company for any loss caused to the company by any act or thing done or suffered by the company not within the objects of the Memorandum of Association unless the company in general meeting shall have authorised or ratified such act or thing.

(v) That rights attaching to shares and specified in a company's Memorandum of Association may be altered in the same manner and to the same extent as if such rights were specified in the company's Articles of Association.

(d) *Shares of no par value*

RECOMMENDATION

That the majority report of the Gedge Committee on Shares of No Par Value be adopted and effect given thereto by appropriate amendments to the Companies Act, 1948.

4. Donations by Companies for Charitable and Political Purposes

COMMENT

The making of reasonable donations in the interests of a company's business for these purposes should be permitted to continue and be made at the discretion of the directors.

RECOMMENDATION

That there be no alteration in the Law.

5. Exercise of Powers of Companies by Directors

(a) *Fundamental changes in a company's activities*

COMMENT

It may be suggested to the Committee that fundamental changes in a company's activities should be subject to the prior approval of the shareholders in general meeting. While the Institute is in favour of directors keeping their shareholders informed on such matters and of the general desirability of the shareholders being enabled to express their approval or otherwise of such fundamental changes, the practical difficulties involved in imposing a legal obligation to obtain such approval make it unwise to attempt to do so. In particular it would be difficult, if not impossible, to find a satisfactory definition of "fundamental". Furthermore, changes of a material nature do not necessarily take place overnight—frequently they are introduced over a period of years, as part of a developing process, and it might not be clear at what stage the shareholders should be consulted.

RECOMMENDATION

That the Directors' Report, prepared in accordance with section 157 of the Companies Act, 1948, should disclose in general terms the main activities conducted by the company during the period covered by the Report. Alternatively that such particulars should appear in a statement accompanying the Report, unless in either case such disclosure would in the directors' opinion be harmful to the company's interests.

(b) *Disposal of undertaking and assets*

COMMENT

The Institute considers that it should not be within the power of a Board of Directors to dispose of the whole or substantially the whole of the company's undertaking or assets without obtaining the approval of the shareholders. The Institute is however of the opinion that where an undertaking or assets are being sold to a Subsidiary or Holding Company the shareholders' approval should not be mandatory.

RECOMMENDATION

That the Companies Act, 1948, be amended so as to provide that, notwithstanding anything contained in a company's Articles of Association, the directors shall not have power to dispose of the whole or substantially the whole (say 75 per cent.) of the company's undertaking or assets, except to the company's Subsidiary or Holding Company or another Subsidiary of the company's Holding Company, without the consent of the shareholders in general meeting.

(c) *Issue of shares*

COMMENT

Subject to any provision in a company's Articles of Association, the question whether or not shares in the authorised capital should be issued is, and should continue to be, in the discretion of the directors, it being a cardinal principle that the power to issue shares can only be exercised *bona fide* in the interests of the company as a whole. Moreover unless the Articles otherwise provide, the directors have a discretion to choose the persons to whom the new shares shall be offered. There are occasions when it is desirable for directors to issue shares otherwise than to the members, but

except on such occasions it is submitted that new shares should be offered to the members in proportion to their existing holdings in the equity share capital. Whenever it is proposed to offer shares in the first instance to the members otherwise than in proportion to their respective holdings of the equity share capital or otherwise than to the members, the consent of the company in general meeting should be obtained if the offer may result in the issue of shares of a nominal value equal to 20 per cent. or more of the existing equity share capital.

RECOMMENDATION

That whenever an issue of equity share capital (as defined in the Companies Act, 1948) to a nominal value of 20 per cent. or more of the nominal value of the then issued equity share capital is made, such share capital shall in the first instance be offered *pro rata* to the holders of such issued equity share capital, unless the company in general meeting directs otherwise. This principle would also apply with appropriate adjustment to companies whose equity is represented by shares of no par value.

(d) *Borrowing money and charging property*

COMMENT

Whether or not the directors' power to borrow money and charge property should be restricted is a question which at present depends upon the Articles of Association of the company concerned, and it is common practice for some limit to be placed on the directors' power in this respect. Indeed, the regulations of the Stock Exchange, London, require such a limit to be imposed as a condition for granting an official quotation. The Institute is not aware of any reasons for suggesting any alteration in this respect.

RECOMMENDATION

That no change in the Law be made in this matter, and that it continues to be regulated by the Articles of Association.

6. Directors' Duties

(a) *Should directors' duties be stricter and more clearly defined?*

COMMENT

The duties and liabilities of directors are very wide and heavy. To define their duties more clearly and thus impose upon them stricter obligations would be a very difficult task and might absolve them from some duties which they ought to undertake. To do so merely to restrain the unscrupulous few might well result in unduly limiting the actions and initiative of the honest majority.

RECOMMENDATION

That there be no change in the Law in this matter.

(b) *Are directors generally aware of the legal duties arising from their fiduciary position?*

COMMENT

It is the opinion of the Institute that most directors are aware of their legal duties arising from their fiduciary position.

(c) *Directors' and officers' dealings in their own companies' shares*

COMMENT

The Institute considers that the provisions of section 195 of the Companies Act, 1948, are probably useful in deterring improper dealings, but are defective in so far as they provide a limited right of inspection of the Register of Directors' Shareholdings. The period prescribed is too short, and the Institute accordingly recommends its extension.

The Register for a wholly owned Subsidiary Company seems to serve no useful purpose, since in so far as the directors of that company are directors of the Holding

Company the required particulars would be shown in the Register kept by such Holding Company. In so far as the directors of the subsidiary company are not directors of the Holding Company it would seem that improper dealings should be controlled in the same way as are those of the company's officials (i.e. by normal disciplinary control), rather than by requiring their names to be entered in a register which is only open for inspection by the Holding Company.

RECOMMENDATIONS

(i) That the Register of Directors' Shareholdings be required to be available for inspection by shareholders and debenture holders during normal business hours and that copies thereof be supplied to any holder of shares or debentures in the company on payment of a nominal fee.

(ii) That a wholly owned Subsidiary Company should not be required to keep a Register of Directors' Shareholdings.

(d) *Disclosure of directors' interests*

COMMENT

Section 199 of the Companies Act, 1948, as at present worded is unsatisfactory because, if taken literally, it could impose an unreasonable burden on certain directors. It appears that a general notice under this section can only be employed where a director is a member of a specified company or firm (i.e. a shareholder in a company or a partner in a firm). In the practical administration of a company many contracts never come before the Board for consideration, either because they are not sufficiently important or because they are matters of routine not involving a question of principle requiring a Board decision. A director who owns, or is interested as a Trustee or beneficiary of a Trust which holds a large and constantly changing portfolio of investments should not be placed under an obligation to circularise each company of which he is a director with notices of the changes in his investment portfolio. The obligation of disclosure by a director should, as recommended below, be limited to material interests which arise at Board meetings on matters on which he is required to vote or give a decision as a member of the Board. The normal high standard of conduct expected by a Board from its Executive Directors and officers should govern the company's contracts in which they have a material interest.

RECOMMENDATION

That section 199 of the Companies Act, 1948, be repealed and replaced by a section to provide that a director shall make specific disclosure at a Board meeting of any material interest in any matter coming before him for his decision at such Board meeting.

(e) *Should bodies corporate be allowed to be directors?*

COMMENT

A corporate body is a legal entity which cannot act except by or through its directors. Accordingly it is desirable in the interests of shareholders and the public having dealings with a company that an individual or individuals accept responsibility for undertaking and discharging the duties of a director or directors.

RECOMMENDATION

That legislation should prohibit the appointment of a body corporate as a director of a company and only an individual should be eligible to fill this office.

7. Equity Shares with Restricted or No Voting Rights

COMMENT

At the time of the Cohen Committee on Company Law Amendment, in 1943-45, the matter of non-voting shares was one of little consequence, but this is not so today, when the Institute understands there are in existence many millions of equity shares

without votes. In the intervening years opinion has been growing that equity shares which do not carry full voting rights at all general meetings are objectionable in that they conflict with the feeling which is generally held that the members who run the most risk should have the power of ultimate control over the affairs of their company. To the extent that non-voting shareholders are barred from voting at general meetings of their company, this, the Institute submits, is a valid point of view. In its opinion, however, there are reasons why it would be inadvisable to make the issue of such shares illegal or to enfranchise compulsorily existing non-voting equity shares.

First, the Institute is not aware that any actual harm has been suffered by the holders of non-voting equity shares by reason of the absence of full voting rights.

Secondly, in relation to existing non-voting equity shares in issue, the Institute considers it would not be practicable to introduce legislation applying to such shares.

Thirdly, it is the Institute's belief that legislation could not be made fully effective in regard to existing or future non-voting equity shares short of proceeding on the lines of the Indian Companies Act, 1956, which in brief permits only two kinds of capital—preference and equity—and stipulates that every equity share shall have voting rights proportionate to the amount paid up thereon. To introduce rigid legislation of this type in this country, the industrial structure of which is very different, would be likely to hinder the creation and free flow of new capital. A case in point has been brought to our notice where the preference shareholders possessed equal voting rights with the existing equity shareholders and were in a position under the Articles to block the issue of new shares; such preference shareholders refused to agree to the issue of further equity shares with full voting rights, as this would have diminished the quantum of preference voting control. The company concerned accordingly had no alternative but to issue further equity shares with no voting rights in order to raise additional capital.

Fourthly, the Institute submits that the Companies Act, 1948, affords certain general safeguards which are available to all classes of shareholders, including non-voting equity shareholders, against infringement of class rights or against oppression; the Institute would refer, in particular, to sections 72, 164, 165, 206, 209 and 210.

Section 72

A non-voting equity shareholder whose class rights may be varied pursuant to some power reserved in the Memorandum or Articles of Association has the same right as any other member to apply to the Court to have any such variation cancelled.

Sections 164 and 165

Non-voting equity shareholders may apply to the Board of Trade to investigate the affairs of their company where they feel that there is good reason so to do. Moreover, the Board of Trade may initiate an investigation where one or more of the circumstances mentioned in section 165 (b) is drawn to its attention by a non-voting equity shareholder.

Section 206

A non-voting equity shareholder who is affected by a scheme of compromise or arrangement has the same right to apply to the Court as any other member and will only be bound by the scheme if the requisite majorities are obtained at the meetings convened by the Court under section 206.

Section 209

A shareholder who receives an offer for his shares has a statutory right to apply to the Court if the machinery of section 209 is put into operation; and he will be protected by the Court if the terms of the offer are unfair. This protection is available where the dissenting shareholder holds non-voting equity shares in the "transferor company" and where the consideration consists of non-voting equity shares in the "transferee company".

Section 210

It is already open to a non-voting equity shareholder who complains that the affairs of his company are being conducted in a manner oppressive to the non-voting equity shareholders including himself to apply to the Court for an order. The Institute believes that if this section is strengthened (in accordance with the recommendation in its main Memorandum) it would serve as a useful safeguard for this class of shareholder.

For all the above reasons the Institute considers that the issue of shares with no voting rights should not be prohibited by law. The same considerations apply to shares with restricted voting rights.

At the same time, it is considered that the present position should be improved in the following respects:—

- (a) The designation of shares with restricted or no voting rights should clearly reveal the true nature of the rights attaching to them, e.g., "non-voting" ("n.v.") or "restricted voting" ("r.v."). If the shares were so described in the company's Memorandum and Articles of Association and on the share certificates they would presumably be so described in the Stock Exchange Official List and in the Press. The present practice of describing non-voting equities as e.g., "A" shares, while being convenient, is, the Institute submits, inadequate and misleading.
- (b) The holders of non-voting equity shares should have the right to receive all documents which the voting equity shareholders are entitled to receive including notices of all general meetings of the company and the right to attend and speak (but not to vote) at them. Apart from the receipt of dividends and the annual accounts, a voteless equity shareholder may have no other contact with his company, and it seems only just that he should be able to attend and (if he wishes) voice his opinion on his company's "open day".

The Institute believes that the rights which have been referred to earlier, together with the power to attend and speak at general meetings of the company, should afford adequate safeguards against any attempt to take advantage of the disabilities of voteless equity shareholders.

RECOMMENDATIONS

1. That the issue of non-voting or restricted voting equity shares should not be prohibited by Law, nor should such shares now in issue be enfranchised compulsorily.
2. That all equity shares with restricted or no voting rights (existing or to be issued) should in their official designation clearly indicate in general terms the voting limitations attaching to them. A description such as "A" share should not in itself be deemed to be adequate.
3. That the holders of equity shares with restricted or no voting right be entitled to receive notices of, and to attend and speak at, all general meetings of the company.
4. That it should be made clear, if it is not already clear, that notwithstanding any provisions to the contrary in the Memorandum or Articles of Association or attached to any shares by the terms of issue non-voting and restricted voting equity shares shall be deemed to be separate classes of their own, independent of any other equity shares of the company, in any matter affecting the rights attached to such non-voting or restricted voting equity shares; and that any provision in the Memorandum or Articles of Association or any term attached by the terms of issue that any equity shares shall have restricted or no voting rights shall be of no effect in relation to any separate general meeting of the holders of such shares.

8. The Protection of Minorities**COMMENT**

The Institute considers that it should be sufficient to support a petition for relief under section 210 of the Companies Act, 1948, that the affairs of the company are being

conducted in a manner oppressive to some part of the members (including the petitioner), oppression having been held to mean something which is "burdensome, harsh and wrongful"—see per Viscount Simonds in *Scottish Co-operative Wholesale Society v. Meyer* 1959 A.C. 324 at p. 342. As the section is drafted, the petitioner (in addition to proving oppression) has to fulfil two conditions, viz:

- (i) he must show that the facts justify the making of a winding up Order under the "just and equitable" rule; and
- (ii) he must show that a winding up would unfairly prejudice the oppressed part of the company's members.

It is suggested that these two conditions impose an unnecessary and undesirable fetter on the Court's jurisdiction to grant relief under section 210. At the same time it is suggested that it should be made clear that the personal representatives of a deceased member can petition for relief under section 210.

RECOMMENDATIONS

(i) That the statutory requirements in section 210(2)(b) of the Companies Act, 1948, to the effect that before the Court can grant relief under the section it must be of opinion

"that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up" be abolished.

(ii) That the personal representatives of a deceased member shall have the same right to petition for relief under section 210 and to be counted as "part of the members" as the deceased member would have had if still living.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders*

COMMENT

The Institute is aware of a feeling among many directors that the nominee system, which enables the true ownership of a company's securities to be concealed, is undesirable. The Institute is, however, of the opinion that it would not be possible to devise legislation on the subject without interfering with legitimate transactions. The right to create a variety of interests under wills, settlements and the like is of benefit to the community and should not be restricted. Legislation to enforce disclosure of the "true" owner would, in the view of the Institute, be likely to encroach on the legitimate rights of individuals in regard to their private affairs. In so far as the nominee system is capable of facilitating improper transactions, the appropriate remedy would seem to be a more extensive use by the Board of Trade of its powers of investigation and report under sections 172 and 173 of the Companies Act, 1948.

(b) *Control through nominee directors*

COMMENT

It is a cardinal principle that any director of a company must exercise his powers as such *bona fide* in the interests of the company as a whole. A nominee director (i.e., a director representing an outside interest) is in no different position in this respect: he must exercise his powers *not* with a view to enhancing the exclusive interests of his nominator but in the interests of the company which he and his colleagues were appointed to direct.

RECOMMENDATION

That there be no change in the Law.

13. Multiplicity of Directorships Held by One Individual

COMMENT

It would not be commercially desirable to limit by legislation the number of directorships which any individual may be permitted to hold since it is in the opinion

of this Institute a matter of domestic policy for decision by the companies concerned in each individual case, depending upon the director's required contribution in time or specialised knowledge to the business of the company.

14. Practice of carrying on Business through Associated and Subsidiary Companies

(a) *Associated companies*

COMMENT

A number of cases have recently arisen, particularly in connection with take-over bids, in which shareholdings in Associated Companies have appeared in the accounts of the companies owning the shareholdings at quite nominal figures, well below the true worth of such investments. Where such investments in Associated Companies are at all substantial, it would seem that some indication of the dividends received from them, and the cover for such dividends, ought to be given to the shareholders in the company owning the shareholding or shareholdings.

RECOMMENDATIONS

(i) That where a trade investment is quoted on a Stock Exchange the market value be given in the balance sheet (whether by way of note or otherwise): where there is more than one such investment, the aggregate market value should be stated.

(ii) That a company be required to state by way of note to its accounts in respect of its holdings in Associated Companies (being investments not quoted on a recognised Stock Exchange in the United Kingdom):

(a) the total amount of the dividends, if any, paid by the Associated Companies and received by the Holding Company in respect of the year being reported on;

(b) the total amount of the earnings from which these dividends have been paid attributable to the Holding Company by reason of its investments in such Associated Companies.

A company shall be deemed to be an Associated Company of another company where the latter company holds more than 25 per cent. of the equity share capital of the former and is not its Holding Company.

(iii) That these requirements should not apply where the principal business of the company is the holding of, or dealing in, investments.

(b) *Subsidiary companies*

COMMENT

It is considered that the conduct of business and administration through the medium of a Holding Company and Subsidiary Companies is a practice which has been of considerable benefit to industry and commerce.

RECOMMENDATION

That the structure of Holding and Subsidiary Companies be permitted to continue.

16. Take-over Bids

COMMENT

It is the firm belief of the Institute that the development and expansion of business by the process of amalgamation is an essential and natural feature in the economic growth of this country and it should not be impeded by unnecessary restrictions. Many of the larger companies have been built up in this way. It is very desirable, however, that the satisfactory code of conduct which is at present observed in almost all cases should be adopted universally and it is suggested that it could conveniently be laid down in the Companies Act itself so as to apply to any individual or corporation making a take-over bid. Having regard to the great diversity between different bids and circumstances, it is recommended that a measure of discretion be given to the

Board of Trade to relax or vary upon application in any particular case any requirements which may be prescribed.

The principal requirements should ensure that:

- (a) Sufficient time be given to the shareholders concerned (and their directors) to enable them to make the necessary decisions and sufficient information be available to them for this purpose.
- (b) There be a reasonable certainty as to the ability of the bidder to comply with his undertakings.
- (c) The identity of the bidder be disclosed.

RECOMMENDATIONS

(i) That take-over bids be covered by the Companies Act and the bidder and the biddee Board be under an obligation to conform to certain requirements governing information and procedure to be included in a Schedule to the Act. A proposed form of Schedule is annexed to these Recommendations.

(ii) That the expression "take-over bid" be clearly defined. It should be wide enough to cover a general offer to acquire shares of other securities of a particular class or classes, where the result of full acceptance would be the acquisition of such a percentage as together with any shares or securities already held by or on behalf of the bidder would total more than 50 per cent. of the class or classes or would give voting control of the company to the bidder. The definition should be so drawn as not to cover market dealings or acquisitions privately entered into. (Note: A take-over bid normally involves both a time limit for acceptance of the offer and a minimum volume of acceptances.)

(iii) That compliance with the proposed statutory requirements be enforced by adequate penalties and all circulars issued by or on behalf of the bidder and the directors of the biddee company continue to be subject in all respects to the provisions of section 13 of the Prevention of Fraud (Investments) Act, 1958.

(iv) That all or any of the requirements contained in the Schedule and to be complied with by the bidder and by the biddee's directors may be waived by the Board of Trade on application in any particular case or cases and the waiver should be subject to such conditions, if any, as the Board of Trade shall direct.

(v) That the take-over bid may be made to the Board of the biddee for circulation (with the agreement of such Board) to the biddee's shareholders or direct to the biddee's shareholders, but in the latter event it must not be despatched until it has been lodged at the registered office of the biddee for a period of at least 14 days. If the directors of the biddee circulate to their shareholders a bid which they have received they should at the same time despatch to their shareholders a copy of any prior bid, the 14-day time limit for which has not then expired.

(vi) That the bidder shall not circularise the biddee's shareholders prior to the despatch of his bid and the biddee directors (unless they are recommending acceptance of the bid or the bidder agrees) shall likewise not circularise their shareholders in connection with the bid before the 14-day time limit has expired.

Proposed Schedule

Part I. Requirements applicable to the bidder

1. The offer must contain full details of:

- (a) the securities which it is proposed to acquire and the consideration offered;
- (b) any interest whatsoever (including shareholding interests held directly or indirectly through nominees) of the bidder and its directors in the biddee;
- (c) the arrangements made for payment of the cash purchase price (if it is a cash offer) at the due date;
- (d) the securities offered in exchange and such details must conform to the requirements of the Companies Act, 1948, regarding the contents of prospectuses unless

- (i) the securities offered are dealt in on any recognised Stock Exchange in England or Scotland, or
- (ii) the securities offered by the bidder will, in fact, be of the same class as other securities issued by the bidder which are then dealt in and officially quoted on any recognised Stock Exchange in England or Scotland and it is a term of the offer that permission is granted by any such Stock Exchange for dealing in and quotation for the securities offered, or
- (iii) the securities offered are not dealt in or officially quoted on any recognised Stock Exchange in England or Scotland but other securities of the bidder are so quoted and dealt in and it is a term of the offer that permission for dealing and quotation in respect of the securities offered is so granted.

[N.B. It is proposed that the Board of Trade be given power to relax the foregoing requirements in any particular case.]

2. The offer must state whether the bidder is acting as principal or agent and if the latter the name of the individual or corporation on whose behalf the bidder is acting either directly or indirectly and full particulars of any collateral arrangement to transfer the securities to a third party or to grant or agree to grant to any third party any option or pre-emption right in respect of the securities.

3. The offer must state clearly whether it is proposed to make any payment or grant any benefit (by or from the bidder or the biddee) to the directors of the biddee for loss of office or early retirement or otherwise in connection with the offer and, if so, full details must be disclosed.

4. No offer may be made in relation to a take-over bid in respect of any class of securities unless it is made to all holders of securities of that class.

5. If the offer relates to less than the total amount in issue of any class of securities of the biddee (other than those held by or on behalf of the bidder) it shall be open to acceptance by all the holders of that class of securities and if acceptances are received for a greater number of securities than that in respect of which the offer is made the number of securities to be acquired by the bidder from each of the acceptors shall be reduced rateably, so far as practicable, according to the number of securities in respect of which the offer is accepted by each acceptor.

6. Every bid must be open for acceptance for not less than 21 days after it is communicated to the biddee's shareholders.

7. When a bid which is dependent upon a minimum number or amount of acceptances is declared unconditional, the bidder must at the time of that declaration also state the number or amount of the securities in respect of which acceptances have been received.

Part II. Requirements applicable to the Board of the Biddee

(1) By agreement between the bidder and the biddee's Board, the bid and the communication from the biddee's Board referred to below containing all necessary information may be circulated to the biddee's shareholders at any time.

(2) Except as provided in (1) above, the biddee's Board shall not earlier than 14 days and not later than 21 days after receipt of the bid from the bidder send to the biddee's shareholders a communication containing in particular the following information:

- (a) Their comments on the offer and their recommendation to accept or reject it or a statement that they can give no advice as to acceptance or rejection.
- (b) All information concerning the biddee which, in the opinion of the directors, is reasonably necessary and relevant to enable shareholders to decide whether to accept or reject the bid.

- (c) Particulars of the securities (if any) held by each of the directors of the biddee in the bidder and the biddee and whether the directors propose to accept the offer in respect of their holding of securities in the biddee.
- (d) Particulars of any payment or the grant of any benefit proposed to be made to the directors of the biddee for loss of office or early retirement or otherwise in connection with the offer.
- (e) If the securities for which the bid is made are officially quoted on any recognised Stock Exchange in England or Scotland, a statement
- (i) of the latest available middle market quotation prior to the date of the offer,
 - (ii) of the highest and lowest middle market quotations during the 12 months immediately preceding the date of the offer and the respective dates of such quotations, and
 - (iii) where the offer has been the subject of a preliminary announcement in the Press or by other means the latest middle market quotation immediately prior to that announcement.
- [If the securities are officially quoted on the Stock Exchange, London, only the prices on that Stock Exchange need be stated.]
- (f) If the securities in respect of which the bid is made are not officially quoted on any recognised Stock Exchange in England or Scotland, a statement of the highest and lowest prices (ascertained from registered transfers) at which the securities have changed hands during the 12 months prior to the date of the offer and the dates of such prices. In addition, if there has been a preliminary announcement to the public in the Press or by other means any effect of such announcement on the aforesaid prices.

21. Accounts

(a) *Revaluation of fixed assets and use of any resulting surplus*

COMMENT

In many cases the value attributed to the fixed assets appearing in a company's accounts is in today's circumstances much less than their current value and in some quarters the suggestion has been made that company accounts should give an indication of present-day values. The general principle enacted in Part I of the Eighth Schedule to the Companies Act, 1948, is that a company's fixed assets are to be shown at their original cost and that the total provided to date for depreciation thereon is also to be shown. It is, however, provided alternatively that fixed assets may be shown at a valuation if the directors so wish.

The general basis of showing the fixed assets at cost follows the practice for a company's accounts to take the form of an historical document by which directors account for the monies with which they have been entrusted and the manner in which they have been applied. A few companies have in fact revalued fixed assets in recent years, carrying any resulting surplus to a capital reserve. Such a surplus is not available for distribution to shareholders in cash because there is a well-established principle that capital surpluses can only be distributed in cash if they have in fact been realised and if also before such distribution is made provision has been made for any unrealised capital losses which may exist. The surplus is, however, available for a bonus issue of shares and that course has been adopted in some cases.

Revaluation to a figure higher than existing book values can present a company with some problems. The annual charge for depreciation would have to be calculated on the new figures and would probably be higher than depreciation calculated by

reference to original cost. Economists hold that this does in fact produce a more correct result. Many companies which have not chosen to revalue achieve an equivalent result by appropriating from their profits a sum equal to the difference between depreciation calculated on historical cost and depreciation calculated by reference to current values. An important factor in this connection is that for taxation purposes depreciation allowances are calculated by reference to original cost so that if the charge in a company's profit and loss account is a higher figure because it is calculated by reference to current cost, the excess has been borne out of taxed profits. It is possible to imagine cases where after providing for taxation computed by reference to a depreciation allowance based on original cost and after charging depreciation calculated by reference to current values, nothing would remain for the shareholders.

Suggestions have been made that the law should require a company to revalue its fixed assets at stated intervals, say every five years. Apart from the points already mentioned there would be the very real difficulty of ensuring that such revaluations were made on comparable bases as between different companies. Experience has shown that valuations made by professional valuers can and do differ widely and quite apart from this it would seem to be impracticable to insist on professional valuation because the amount of work entailed would be immense.

In many responsible quarters it is held that the value to a company of its fixed assets turns very largely on the profit which emerges from their use. If profits are high then fixed assets may have a substantial going-concern value. If profits are low then the value of the fixed assets to the company in their existing use is correspondingly reduced and the stage might be reached where it would be better for a relatively unsuccessful company to cease trading and to dispose of its assets for some other purpose.

RECOMMENDATION

That companies should not be required by law to revalue fixed assets in their accounts, since it is always open to the directors to give their shareholders an indication of current values if they so decide. Moreover, there is nothing to prevent a Board from incorporating revalued figures in the accounts should they consider that that is the proper course to adopt in the circumstances.

(b) *Share premium account*

COMMENT

The attention of the Institute has been drawn to differences of legal opinion regarding the procedure which directors should adopt when their company acquires the shares of another company and the consideration consists of shares issued by the purchasing company. Where in such circumstances the value of the shares acquired exceeds the nominal value of the shares issued as consideration for the purchase and the shares acquired are brought into the balance sheet of the acquiring company at their true value, it is clear from *Henry Head & Co. v. Ropner Holdings Ltd.* 1952 Ch. 124 that the excess must be transferred to Share Premium Account. Some legal authorities take the view that having regard to the decision in that case it is the duty of the directors of a purchasing company to value the assets acquired in order to ascertain whether that value exceeds the nominal value of the shares issued to the vendor, with a view to the excess, if any, being transferred to Share Premium Account. Other authorities, however, take a more restricted view of the decision in the *Ropner* case and suggest that there is no such duty applying to the directors of the purchasing company and that they are entitled if they so desire to take the assets acquired into their books at the nominal value of the shares issued in exchange for them.

RECOMMENDATION

That the new Companies Act should clarify the position arising from conflicting opinions regarding the decision in *Henry Head & Co. v. Ropner Holdings Ltd.* As to the manner in which the decision should be clarified, the Institute considers that the assets acquired should be valued by the Board of the acquiring company but without any obligation to incur the expense of obtaining professional valuations; the Board

should make a *bona fide* estimate of the value of the assets acquired, and if they form the view that there is a surplus value compared with the nominal value of the shares their company is issuing, then it should be placed to the credit of a Share Premium Account.

(c) *Use of pre-acquisition profits of subsidiaries*

COMMENT

The only reference in the Companies Act, 1948, to the treatment of revenue reserves of a company which is taken over by, or amalgamated with, another company is contained in paragraph 15 (5) of the Eighth Schedule where it is provided that "Profits or losses attributable to any shares in a subsidiary shall not be treated (as revenue profits or losses) so far as they are profits or losses for the period before the date on, or as from which, the shares were acquired. . . ." This provision is in line with the general proposition that pre-acquisition profits of a subsidiary are of a capital nature so far as the holding company is concerned.

In the simple case where Company A pays, say, £200,000 for the whole of the shares in Company B (share capital £100,000 and revenue reserves £100,000, together represented by net current assets of £200,000), the total purchase consideration of £200,000 paid by Company A is clearly represented by the £200,000 net current assets in Company B. If then Company B declares a dividend of £100,000 out of its revenue reserves and pays that amount to Company A the net assets of Company B become diminished to £100,000 and it would seem to be desirable for Company A to apply the dividend in writing down the value of the shares acquired. It is thought that the payment of the dividend by Company B cannot itself be illegal, but it is suggested that the matter be put beyond doubt by legislation.

There is, however, a much more difficult point in connection with pre-acquisition profits when companies merge. A common form of merger is for a Holding Company to be set up which acquires the shares of two or more underlying companies so that the shareholders in those companies become shareholders in the new Holding Company. It seems unreasonable in such a case for the revenue reserves of the original companies to be frozen by the merger because in that event the new Holding Company starts operations without any revenue reserves at all. If the underlying companies were to run into trading difficulties in the years following the merger they might, had they remained independent, have been able to continue paying reasonable dividends to their shareholders by using their existing revenue reserves. On the same basis they could, of course, still pay corresponding dividends to the new Holding Company, but if a strict interpretation of the law is that such dividends are capital in the Holding Company's hands then merely because the merger had taken place such dividends would have to be regarded as capital in the Holding Company's accounts and that company would have nothing out of which to pay dividends to its members.

Here responsible legal opinion is divided, some lawyers taking the view that, because the Holding Company is a new undertaking, the freezing as capital of the revenue reserves of the underlying companies must be accepted, while other lawyers take the view that this is not the case. In some of the recent mergers an attempt to overcome the difficulty has been made by inserting into the terms of the merger documents an agreement by the shareholders of the underlying companies that distributions out of the revenue reserves of their companies existing at the date of the merger can be regarded as available for revenue purposes in the Holding Company's accounts; but (if the former view is correct) it is suggested that the difficulty is not overcome. Shareholders cannot confer on the Board a power to distribute dividends out of profits not available for dividend—and *ex hypothesi* the pre-acquisition profits are not so available.

RECOMMENDATIONS

(i) That it be put beyond doubt that the payment by a subsidiary to its Holding Company of a dividend out of pre-acquisition profit is not illegal.

(ii) That where upon a reconstruction or amalgamation shareholders remain substantially the same revenue reserves should remain as such notwithstanding the

reconstruction or amalgamation. This follows the recommendation in paragraph 65 of the Majority Report of the Gedge Committee, and in the view of the Institute (and indeed of the Gedge Committee) it should also apply to shares having a nominal value.

Disclosure of "turnover"

COMMENT

The Institute believes that under this heading evidence will be given to the Committee proposing that the Eighth Schedule to the Act should be amended so as to require the Accounts to show details of turnover or sales figures, possibly supplemented by particulars of outgoings and overhead expenses. We recognise that many companies already publish information of this kind and that this is a tendency which should be encouraged, since such figures often provide valuable information on the progress of the business. We are, however, strongly of the opinion that to attempt to lay down a legal obligation in this matter which would apply to all companies would be a mistake, since circumstances differ so widely. In some cases, turnover can be appropriately expressed in money terms, while in others a more informative picture can be presented by doing so in quantitative terms. In certain instances turnover figures could very easily be misleading. Again, there are instances where such figures are completely valueless as an indication of the trend of the business; for example, a company dealing as factor in a particular commodity may be remunerated on quantity, irrespective of the price charged to the customer, and it would be entirely irrelevant in comparing one year with another to note that turnover had increased merely as the result of an increase in the price of the goods handled. For these reasons the Institute is of the opinion that a company should, as at present, have absolute discretion to withhold or give to the shareholders and the public information on the volume of business done.

RECOMMENDATION

That it is not desirable to impose any legal obligation upon a company to disclose in its accounts information concerning production, trading or turnover additional to the requirements laid down in the Companies Act, 1948, and that it should remain a matter for decision in the discretion of each company whether any such disclosure is made, and the extent and form of it.

Disclosure of directors' remuneration

RECOMMENDATIONS

(i) That section 196 (2) of the Companies Act, 1948, be amended so that benefits received by a director (otherwise than in cash) to be disclosed shall be confined to those charged to United Kingdom Income Tax.

(ii) That section 198 of the Companies Act, 1948, be amended so that the notice to be given by a director of his emoluments, compensation, pension, etc., shall be given in writing.

23. Provisions as to Returns—Return of Allotments

COMMENT

The descriptions of shareholders, although no longer required in the Register of Members and Annual Return, is still required in the Return of Allotments under section 52 of the Companies Act, 1948. This seems unnecessary.

RECOMMENDATION

That it should no longer be necessary to state a shareholder's description on the Return of Allotments.

25. Foreign Companies

COMMENT

The Institute is of opinion that the wording of section 410 of the Companies Act, 1948, is rather unfortunate in that it encourages foreign countries to impose unduly irksome accounting regulations on British companies with trading concerns abroad,

on the ostensible ground that foreign companies have to comply with the full accounting requirements of the Companies Act, 1948, whereas it is understood that in practice they are given very reasonable treatment.

RECOMMENDATION

That section 410 of the Companies Act, 1948, be replaced by a section permitting foreign companies to file accounts in the form required by their country of residence (suitably translated) subject to power being reserved to the Board of Trade to demand presentation in the form required by the Companies Act, 1948 (e.g., where the standard of accounting is abnormally low or where the regulations of a particular overseas country as applied to foreigners are themselves unduly strict).

26. Internal Management and Administration

(b) *Extraordinary and Special Resolutions*

COMMENT

The distinction between a Special and an Extraordinary Resolution serves little, if any, useful purpose.

RECOMMENDATION

That all business at present requiring an Extraordinary Resolution should in future require to be passed by a Special Resolution.

28. Disclosure of Directors' Names

COMMENT

Section 201 of the Companies Act, 1948, requires the publication of the names of a company's directors on its letter headings and other documents issued to any person in Her Majesty's Dominions. It does not, however, apply to any company incorporated prior to 23rd November, 1916. It is understood that this section was introduced during the 1914-1918 war as a measure directed against persons of enemy origin in this country, and it is difficult to understand why it has persisted, since the public feeling which brought it about has long since changed.

The Board of Trade has power to exempt companies from the requirement, and it is believed that this power is freely exercised. In the view of the Institute the section is not in accord with current requirements, at least so far as public companies are concerned.

RECOMMENDATION

That section 201 of the Companies Act, 1948, be repealed or, if it is thought that there is some value in retaining its provisions in respect of private companies, that it be limited in its application to those companies.

29. Any other matters

(a) *Register of Directors and Secretaries*

COMMENT

The existing provisions of section 200 of the Companies Act, 1948, require that where a director is a member of the Boards of a number of companies the slightest change in his address or other particulars has to be notified to the Registrar of Companies by each of the Companies of which he is a director. The Institute submits that this duplication is unnecessarily cumbersome and that a great deal of time and labour would be saved if the recommendation submitted below were put into effect.

RECOMMENDATION

That sub-sections (4) and (5) of section 200 of the Companies Act, 1948, be amended so that upon a person being appointed or ceasing to be director or secretary of a company, that company only shall be required to send the return or notification mentioned in sub-section (4) within the statutory period of 14 days, and so that (subject as aforesaid) a company shall not be required to notify changes in any of the particulars as to its directors or its secretary more than once a year.

(b) Alternate directors

COMMENT

The Companies Act, 1948, contains no reference to alternate directors although modern Articles of Association commonly contain provisions empowering a director to appoint an alternate to attend and vote in his stead.

RECOMMENDATIONS

(i) That a provision be inserted in the new Companies Act expressly permitting (if the Articles so provide) a person to be appointed an alternate director to attend and vote in place of the director appointing him.

(ii) That unless the Articles of Association otherwise provide—

(a) every such appointment shall be made by notice in writing to the company;

(b) any person approved for the purpose by the Board (whether a member of the company or not) may be appointed;

(c) every alternate director while holding office as such shall be entitled to notice of meetings of the directors as if he were a director and not an alternate director, and

(d) a director may act as alternate director for another director and shall be entitled to vote for such other director as well as on his own account.

(iii) That an alternate director shall *ipso facto* vacate office if and when his appointment expires by effluxion of time or the director appointing him vacates office as a director or removes the alternate director from office as such by notice in writing under his hand served upon the company;

(iv) That no alternate director shall be entitled as such to receive any remuneration from the company, but that an alternate director shall be entitled to be paid all travelling, hotel and other expenses reasonably incurred by him in exercise of the duties or privileges of his office if the Articles of the company so provide;

(v) That an alternate director shall be entitled in the absence of his appointor to attend at general meetings and to attend and vote and be counted in the quorum at meetings of the Board or any Committee of the Board and if duly authorised in that behalf by the Board to sign or countersign an instrument to which the seal of the company is affixed or any cheque, promissory note, draft, bill of exchange or other negotiable instrument;

(vi) That subject as aforesaid an alternate director shall not be entitled to exercise any of the powers or duties of a director;

(vii) That (even if section 201 is not repealed) the names of alternate directors should not be required to be shown on the company's trade catalogues, trade circulars, show-cards and business letters, and they should not be deemed directors for the purposes of section 200.

(c) Local, service and subordinate directors

COMMENT

It is the view of the Institute that it is undesirable that anyone should be permitted to describe himself as a director unless he has the full responsibilities associated with that title.

RECOMMENDATION

That every person appointed to any position with a company described as that of director (whether entitled a Service Director, Local Director, Executive Director or Subordinate Director or howsoever the directorship be described or qualified) be entitled so long as he occupies that position (notwithstanding any provision to the contrary in the company's Articles of Association or in the terms of his appointment) to notice of, and to attend and vote at, every meeting of the Board of the company and to inspect its books of account and statutory books and registers, but this recommendation shall not apply to Banking Companies or Assurance Companies or to any

person described as a director only by virtue of his appointment as an alternate director and unless the Articles otherwise provide it shall not require notice of Board Meetings to be given to a director who is absent from the United Kingdom.

(d) *Minimum age for directors*

RECOMMENDATION

That no individual shall be eligible for appointment as a director unless he has attained the age of twenty-one years.

(e) *Directors' qualification shares*

COMMENT

It is not considered desirable to repeal section 182 of the Companies Act, 1948, because the imposition of a director's share qualification is not mandatory and depends on the Articles of Association of a company; moreover the regulations of the Council of the Stock Exchange, London, do not require directors to hold qualifying shares as a condition precedent to permission to deal in and quotation for the securities of a company. Owing to delays, e.g., during periods of extreme pressure on the Stock Exchange, between the date of purchase of a shareholding and the entry of a purchaser's name on the Register of Members and the issue of the relative share certificate, it is considered desirable that the present period of two months be extended to three months.

RECOMMENDATION

That section 182 of the Companies Act, 1948, be amended to permit a director to acquire his qualification shares within three months instead of two months after his appointment.

E. L. SPEARS,
*Chairman of Council,
Institute of Directors.*

ALFRED READ,
*Chairman of Company Law Committee,
Institute of Directors.*

RICHARD POWELL,
*Director General,
Institute of Directors.*

APPENDIX XXXII

Memorandum by The Chartered Institute of Secretaries

1. The Council of the Chartered Institute of Secretaries, in compliance with the invitation contained in a letter from the Secretary of the Company Law Committee dated 15th January, 1960, has considered carefully the terms of reference of the Committee set up under the Chairmanship of Lord Jenkins, and is happy to submit the observations and suggestions thereon, set out in the following paragraphs of this memorandum.

Introduction

2. Before dealing with particular issues, however, the Council desires to record its view that while the substantial developments which have occurred in the past twelve years in business organisation and methods in Britain have inevitably created some problems which appear to render legislative action desirable, the Companies Act, 1948, has on the whole proved to be satisfactory and efficient in operation, with the consequence that in the opinion of the Council there are relatively few matters of substance upon which further statutory provision is needed.

3. In compiling this memorandum, while regard has been had to the list of subjects set out in the annex to the Secretary's letter of 15th January, 1960 (and the following observations have been arranged, as far as practicable, to conform with that list), the Council has drawn primarily on the practical experience of members of the Institute of the operation of the law. Accordingly the suggestions made relate primarily to matters which come within the particular sphere of the company secretary. References in brackets are made to the sections of the Companies Act, 1948.

Incorporation of Companies—Memorandum of Association

4. *Number of Members (section 1).* There seems to be no valid reason, in modern circumstances, why the minimum number of persons required to form a company should be larger in the case of a public company than for a private company. However, the Institute feels that three is more satisfactory than two for the minimum number, since it makes it possible for a quorum to act. It is therefore suggested that the minimum number of persons required to form a company should in all cases be three.

5. *Ultra vires Rule: The Objects Clause (section 5).* The *ultra vires* rule appears to have been designed for the protection of third parties who deal with the company, and of its shareholders. The report of the Committee under the chairmanship of Mr. Justice Cohen (as he then was) has pointed out that the development of the practice of drafting the objects clause in the memorandum of association in the widest terms has changed the protection which the *ultra vires* rule might have afforded to third parties into something of a "pitfall" for them, while making the protection for shareholders largely illusory.

6. It is therefore suggested that the view submitted by the Cohen Committee should now be adopted—i.e., that since the doctrine of *ultra vires* serves no positive purpose but is a cause of unnecessary prolixity and vexation, the law should provide that any company, whenever incorporated, and notwithstanding the terms of its memorandum of association, should have, as respects third parties, the same powers as a natural person; and that the objects clause in the memorandum should operate only as a contract between a company and its members as to the rights exercisable by its directors.

7. It is further suggested that, in the interests of simplification and efficiency, a new measure should contain a schedule, perhaps on the lines of the Third Schedule

to the Companies Act, 1959, of Tasmania, setting out incidental and ancillary objects and powers which would be statutorily implied in addition to the main and any other objects of the company as specified in its memorandum whenever such company was registered—except to the extent that such statutory addition is expressly excluded in any particular memorandum.

8. The Institute wishes also to suggest that the power at present given to a minority by section 5 of the Companies Act, 1948, to apply to the Court for cancellation of any alteration of objects decided upon by special resolution of the company should be removed.

9. *Shares of No Par Value.* In March, 1953, the Institute submitted a written memorandum of evidence to the Committee appointed under the Chairmanship of Mr. Montague L. Gedge, Q.C., and in the following month supplemented that memorandum by oral evidence given by three representatives of the Institute.

10. The evidence then given made it clear that the Institute was of the opinion that it was desirable to amend the Companies Act, 1948, so as to permit of the issue of shares of no par value. The Institute today is of the same opinion. Indeed it feels that now there can scarcely be any logical objection to the proposal, inasmuch as securities issued by unit trusts under regulations made by the Board of Trade are, in effect, shares of no par value; and, according to figures published by the "Financial Times", units to the value of nearly £200,000,000 were in existence at 31st December, 1959.

11. A copy of the written evidence submitted is annexed to this memorandum for reference. It will be observed from paragraph 7 of that evidence that certain conditions governing the issue of no par value shares were suggested by the Council of the Institute. Amongst other things it was suggested that the facility (i.e., of issue of such shares) could apply to preference as well as to ordinary shares; in the light of experience in North America since 1953 the Institute would wish now to withdraw that suggestion.

12. In suggesting special safeguards relating to the issue of shares of no par value, the Institute proposed that it should be required that all issues for cash of such shares subsequent to the first should be offered *pro rata* to the existing members holding shares of the same class. The Institute now feels that this proposal should be modified so that that condition should not apply in the case of issues made in connexion with the taking over of another business, or in a case in which the company in general meeting, or, subject to any conditions imposed at the time when the creation of the capital was authorised, the directors, decide otherwise.

13. Subject to the points set out above, the Institute desires to confirm the evidence submitted in 1953 to the Gedge Committee.

14. *Application of Table A (section 8).* It is felt that the opportunity might be taken, in amending legislation, to provide that if, in the case of any company, articles are not registered, and the company concerned does not expressly adopt Part I or Part II of Table A, Part I should apply.

Classification of Companies

15. The Institute does not desire to recommend any drastic change in the law relating to the classification of companies, as between public and private and exempt and non-exempt private companies. It is suggested, however, that the opportunity should be taken of making some relatively minor amendments to provisions relating to exempt private companies, as indicated in the following three paragraphs.

16. *Notice of Increase of Share Capital (section 63 (2)).* The Institute suggests that this section, 63 (2), should be brought into conformity with section 143 (1) (dealing with registration of certain resolutions and agreements), so as to permit exempt private companies to file with the Registrar a copy of an ordinary resolution authorising an increase of capital not necessarily in printed form, but "in some other form approved" by the Registrar.

17. *Seventh Schedule, paragraph 2 (4)*. The Institute feels that clarification of the paragraph is desirable in reference to the provision that on the execution of a transfer "the transferee shall be treated as the holder notwithstanding that the transfer requires registration with the company", since the company could only be aware of the execution of the transfer if it had it in its possession, when registration would be effected (or refused) in the usual way.

18. *Seventh Schedule, paragraph 3 (2) (b) (ii)*. The Institute here feels that a careful rewording of this sub-paragraph is desirable in order to clarify the definition of "family settlement" which it purports to provide.

Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

19. Some of the major issues arising under this head—e.g., in connexion with fundamental changes in companies' activities and disposal of undertaking and assets—are commented upon elsewhere in this memorandum under the sub-titles of "Take-over Bids" and "Disclosure of Ownership and Control". Here the Institute desires to comment upon points of rather lesser importance.

20. *Rights Issues (section 38 (5))*. The Institute suggests that the words "provisional letters of allotment or letters of rights" (or alternatively the words "temporary documents"—as commonly used in this connexion in banking and Stock Exchange practice) should be substituted for the words "forms of application".

21. *Allotment (section 47)*. It is very unusual for a company in present-day conditions to offer shares for public subscription without arranging for the whole of the issue to be underwritten. In such circumstances it seems that the prohibition of allotment (unless the minimum subscription has been received) imposed by section 47, serves no useful purpose; and the Institute suggests that section 47 (6) be amended to provide that the section except sub-section (3) thereof, shall not apply to the first allotment of shares offered to the public for subscription if the issue is underwritten.

22. *Return as to Allotments: Renunciations (section 52)*. The requirement imposed by the statute to file a return of allotments within one month sometimes causes difficulties where letters of allotment are issued with a longer period during which renunciation is permitted. In some cases it would be more convenient or appropriate that the return should include details of effective renunciations. The Institute therefore suggests that the section be amended so as to give a company the option to make the return in that form within one month after the last date for registration of renunciations where renounceable allotment letters are issued. The Institute also suggests that the requirement in section 52 (1) (a) to give the descriptions of allottees be omitted from fresh legislation.

23. *Return of Allotments: Capitalisation Issues (section 52 (1) (b))*. In the case of capitalisation issues, although no written contract is required, it is at present, in the absence of such a contract, necessary to complete and file Form 52 in lieu thereof with the Registrar of Companies. The Institute feels that in the case of a capitalisation issue it should not be necessary to file, as at present required by the section, either a contract in writing or any particulars in lieu thereof; and recommends that the section be amended accordingly.

24. *Issue of Shares (section 61)*. It appears to the Institute to be unnecessary that a company should be obliged first to issue shares and then to convert them into stock in cases such as the issue of capitalisation shares or where the full price is paid on allotment; and recommends that power be given to companies to issue stock, without the necessity for prior issue of shares followed by conversion to stock, in all cases in which the issue is made on such terms that no liability remains after allotment.

25. *Numbering of Shares (section 74)*. Here the Institute would like to suggest that where an issue of further shares, not ranking *pari passu* with the existing shares of the same class, is made, the existing shares be not required to be renumbered.

26. *Removal of Directors (section 184)*. It seems to the Institute to be inequitable that a single shareholder holding perhaps only one share should be able to give special notice—and to repeat the procedure from time to time—of intention to propose the removal of a director. The shareholder may receive little or no support and, while his action costs him nothing, the company and the director concerned suffer needlessly, and sometimes harmful, publicity as well as expense. It is therefore suggested that the facilities afforded by section 142 (dealing with resolutions requiring special notice) should not be available to a single shareholder in such a case, and that provision should be made that any such notice must be given by not less than the number of members empowered by the Act to demand a poll, as provided by section 137. It is also suggested that in the proviso to section 142 the word "section" be substituted for the word "subsection", to remove an obvious drafting error.

27. *Directors Acting in Dual Capacity (section 179)*. The Institute desires to suggest that the words "one or more directors" be substituted for the words "a director" in the second line of the section, so that the Act, which prohibits action in a dual capacity by providing that at least two persons must act where a director and secretary have to attest documents, shall go on to provide that at least three persons must act where two directors and a secretary are required, and so on.

28. *Loans to Officers (section 197)*. The Institute feels that the term "officer" in this section is ambiguous, and that it should be made clear. The Institute would in fact recommend that the present definition of the term in section 455 be limited, and especially by exclusion of the office of manager—a subject also referred to elsewhere in this memorandum of evidence.

Directors' Duties

29. *Register of Directors' Shareholdings (section 195)*. The Institute entertains considerable doubt as to the value and desirability of retaining the provisions of this section on the statute book, but does not at present wish to make any positive plea for repeal, since a decision on the future of the section must be closely linked with the conclusions ultimately reached as respects nominee shareholdings.

30. However, the Institute would urge that the section should in any event be amended so that its provisions do not apply in the case of wholly-owned subsidiaries; and desires to invite the attention of the Company Law Amendment Committee to the cumbersome and unwieldy nature of the section in its practical working in relation to groups of companies in which the subsidiaries are not wholly-owned; and to the enforced disclosure, in certain circumstances, of information not connected with shares and debentures owned by a director.

31. *Disclosure by Directors of Interests in Contracts (section 199)*. The Institute feels that this section as it stands imposes too heavy a burden of disclosure upon directors and suggests that it should be qualified by an additional provision to the effect that where a director's interest consists only of being a member or creditor of a company which is interested in a contract or proposed contract with the company, a director shall not be required to declare the nature of such interest if such interest can properly be regarded as not being a material interest. The Institute suggests that a director should always be under an obligation to disclose his interest in this connexion when he is a director of, or holds a controlling interest in, the company with which the contract is being entered into.

32. *Register of Directors (section 200)*. The Institute feels that there are several points arising on section 200, requiring every company to keep a register of directors and secretaries, which might be dealt with in new legislation.

33. In the first place there should be an obligation imposed upon directors to disclose to the secretary of the company the information required for the purposes of the section.

34. The provisions of the section, and of the 6th Schedule (and especially the note on the form of annual return, which does not appear to be a correct summary of the provisions of the Act), leave it open to doubt whether directorships of foreign companies are covered by the section; and the Institute suggests that amending legislation should provide that such foreign directorships be specifically included.

35. In view of the weight of the burden cast upon companies to notify changes, by section 200 (4), the Institute suggests that such notification should be filed only by the companies the boards of which the director joins or leaves, and not by all the companies of which he is a director (which companies should merely, in their annual returns, reflect the change); and further that the requirement to notify any changes within 14 days be modified so that that time limit applies only in cases of appointment or retirement, other changes being notified annually.

36. The present terms of section 200 (9) (a) leave it open to doubt whether a subsidiary company should enter the name of its parent company in its register of directors. If that is the intention, it is difficult to see any valid reason therefor, nor how such a requirement could be enforced. Indeed the Institute feels that the provision generally is unsatisfactory and that consideration should be given to its removal altogether.

37. Finally on this section it is suggested that provision might be made for the register of directors and secretaries to be kept elsewhere than at the registered office of the company, subject to notice to the Registrar of Companies. This might also be applied to the register of directors' shareholdings (section 195). Reference is made elsewhere in this memorandum to other records—e.g., minute books—in this connexion.

38. *Publication of Names of Directors* (section 201). The Institute is doubtful whether a case still exists for retention of the requirements imposed by this section, originally introduced as it was during a war period in an attempt to secure that persons of enemy origin or association should not be able to carry on business in the United Kingdom without disclosing their identities. However, if it is felt that the need to retain the section remains, the Institute feels that it should be made applicable to all companies, irrespective of the date of registration, and to all appropriate documents issued by the company and not merely to those sent to persons "in any part of Her Majesty's Dominions". In addition the Institute feels that the section should be modernised by clarification of the exact documents to which it is intended to apply and particularly by deletion of reference to show cards.

39. "*Special*" or "*Executive*" Directors. While referring to the duties of directors, the Institute feels that attention should be called to the disquiet felt in many quarters at the growth in the use of the word "director" qualified by such terms as "special", "executive", etc., which is likely to mislead the public since such directors may, under the articles permitting their appointment, be relieved of the statutory obligations and responsibilities of directors. The following is an example of an article actually in use by a large public company in this connexion:—

40. "The board of directors from time to time, and at any time, may appoint any other persons to be executive directors of the company and may define and limit and restrict their powers, authorities and discretions, and may fix and determine their remuneration and duties, and subject to any contract between him and the company may remove any executive director so appointed. No share qualification shall be required for an executive director. An executive director shall not be a member of the board of directors or of any committee thereof, and shall not be entitled to be present at any meeting of the board of directors or of any such committee, except at the request of the board of directors or of such committee, and if present at such request he shall not be entitled to vote thereat."

41. While the Institute realises that appointments under such an article are usually made either to give improved status to a company's senior officials or to provide a

training ground for selected personnel, in general, for the reasons given above, it deprecates the practice and considers that the use of the term "executive director" is particularly open to criticism since that term is used so frequently to denote a full-time director working in an executive capacity.

Shares with Restricted or No Voting Rights

42. In October, 1955, the Council of the Institute declared its conviction that the practice of issuing non-voting equity shares tended to contravene the commonly accepted doctrine that the equity shareholder should have a voice in the management of the company; and that it (such practice) contained certain inherent dangers against which the Institute had a public duty to warn the uninformed investor.

43. The Institute also expressed the hope that the Stock Exchange authorities would do everything possible to ensure that the words "non-voting" (or "voting restricted", as the case might be), should be included in the title of all such shares issued in the future.

44. The Council of the Institute has had regard to developments and changes in the climate of opinion which have taken place in connexion with the issue of such shares since that time.

45. In the first place, the Institute feels that account must be taken of the fact that non-voting equity shares are in issue having a market value of well over £500 million, and that notwithstanding the conversion of voteless into voting shares by some companies in recent months, new issues of non-voting shares are still being made, usually by way of capitalisation issue. Moreover it cannot be denied that there are or have been, and may well be in the future, circumstances in which the issue of such shares may be justifiable—and, indeed, even desirable. The Institute therefore thinks that the complete prohibition of new issues of non-voting shares by legislation is not a satisfactory or desirable method of dealing with the subject. Nor would this method cover all outstanding non-voting shares unless such legislation had retrospective effect. The essence of the problem as the Institute sees it is that it cannot be equitable to voting shareholders to enfranchise voteless shareholders (who may well be contented with their voteless position and have paid significantly less for their shares than would have been the case had the shares carried votes) without compensation; while it may be equally objectionable to the holders of non-voting shares, on enfranchisement, for compensation to be paid to those already holding votes because those without votes have been given a vote which they did not seek and do not value.

46. The Council of the Institute does not think that this is really a matter for further Stock Exchange action either. Apart from the fact that the issues involved may well be regarded as too fundamental to be dealt with by reference to the granting of an official quotation, such a method of dealing with the matter may be considered as inflexible and indiscriminate in operation as legislation itself. Nor does the Institute think that pressure or exhortation applied to the companies concerned is a satisfactory and suitable method.

47. In truth the Institute believes that it is only in the abuse, actual or potential, of voting power made possible by the issue of non-voting equity shares that such issue is objectionable; and that, at the time of issue, the changes of circumstance which might give rise to action of an oppressive or unjust character against the non-voting shareholders cannot reasonably be foreseen. This brings to mind the provisions of section 210 of the 1948 Act, designed to provide relief in case of oppression of certain members of a company; this section does, perhaps, provide an illustration of the way in which the subject of actual or potential abuse might be dealt with.

48. Having regard to the almost infinite variety of circumstances which may arise, the Institute believes that the instrument for dealing with the matter must be flexible and discriminating and that in the ultimate resort this must be the Court. On the

other hand the Institute does not think that the Court should be given power to direct the manner in which the company should be carried on; on the contrary, its power to intervene should be confined to giving, in certain circumstances, a right to vote to non-voting shareholders.

49. The Institute therefore suggests that consideration should be given to a proposal that, where the holders of a proportion (which should be specified by legislation—e.g., at 15 per cent.) of the company's issued capital can show to the Court a *prima facie* case that a course of action is contemplated by the company on which it is desirable that the wishes of the holders of non-voting shares should be consulted, the Court for this purpose may confer appropriate voting power upon the voteless shareholders.

50. For such a power to be effective, of course, certain ancillary provisions would be essential. Thus holders of non-voting shares should be entitled to receive notices of, and to attend and speak at, every meeting at which "voting" shareholders might attend, and, where the Court so ordered, to requisition a general meeting.

51. This proposal is based on the Institute's feeling, generally, that the way to tackle problems of potential and actual abuse of power is by conferring upon the Court some degree of control—not of the company, but of the voting power which will decide its future; and that such a method has an affinity with, and can be assimilated to, existing provisions of the 1948 Act.

52. In the proposal outlined above, reference is made to the conferment by the Court of "appropriate" voting power upon the voteless shareholders. This has reference to the difficulties which might arise in applying the remedy proposed in the case of a company with a complicated capital structure, where, for instance, there are several classes of equity shares with varying voting rights in respect of each class. In the Institute's view, rather than to attempt to provide an equally complex statutory code for the guidance of the Court in such circumstances, it is preferable—and in conformity with other important aspects of company legislation—to provide that in the circumstances contemplated such voting power shall be awarded by the Court to the respective classes of equity shareholders as to the Court shall seem just and equitable.

53. *Equity Share Capital (section 154 (5))*. The Institute desires to point out that the definition of equity share capital provided by this section may require careful revision in the light of any decisions that may be reached by the Company Law Amendment Committee on the question of non-voting equity shares above mentioned; and further that where such shares are in existence it is possible for a company to be the subsidiary of more than one other company at one and the same time—a fact which may have important repercussions in relation, for example, to group borrowing powers.

The Protection of Minorities

54. *Power to Acquire Shares of Dissenting Shareholders (section 209)*. The Institute suggests that the provisions of this section require a full and thorough review, having regard to the ambiguities which it contains, and to the developments that have taken place since it first came into operation. In connexion with those developments there is one point which the Institute feels should be covered in any re-casting of the section. The section gives certain powers to an acquiring company in the case of a take-over bid to force reluctant shareholders to sell their shares when acceptances have been received in respect of 90 per cent. of the shares other than those already held by the acquiring company. In the event of acceptances of less than 90 per cent. of the "free" shares, there is nothing in the section or otherwise under the Act to prevent a subsidiary of the acquiring company making a similar offer for all the shares (including those held by its parent company) and thus acquiring more than the requisite percentage required to force the reluctant minority shareholders to sell their shares at the price first offered by its parent company. This the Institute believes should be covered by amending legislation.

55. On the other hand, cases arise in which holding companies are willing and anxious to buy out an old holder of shares in a subsidiary company if he can be traced. In those circumstances price will often be a secondary consideration. Accordingly the Institute feels that subject to suitable safeguards the provisions of section 209 might be extended to deal with holders of shares where not less than 90 to 95 per cent. of the capital of a company is already held by another company, so that the power of acquisition by that other company should be restricted to shares held by members who cannot be traced or who are not in a position, or are unwilling to put themselves in a position, to deal with the shares.

56. In a scheme or contract involving the transfer of two or more classes of share, the offer should be approved by the holders of not less than nine-tenths in value of the shares of each class before the shares of dissenting shareholders of that class can be compulsorily acquired.

57. Other points of detail arise on section 209. The Institute feels that sub-section (1) should indicate clearly the "prescribed manner" in which the purchaser may give notice within four months of the acceptance of the offer by over 90 per cent. of the holders—or alternatively that reference be made to the appropriate form in the Companies (Forms) Order, 1949, to which at present reference has to be made for this information. Similarly, it is suggested that in sub-section (2) (a) an indication be given of the "prescribed manner" in which the transferee company must give notice within one month of the date of the transfer of 90 per cent. of the shares of the transferor company to the transferee company; and that in this connexion the date of the transfer be defined (e.g., as the date on which the transfer is approved by the board of the transferor company).

58. *Alternative Remedy to Winding up in Cases of Oppression (section 210).* Whilst at one time the Institute felt that it might be desirable for this section to be subjected to a careful review, with the object of making amendments to make the section more effective in operation, it now feels that, in view of relatively recent decisions of the Courts on the section, it might perhaps be unwise to attempt any general amendment of the section in case any such amendment should operate rather to restrict than to extend the scope and effectiveness of the section. There are, however, certain subsidiary points which the Institute desires to raise on the section.

59. There is at present no statutory protection for dissentient holders of debenture stocks who subscribed money on the terms of a prospectus or circular in cases where material alteration is made on a majority vote in those terms or in the terms of the relative trust deed. The Institute therefore feels that section 210 might be extended so as to apply to debenture holders as defined in the Act as well as to shareholders.

60. The Institute also feels that the Committee might be invited to give consideration to the question whether the term "conducted" used in the section necessarily implies a continuous process. Should this be so, the Institute feels that the section should be amended so as to cover not only such a continuous process, but also an isolated act or acts which is or are oppressive to some part of the members of the company.

Disclosure of Ownership and Control

61. *Nominee Shareholdings.* While there may be a case in general for the inclusion in company legislation of provisions requiring that the beneficial ownership of shareholdings should be known to the directors, to shareholders and perhaps, indeed, to the public at large, the Institute entertains such grave doubts as to the practicability and enforceability of such provisions designed to secure disclosure that it feels that the inclusion of such general provisions in new legislation would be of little value. The matter is, however, further considered elsewhere in this memorandum in the specific context of take-over bids—i.e., when the question of control of the company is specifically in issue.

62. *Nominee Directors (section 200)*. This subject has already been considered earlier in this memorandum under the heading of Directors' Duties. As there pointed out, the precise scope of section 200 (9) dealing with nominee directors is far from clear in its scope, and the Institute has considerable doubts as to the value of retaining the provision at all.

Share Transfer and Registration Procedure

63. The Institute through its representatives has been participating fully in the work of the committee set up under the chairmanship of the Chairman of the Council of the Stock Exchange, London, to consider share transfer and registration procedure with the specific object of simplification and expedition of the work involved in the transfer and registration of share holdings. The Institute would prefer to reserve comment generally on this head until the work of that committee has been completed, as it may well be that the Institute would wish simply to endorse the conclusions reached by that committee in view of the full participation of Institute representatives in its work.

64. *Execution of Transfers (section 73)*. However, there is one specific point arising on section 73 of the Act which might be dealt with here. The section provides that shares shall be transferable in the manner provided by the articles of the company; and the articles of some companies require that the instrument of transfer shall be executed as a deed. The Institute believes that such a manner of execution of a form of transfer is unnecessary and outmoded, and suggests that provision be made in amending legislation so that execution of a transfer of the shares or other interest of any member in a company under hand shall be good and sufficient notwithstanding any provision in the articles of that company to the contrary.

Loan Capital

65. The Institute notes that sections 86, 87 and 125 (i) (c) make reference to the keeping of a register of debenture holders, although no provision is included in the 1948 Act positively requiring such a register to be kept. The Institute, therefore, suggests that where the records kept in such a register are not already maintained for other statutory purposes—for example under section 104, or in compliance with the requirements of a trust deed for securing the issue of debentures—the keeping of such a register should be required by law.

66. *Endorsement of Certificates of Registration on Debentures (section 99)*. It seems to the Institute doubtful whether the requirements for companies to endorse on all debentures and debenture stock certificates a copy of every certificate of registration of charges created by the company serves any useful purpose, since the company's register of charges gives all the required information. Moreover, the endorsement causes printing difficulties for companies which have many properties separately charged. The Institute, therefore, suggests that this statutory requirement be discontinued.

67. *Entries of Satisfaction of Charges (section 100)*. The Institute believes that it is desirable that it should be made compulsory for a company to register evidence of satisfaction of a charge and for the Registrar of Companies to register a memorandum of satisfaction in his register. The failure or unwillingness of a company to provide the necessary evidence may prove misleading to creditors and, if only indirectly, detrimental to the shareholders—for example, by enforced contraction of trading arising from credit restrictions imposed under the erroneous impression that a charge is still outstanding.

68. *Powers and Duties of Receivers (section 372)*.* Sub-section (1) (b) of section 372 provides that, on the appointment of a receiver, a statement of affairs of the company shall be submitted to the receiver within 14 days or such longer period as may be allowed by the Court or the receiver, who shall within two months thereafter forward

* See supplementary note on page 830.

this to the Registrar of Companies under penalty for default (section 372 (7)). There appear to be no powers under the Act pursuant to which the receiver can enforce production of the statement of affairs and, in order to protect his position, the Institute suggests that a further penalty clause be incorporated in the section for cases where the statement of affairs is not produced to the receiver within the statutory period.

69. Under this head the Institute also desires to refer to the decision in the case of *re Welsh Anthracite Collieries Ltd. Industrial and General Trust Ltd. v. Welsh Anthracite Collieries Ltd. and Others* (1949). In that case it was decided that section 372 had no retrospective operation and therefore did not apply to receivers appointed before the Companies Act, 1948, came into operation. The Institute believes that as a result a considerable number of old receiverships still remains to be cleared up. It is, therefore, suggested that the section should be amended so as to make it applicable to all receivers whether or not appointed after 1st July, 1948.

70. *Bank Overdrafts (Table A, Regulation 79)*. Finally, under the heading of loan capital, the Institute desires to recommend that regulation 79 of Table A might be re-framed so as to make the clause clear on its face as to whether or not a bank overdraft is considered as a temporary loan for those purposes.

Take-over Bids

71. The Institute has given careful consideration to this subject, and has had particular regard to the "Notes on Amalgamation of British Businesses" prepared at the instance of the Bank of England by the executive committee of the Issuing Houses Association in co-operation with other bodies, and published in November, 1959. In the Institute's opinion these provide a sound code of principles and practices to be followed in such operations. It is recognised, of course, that they are without direct statutory sanction, but the Institute believes that in practice they will secure the strong—and effective—support of financial interests generally.

72. In view of the great variety of circumstances which may obtain when a take-over bid is made the Institute has, after careful review of the matter, come to the conclusion that it would be very difficult, if not impracticable, to devise through the medium of the Companies Act statutory sanctions to support the code of procedure above mentioned which would be neither ineffective nor too restrictive in operation.

73. There are, however, two matters which have relation to take-over bids upon which legislative provision might be practicable and desirable. The first concerns the "partial offer"—made by a person who seeks, and offers, to acquire only a percentage of the issued capital—say, 60 per cent. In such a case, where acceptances in respect of more than the stated percentage are received, the Institute feels that the offeror should be subject to a statutory obligation to acquire the stated percentage in respect of each acceptance received, rather than to select those offerees whose holdings he prefers to acquire to make up the percentage.

74. The other issue upon which the Institute feels that legislation might be desirable is connected with nominee shareholdings. It has been pointed out earlier in this memorandum that in the Institute's view there would be little value in the inclusion in fresh legislation of provision designed to enforce a general disclosure in all cases of the beneficial ownership of shares.

75. The considerations are rather different, however, where the motive for acquiring shareholdings in the names of nominees is the acquisition of control of the company; and notwithstanding the obvious difficulties of devising and enforcing statutory provision, and the fact that, in the vast majority of cases, shares are held in the names of nominees for reasons which are entirely valid, the Institute feels that there should be some provision in legislation which would require, perhaps by direction of the Board of Trade on application of the company for good cause, the beneficial owner of shares in that company constituting not less than a prescribed percentage of the issued

shares of that class, to disclose details of such beneficial ownership to the board; and in default to suffer penalties.

76. Reference is made to the statutory power to acquire shares of dissenting shareholders, under section 209, earlier in this memorandum, under the heading "The Protection of Minorities".

Prospectuses

77. Some reference is made in other paragraphs of this memorandum to points bearing upon the prospectus, but the Institute does not desire to make any representations for drastic alteration of the present law concerning prospectuses.

78. *Registration of Prospectus (section 41)*. However, one point arises on the wording of section 41 which creates some difficulty in practice. The section requires that prospectuses when filed shall be "signed by every person who is named therein as a director". In the case of a rights issue the circular setting out the details of the issue is filed as a prospectus. In the ordinary course it would not contain any directors' names and would, therefore, not require a signature. In the case of groups of companies, one company may underwrite an issue made by another company in the group and there will be an element of common directorship. The issuing company, when mentioning the underwriting agreement in its circular, must also intimate the names of any common directors and in this case the Registrar requires that such named directors must sign the circular. The Institute feels that this cannot have been the intention of the legislature since all the directors, whether named or not, are equally responsible for the document. It is suggested that the difficulty might be overcome by the deletion from section 41 (1) of the words "named therein as" before the words "a director" and insertion of the words "is named therein as a" before the words "proposed director".

Reduction of Capital

79. *Confirmation by the Court (section 66)*. The Institute feels that where a company is cancelling any of its capital lost or unrepresented by available assets, it should be relieved of the expense of a petition to the Court for an order confirming the reduction. In such a case the reduction does not affect the rights of creditors, and it appears to the Institute to be sufficient for provisions to be applied to reduction of capital similar to those governing the alteration of the objects under section 5 of the Act, as it stands at present. A scheme for reduction of capital would then be brought before the Court only if the holders of not less than 15 per cent. of the share or loan capital objected to the scheme.

80. It appears to be illogical that an unlimited company is prohibited by section 54 from providing financial assistance to any person to purchase shares in that company notwithstanding that the company is not precluded from purchasing its own shares.

Accounts and Audit

81. *Share Premiums (section 56)*. The existing provisions of section 56 restrict the use of share premiums by a company and in certain circumstances this may operate harshly where one company acquires another. Accordingly where the identity of the members of the acquiring company is substantially the same as that of the acquired company, the Institute feels that power should be given by legislation to the Board of Trade on application to relax the restrictions of section 56 and to permit a proportion of the premium (being the excess of the paid-up value of the shares acquired over that of the shares issued by the acquiring company) to be used for wider purposes than is at present provided.

82. *Profit and Loss Account and Balance Sheet (section 148)*. The wording of section 148, by requiring accounts to be laid before a company in general meeting, provides a method by which companies can delay the filing of their accounts with the Registrar of Companies for so long a period (as long as two years from the date of

the accounts) as to render the information contained in them of little more than academic interest. Section 126 requires the annual return to be completed within 42 days after the annual general meeting. It is thus possible for a company to submit its accounts to an extraordinary general meeting so as to comply with the Act (as indeed often happens in practice where the preparation of the accounts cannot be completed in time for the annual general meeting, or on a change in a company's financial year), but to delay filing those accounts by holding its annual general meeting much later.

83. To remedy this position the Institute recommends that section 148 should be amended by addition of a provision that companies are required to file their accounts with the Registrar of Companies within six weeks after their presentation to the company in general meeting (annual or otherwise), irrespective of whether the annual return is or is not then due.

84. *Right to Receive Copies of Balance Sheets (section 158).* The wording of section 158 (1), and particularly proviso (b), as at present framed is misleading. The Institute suggests that the sub-section should be re-worded so as to absolve companies from the necessity to issue accounts to members or debenture holders (whether or not they are entitled to receive notice of general meetings of the company) of whose addresses the company is unaware. This the Institute believes to be the intention of the section, but the wording appears to be defective to achieve that purpose.

85. *Appointment of Auditors.* The Institute feels that the opportunity of fresh legislation might be taken to make slight modification of the terms of this section (dealing with the appointment and remuneration of auditors) as at present sub-section (1) appears to be in conflict with the requirements of sub-section (2). Sub-section (1) requires the appointment of auditors at each annual general meeting, whereas, of course, sub-section (2) contemplates the reappointment of retiring auditors without any further resolution being passed. The Institute suggests drafting amendment accordingly.

86. *Disqualifications for Appointment as Auditor (section 161).* As the law now stands an auditor, including the auditor of a public company, can also be the registrar of the company and can provide from his staff the whole of the board of directors and the secretary of the company. Whilst it is not suggested that this position is often likely to arise, it does appear that the possibility is unsatisfactory and contrary to public policy. The Institute feels that in this respect section 161 has failed to achieve that measure of independence for the auditor envisaged by the Cohen Committee. The Institute accordingly recommends that the section be reviewed, with the object of ensuring that the two functions of secretaryship and auditing in particular be clearly and completely divorced.

87. *Particulars in Accounts of Directors' Salaries, etc. (section 196).* The Institute suggests that it is not always practicable to comply with section 196 (6). Many companies are empowered under their articles to fix the remuneration of their directors in respect of any financial year at the annual general meeting of the company at which the accounts for that year are submitted. The accountant making his statement of directors' emoluments in the accounts is obliged in such a case either to show the emoluments paid in the financial year but in respect of the previous year, or to make an estimate of what the emoluments will be. In neither case can he comply with the section. The Institute accordingly recommends that the section should be amended so as to allow the accountant to show the emoluments actually paid in the financial year in such circumstances.

88. It also seems to the Institute to be unreasonable that a wholly-owned subsidiary company should be required to conform with the provisions of the section. The only person concerned with the information is the parent company, which can obtain it without relying on section 196. The Institute accordingly recommends that section 196 should be amended so as to relieve wholly-owned subsidiaries from the necessity to comply with the provisions of the section.

89. *Group Accounts (8th Schedule)*. The Institute feels that the requirement to annex to a holding company's accounts a statement of past profits and losses of subsidiaries not included in consolidated accounts should not apply when their exclusion is due to the holding company being itself a wholly-owned subsidiary of another body corporate and being accordingly excused from preparing consolidated accounts by section 150 (2) (a). The Institute suggests that paragraph 15 (4) of the 8th Schedule be amended accordingly.

90. *Treatment of Tax in Accounts (8th Schedule)*. The Institute suggests that paragraph 27 of the 8th Schedule should be amended so as to make it clear how reserves for payment of income tax on profits of the year to date should be treated in published accounts, since they do not clearly fall within any of the categories distinguished by the Act—viz., liabilities, provisions, revenue reserves and capital reserves.

Provisions as to Returns

91. *Annual Return (section 124 and 6th Schedule)*. In view of the heavy burden falling upon company secretaries by the necessity to compile each year a list of present and past shareholders the Institute recommends that amending legislation should not require details of shares transferred since the date of the last return to be shown in the annual return, which should only contain a straight list of all present members with their current holdings.

92. Moreover there are many private companies in respect of which the annual return contains, year after year, exactly the same information as recorded in the preceding year. The Institute feels that, in order to save such companies time and trouble and perhaps also to assist the demands of the Registrar for storage space, companies might be permitted in such circumstances to file a declaration of "no change".

93. *Commissions Paid (6th Schedule, paragraph 3 (f))*. Similarly it is suggested that in compiling the annual return, a record of commissions paid since the date of the last return only be required.

94. *Closing Date of Return*. The Institute recommends that the Act itself should clearly specify the date to which the annual return must be made up (at present that information must be sought in paragraph 5 (o), 6th Schedule); and that the closing date should be that of the annual meeting instead of 14 days thereafter, as at present required.

95. *Exempt Private Companies (section 129)*. The Institute suggests that, in the case of a company which is a subsidiary of a private company, nominees of the holding company should be allowed to hold shares to the extent of not more than 5 per cent. of the total issued share capital of such subsidiary company.

96. *Overseas Companies' Return (section 409)*. At present it is necessary for an overseas company, in the case of any change, to register under section 409 a return (form 5F) repeating the full particulars of all the directors and the secretary—particulars of the change alone not being accepted. The Institute feels that overseas companies should in this respect be placed in the same position as English and Scottish companies, which in similar circumstances have to register only the change.

97. *Convertible Preference Shares*. Where a company has issued preference shares with a right of conversion to ordinary shares at the request of the shareholders, all that is necessary is for the shareholders to serve notice on the company requiring their shares to be converted to ordinary shares under the articles or the terms of issue. Where such conversion takes place shortly after an annual general meeting, it may be many months before the change in the capital structure of the company is reflected in the company's file at Bush House. It is therefore suggested that statutory provision be made for such conversion to be notified within one month to the Registrar of Companies.

Management and Administration

98. *Restrictions on Commencement of Business (section 109).* The Institute is of the opinion that section 109, imposing restrictions on commencement of business, might well be repealed, since the present requirements of the 1948 Act in regard to prospectuses, and the regulations of the Stock Exchange as to securing a quotation, are such, in the Institute's view, as to make the section redundant. However, if it be thought that the section has any value in the light of present-day practice, it is suggested that the scope of the exempting provision contained in section 109 (7) might be varied so as not to cover a case in which a private company is converted into a public company.

99. *Register of Members (section 110).* The Institute suggests that section 110 (1) should be amended so as to provide that nothing shall prevent a company from removing from its register of members particulars relating to members who have ceased to be members for a period of, say, six years, notwithstanding that any such member might again become a member within that period.

100. Sub-section (1) requires the register of members to show the date at which any person ceased to be a member, which means that particulars relating to past members must be retained during the lifetime of the company. In companies where the register is kept in looseleaf form the retention of the "dead" accounts removed from the register presents a considerable problem of storage space. The second part of the suggested amendment is designed to meet the practice of many companies which open new accounts in respect of all transfers rather than re-open closed accounts.

101. The proposed amendments might involve also consequential amendment of sections 111 (index), 112 (entries in relation to share warrants to bearer), 113 (inspection), 114 (default by agent keeping register), 116 (wrongful omission of name from register), 119 (dominion register) and 341 (disposal of books).

102. *Date of Entry (section 110 (1) (b)).* The Institute thinks that clarification is needed on the subject of the date on which a member of the company attains and loses that position; and suggests that the date of becoming a member should be defined as the date of the making of the allotment, or approval of the transfer by the board of directors, with similar consequential provision concerning cesser of membership. This would, of course, involve further consequential amendment of section 26 (2).

103. *Records—Place of Keeping (section 110 (2)).* The Institute suggests that the facility provided by section 110 (2) under which the register of members, if made up at another office (than the registered office) of the company may be kept at that other office, subject to notice to the Registrar, should be extended to other records, in similar circumstances, including minute books (section 146); registers of directors and secretaries (section 200); registers of directors' shareholdings (section 195); and registers of charges (section 104).

104. *Register of Members—England and Scotland (section 110 (2)).* A certain amount of inconvenience is caused by the present provisions precluding the register of an English company from being kept in Scotland—and *vice versa*; and the method generally employed to mitigate the effect of the restriction—the keeping of a duplicate register—is cumbersome. In view of this, and having regard to the current trend towards a wider geographical spread of investors, the Institute asks that consideration be given to the desirability of amending section 110 (2) so as to make it lawful to keep in England the share register of a company registered in Scotland, and *vice versa*.

105. *Register of Members (section 110 and Table A, Part II, regulation 6).* Regulation 6 of Part II of Table A empowers directors to seek information from members for the purpose of determining whether the company is an exempt private company. The Institute is doubtful whether the regulation in its present form has any practical effect. It is permissive in form, neither compelling the directors to seek information nor the shareholders to provide it. The secretary has no power to make enquiries

without consent of the directors, although he has to join with a director in giving the required certificate on the annual return. The Institute therefore suggests amendment or repeal of this regulation.

106. *Payment for Copies of Company Records.* Section 113 provides that copies of the register of members may be obtained on payment of sixpence (or less) for every 100 words copied. Similar provision is made elsewhere in respect of other records. The Institute suggests that all sections of the Act which name a sum payable for copies or inspection of records be reviewed, so as to provide for payment of a more realistic sum in the light of increase in costs since the Act came into force; and so as also to provide that sums mentioned in this connexion in companies' articles may be overridden without the necessity for formal amendment of the relevant articles.

107. *Supply of Copies of Records (section 113).* In the case of large companies it is often very difficult to prepare a copy of the register of members within the present statutory period of 10 days. The Institute is anxious not to make any recommendation which might have the effect of lessening the protection afforded to the public, but would like to suggest that some increase (e.g., to 21 days) in the present time limit is very desirable.

108. *Dominion Register (section 119).* The Institute feels that the provisions of this section might be improved by the substitution of the words "any part of the British Commonwealth" for the words "any part of Her Majesty's Dominions", and by addition of a provision to the effect that, where business is carried on in two or more parts of the British Commonwealth which are contiguous or adjacent, it shall be lawful, subject to the consent of the Board of Trade, to keep a dominion register covering all such parts in any one of them.

109. This question arises, for example, in the case of an English company with interests in what was formerly the colony of Singapore and in the Federation of Malaya, which wished to establish a dominion register in Singapore and intended to enter therein the names of members with addresses in the Federation. This would have involved a two-fold breach of the section in that (i) the Federation of Malaya (except for the former settlements of Malacca and Penang) cannot be regarded as still part of Her Majesty's Dominions for the purposes of section 119, and (ii) members resident in the Federation would clearly not be resident in Singapore, where the register was to be established. The difficulty under (ii) would arise also in the case, for example, of the adjacent territories of Kenya, Tanganyika and Uganda.

110. *Statutory Meeting and Statutory Report (section 130).* The Institute feels strongly that all references to the statutory meeting and statutory report should be removed from the Act, since in the light of modern conditions these no longer serve any useful purpose. In the event of repeal of section 130, consequential amendment would be necessary to sections 42, 222, 224, 225 and 438, and the 15th Schedule.

111. *Requisition for Extraordinary General Meeting (section 132).* As this section stands at present, there is nothing to prevent the directors from convening a meeting for a date so far ahead as to frustrate the purpose of the requisitionists, by making it impossible for them to convene and hold a meeting within the period limited by the section. It is therefore suggested that the section should be amended by providing a time limit within which the meeting convened by the directors is to be held.

112. *Length of Notice of Meetings (section 133).* A case has come to the notice of the Institute in which a company had a small number of shareholders resident in the United States who had not registered an address within the United Kingdom. By the company's articles, such shareholders were not entitled to receive notices of annual general meetings. They were, however, still entitled to attend and vote at such meetings and their consent was required before the company could hold a meeting at less than the statutory 21 days' notice.

113. The Institute accordingly suggests that to remove anomalies of this kind section 133 (3) (a) and (b) should be amended by including reference to the right to receive notice as well as to attend and vote at meetings.

114. *Proxies (section 136)*. It appears to the Institute to be logical that the right of a person appointed as proxy to speak—at present confined to meetings of private companies—should be extended to cover meetings of public companies.

115. *Right to Demand a Poll (section 137)*. The present provision that five persons may be required for a demand for a poll renders it difficult for shareholders or their proxies to make an effective demand unless they are well versed in meetings procedure. This contrasts with the ability of a chairman alone, under most articles, to demand a poll, and it is felt that articles requiring a poll to be demanded in writing unless the request is made by the chairman should be overridden by statute.

116. Accordingly the Institute suggests that the statutory number of persons who may be required for a demand for a poll should not exceed three, and that a statutory right be given to demand a poll orally.

117. *Voting on a Poll (section 138)*. The section does not make it clear that, as must have been intended, "member" here includes the holder of a proxy, and the Institute accordingly suggests that after reference to "a member", words such as "whether present in person or by proxy" might be inserted, to remove any doubt.

118. *Extraordinary Resolutions (section 141)*. The Institute feels that the extraordinary resolution is really now only of historical significance and recommends that, in the interests of simplification of the new law, all reference to it should be repealed, except for necessary saving provisions covering companies' articles which make specific reference thereto.

119. *Special and Extraordinary Resolutions (sections 141 and 143)*. There appears to be some conflict between these two sections. Section 143 (4) appears to confirm that resolutions in writing signed by all the shareholders may be effective as extraordinary or special resolutions, whereas section 141 (5) may be (and has been) interpreted as requiring that a physical meeting of shareholders must have taken place in order to pass any extraordinary or special resolution. The Institute asks that this doubt and apparent conflict should be removed by amending legislation.

120. *Registration of Certain Resolutions (section 143)*. The Institute recommends that where an ordinary resolution has been passed in general meeting in pursuance of a permissive power in the articles—as, for example, to increase the directors' borrowing powers, or to increase the maximum number of directors, or their remuneration—it should be made obligatory upon the company to register such a resolution with the Registrar of Companies so that a search of the register will disclose the true position in such matters.

121. *Directors' Report (section 157)*. This section does not require that the directors' report shall be annexed to the accounts and circulated with them. Stock Exchange regulations remedy this defect in respect of companies the shares of which are quoted; but it is still possible that shareholders of all other companies may see the directors' report only if they attend the annual general meeting or—except in the case of exempt private companies—if they subsequently search the company's file at Bush House. The Institute recommends accordingly that the section be amended so that the report must be annexed to and circulated with the accounts.

122. *Form of Registers, etc. (section 436)*. The Institute suggests that this section may require review and amendment in the light of modern developments in the maintenance of records by mechanised accountancy methods and computers.

123. *Quorum (Table A, regulation 53)*. In view of the uncertainty arising from the decision in *re Hartley Baird Ltd.*, (1955) Ch. 143, the Institute suggests that such words as "and continues to be present until the conclusion of the meeting" should be inserted in the regulation after the words "proceeds to business".

124. *Directors' Resolutions in Writing (Table A, regulation 106)*. The Institute wishes to call attention to an apparent anomaly between regulations 106 and 84 (2).

Regulation 84 (2) requires the presence of an independent quorum of directors, but these provisions could be circumvented by securing a resolution in writing signed by all the directors for the time being entitled to receive notice of a meeting of the directors in the terms of regulation 106.

125. The Institute suggests that these varying provisions might be reconciled accordingly.

Miscellaneous Matters

126. *Unclaimed Dividends.* The Institute suggests that statutory provision be made to ensure that the operation of the Limitation Act, 1939, is not prevented by reason only of the fact that a company's balance sheet discloses an item which includes unclaimed dividends and that copies of the balance sheet are sent to the shareholders who have not claimed those dividends.

127. At present, applying the ruling in *Jones v. Bellegrove Properties* (1949), the appearance in a company's balance sheet of an item which includes unclaimed dividends may constitute an acknowledgement of the debt and will prevent the dividends from becoming barred for a further period of 12 years from the date of acknowledgement.

128. The proposed alteration would enable companies to write off any liability arising from an unclaimed dividend after it had remained unclaimed for a period of 12 years from the due date of payment.

129. *Manager (section 455, etc.).* The Institute recommends that the term "manager" be deleted from the Act except when used in relation to sections 366-376. Since every company must have at least one director and a secretary, the word "manager" (in any event an imprecise term) has lost its significance.

130. Adoption of the suggestion would involve consequential amendment of sections 130 (3) (d), 145, 180, 202, 203, 204, 212 (2) and 333.

131. *Meaning of "Holding Company" and "Subsidiary" (section 154).* The Institute suggests that consideration be given to amendment of the section so as to remove all doubt as to whether the date when a company first becomes a holding and/or subsidiary company (if not so defined prior to the 1948 Act) is that on which the company first became qualified as now defined, or that on which the Act came into operation.

132. *Representation of Companies in Court.* The Institute does not see why a company should be required, merely because it is an artificial person, to be represented in Court by a lawyer; and suggests that the corporation should be placed on the same footing as a natural person in this respect. It is further suggested that section 36 of the Act, dealing with authentication of documents on behalf of a company by a director or the secretary, should be extended so as to permit a company to be represented in Court by such a director or the secretary.

133. *Registration Fees (section 7 (2) and (3)).* The Institute's attention has been drawn to an apparent conflict between section 7 (2) and (3) and the 12th Schedule of the Act.

134. Section 7 (2) requires the articles of a company limited by guarantee to state the number of members with which the company is to be registered and section 7 (3) provides for registration of increases in such number from time to time. On the other hand, the 12th Schedule, which details the fees payable on registration of companies, provides for a specific fee (the maximum) to be payable "if the number of members is stated in the articles to be unlimited".

135. In some cases it is known that the number of members will continue steadily to increase, so that, if the company is initially registered with a stated number of members, registrations of increases will have to be made at frequent intervals. It is

possible that the contention might be made that it would comply with section 7 (2) if the company were initially registered with an unlimited number of members—i.e., that "an unlimited number" is nevertheless a specific number for the purposes of the sub-section—but, whether or not that contention is accepted, the Institute thinks it is desirable for an appropriate amendment to be made to the Act so as to put the matter beyond doubt.

ERNEST LONG, President.

W. F. TALBOT, Chairman, Law and Parliamentary Committee.

J. F. PHILLIPS, Secretary.

14, New Bridge Street,
London, E.C.4.

June, 1960.

ANNEX

Shares of No Par Value

The Council of the Institute has considered the terms of reference of the Committee appointed under the Chairmanship of Mr. Montague L. Gedge, Q.C., and the further questions set out in the letter from the Board of Trade Committee of 23rd January, 1953.

The Council is of opinion that it is desirable to amend the Companies Act, 1948, so as to permit the issue of shares of no par value, and is further of the opinion that amendments can be made to this end, having due regard to the need for safeguards for investors and for the public interest.

The following observations are submitted, embodying the views of the Council on the general questions put in the terms of reference and on the further points raised in the letter mentioned above.

1. The issue of shares of no par value was first authorised in the United States under a statute of New York State in 1912. Forty-three other States have since followed suit. In Canada the issue of such shares has been permitted under the Dominion Companies Act since 1924. The Dominion Companies Act provides that all or any part of the authorised capital of a company may consist of shares without nominal or par value, except shares which have priority to capital or are subject to redemption.

Every share of the capital stock without nominal or par value must be equal to every other such share of the capital stock subject to the preferred, deferred or other special rights or restrictions, conditions or limitations attached to any class of shares. Furthermore, each share certificate for no par value shares, in addition to complying with the requirements as to share certificates generally, must show the number of shares it represents, and the number of such shares the company is authorised to issue. The certificate must not express any nominal or par value for such shares.

The operation of the system in the United States is described in Ballantine on Corporations (revised edition, 1946); and there is a short chapter in Levy's Private Corporations and their Control (1950) published by Routledge and Kegan Paul.

2. The extent of the use of no par value shares in the United States is not easy to gauge, but a reliable correspondent has expressed the view that *par value* shares are outstanding for about 75 per cent. of the listed and actively traded over-the-counter stocks.

In Canada, under the various special Acts, shares in banks, trust and loan companies, and insurance companies must have a par value. Public utilities which are incorporated under special Act of Parliament also have shares of fixed par value. Most

other companies have their common shares without par value. An analysis of the first 84 companies covering A-C inclusive in the Canadian Securities Manual for 1952 gives the following:—

- 68—no par value—all types of companies
- 8—with par value—being banks or trust companies
- 3—with par value—being public utilities
- 5—as follows:—
- Canadian Iron Foundries \$10 par
- 84 Canadian General Electric \$50 par
- Canadian Marconi \$1 par
- Conduits National \$1 par
- Corporate Investors 50 cents par

Oil stocks and mining stocks are usually issued with a lower par value, such as 50 cents or \$1.00. While it is possible to find instances of no par value oil and mining shares outstanding, we understand that such stocks are normally issued with a par value.

It is understood that the facility is also extended to private companies, but that taxation considerations may have a bearing on the advantages in any particular case.

3. In the United States there appears to be no distinct trend towards increased use of no par value shares at the present day. In Canada, on the other hand, the trend to the general use of no par value shares still continues. For public companies the opinion has been expressed by a representative of a large underwriting house in Canada that he would invariably recommend the issue of no par value stock if it were expected that distribution of the shares would be largely confined to Canada, the chief reason being that no par value stock is more flexible in the event of changes in the financial structure of a company.

Our informant expressed the view that it might be advantageous to issue a par value stock if a substantial part of the issue was likely to be held in the United States, for the reason that transfer taxes in certain States are assessed on par value if there is a par value, but otherwise on the market value. In general, however, the tendency is to issue no par value stock unless there is some legal or other special consideration pointing in the other direction.

4. In the Council's view the advantages and disadvantages of the introduction of the no par value system may be summarised as follows:—

(i) *Advantages*

(a) No par value shares afford a more realistic approach to appraisal of profits in relation to the assets employed in the business and avoid the misunderstanding and uninformed criticism which arise when profits and dividends are measured by reference to the yardstick of nominal value. In assessing the value of a share it is the number of shares issued, the value of the assets of the company and their earning power which are the material factors, and not the nominal par value of the share. Once a share is issued and is fully paid, its real worth may have little relation to par value, but depends on the success or failure of the company. Unless the capital of a company approximates to the value of its assets, profits stated as a percentage of issued capital give no indication of the true state of affairs. In the minds of the uninformed, however, par is the yardstick and is, of course, a most misleading one, because it quickly loses its original significance and tends to become a fiction only. An inexperienced investor is liable to think that a share is cheap if it is below par and dear if it is above par. In essence, a share is a token of a right to a portion of a company's divisible profits and, in a winding up, to a share in the surplus assets. The no par value system recognises this, while the attaching of a par value obscures it.

(b) In reorganisations, mergers and amalgamations, where asset values may be difficult to evaluate, no par value shares can be issued on the basis of earning power and distributed equitably to the parties bringing in assets. Flexibility in the price of

issue would be an advantage in such cases. It would certainly be an advantage when, owing to unfavourable market conditions, the issue of shares with a denomination could not be successfully made at their par value.

(c) Dividends on no par value shares are declared and paid as a stated amount of cash per share and not as a percentage of a nominal value. The dividend yield on any such share is based simply on market price and no calculation related to a nominal or par value of the share is necessary. Earnings yields and dividend yields based solely on market value become much more straightforward if they are not complicated by reference to nominal values which can be, and usually are, entirely out of relation to the real value of a share.

(d) Marketability could be more readily preserved than with shares having a nominal value. While there is some prejudice against shares of as low a nominal value as 1s., no par value shares can be "split" as often as is necessary when the price makes the shares unwieldy, or for any other reason which may be desirable.

(e) There would no longer be any reason for making a scrip bonus issue with the sole object of reducing an obvious discrepancy between nominal share capital and the real assets employed. This would be an advantage since such bonus issues cause considerable misunderstanding. It is not realised by many, and is deliberately ignored by some, that a bonus issue which consists merely in capitalising reserves does no more than divide into smaller pieces the existing claims of the members to the profits and assets.

(ii) *Disadvantages*

The disadvantages of the no par value share system hitherto advanced do not appear to the Council to carry much weight today. It has been said in the past that there was little public demand for the facility, but the Council takes the view that the degree of demand can only be assessed when the facility exists. The system is, of course, not yet familiar to a wide section of the public in this country, but its advantages may quickly be realised by the investing public once its operation becomes legal. Any prejudice which may exist at present is almost certainly due to ignorance or apathy, rather than to hostility.

It has also been suggested that the existence of this type of share might provide opportunities for manipulation of accounts or for such improper conduct as the payment of dividends out of capital or out of the proceeds of new issues. The Council feels that adequate safeguards can, without difficulty, be introduced by way of legislation, supplemented by Stock Exchange regulations and sound accountancy practice, to secure that the investor is as well protected as he is today. An American opinion is that the possibility of abuses to the detriment of investors as a result of no par value shares is a minor consideration in present conditions because of the activities of the regulatory bodies, both Federal and State, and the standardised accounting practice on a high plane.

5. The system does not appear to be more open to abuse than the par value system, provided certain special safeguards are introduced as suggested under 7 below to ensure:—

- (a) that the dissipation of capital by paying it away in dividends is prevented; and
- (b) that the power of the directors to issue further no par value shares at less than market value is limited in favour of the existing members.

The fact that the system has been made to work smoothly in Canada and the United States is evidence that there are no difficulties which cannot equally well be overcome in this country.

6. The Council is not familiar with the legal safeguards provided in other countries. The general impression, however, which the Council has received in answer to its inquiries in the United States is that State and Federal authorities, as well as the Securities and Exchange Commission, have been successful in ensuring that the pro-

tection for investors is just as adequate in the case of no par value shares as it is in the case of shares with a denomination.

It is interesting to note that while the various security frauds prevention Acts have been strengthened in Canada in recent years, it has apparently not been found necessary to make special provision for shares which have no par value as distinct from those possessing a par value.

7. In the view of the Council the issue of no par value shares should be permitted in this country. It should be subject to the approval of shareholders in general meeting by such resolution as may be laid down by the amending Act.

No par value shares should be fully paid within a short time of issue and should be "non-assessable", i.e., without further liability. The facility could apply to preference as well as ordinary shares, and such shares could be cumulative, redeemable, convertible and participating, with one or all of those characteristics according to the terms of issue. It is felt that companies should be allowed to convert existing fully paid shares or stock units into no par value shares; and splitting and subdividing should be allowed. No objection is seen to the extension of the facility to private companies as well as to public companies.

The Council considers that the following special safeguards would be desirable:—

- (a) All sums subscribed on an issue of no par value shares should be used for capital purposes only, and should be subject to the provisions of the Companies Act relating to such matters as the reduction of share capital.
- (b) All issues for cash of no par value shares subsequent to the first should be offered *pro rata* to the existing members holding shares of the same class.
- (c) No issue of no par value shares or conversion of shares or stock into no par value shares should be permitted so as to prejudice the existing rights of any shareholder. Accordingly, there should be a provision that any member may petition the Court to disallow the issue if he can establish that his rights are or may be affected adversely.

3rd March, 1953.

Supplementary note on paragraph 68

The purpose underlying the suggestion made in that paragraph is that a receiver should be given some protection in cases where, through no fault of his own, he is unable to obtain from a company the required statement of affairs, delivery of which he cannot himself enforce. The situation might be met by incorporation in section 372 of a provision to the effect that if after a stated time the statement of affairs has not been delivered to the receiver he should be empowered to request the Board of Trade to enforce its production under penalty for default. The Board of Trade already has such power under section 373, but the receiver cannot at present call for its operation.

It is further suggested that subsection 1 (b) of section 372 should be amended so that some limit should be placed upon the length of time after his appointment that a receiver should be able to give a company in which to deliver the statement of account.

APPENDIX XXXIII

**Memorandum submitted by Mr. E. S. Fay on the practical operation
of a company investigation**

1. My acquaintance with this subject is wholly derived from the investigation of the affairs of General London & Urban Properties Limited which I conducted as Inspector appointed by the Board of Trade by order dated 10th February, 1958. I give below an outline of this investigation, mentioning various relevant legal questions as they arose. The references as to paragraphs of my report, as published by H.M.S.O.

2. The investigation was conditioned from the outset by the facts that I was the sole inspector and that no limitation was placed on the generality of the affairs which I was directed to investigate.

3. The first phase of the investigation was the examination of the company's accounts and records from September, 1952, onwards. This was carried out on my behalf by Mr. C. J. H. Deacon, a chief accountant of the Board of Trade, whose services had been placed at my disposal. It was early apparent that the affairs of two subsidiary companies should be included in the investigation and this was done, as provided by section 166 of the Act. No difficulty arose upon this section.

4. Mr. Deacon prepared under my direction comprehensive summaries of the matters shown by the accounts and records. He was hampered by the absence of many books at the companies' auditors but I received his first reports on 10th October, 1958, and his further reports on 20th December, 1958, by which time the accounts for the 18 months ending 30th September, 1957, had been audited.

5. In the light of this preliminary survey of the field I had to decide what particular matters needed further investigation. To clarify the position I wrote a draft of a Report, sent it on 25th January, 1959, to the Inspector General of Companies and sought and obtained from him guidance on how far, in view of my unlimited mandate, I should investigate.

6. The main lines of investigation having been settled at a meeting with the Inspector General on 18th March, 1959, the next phase was to ascertain further details from the company. It having become apparent that a good deal of explaining was called for from the directors and/or officers of the companies, I thought it right to ascertain facts as fully as possible before a final examination upon oath which was clearly going to be necessary. Most of this information I sought by correspondence with the secretary of the companies. I took the view that his obligation under section 167 (1) of the Act, to give all assistance which he was reasonably able to give, included a duty to furnish information in writing. He did not at this stage demur, although he later took the point with Mr. Deacon that he was not bound to answer written questions. In view of the opportunities for delay and evasion afforded by any ambiguity in the statute I think it would be better if the section expressly imposed the duty to give information as well as assistance, and to give it either orally or in writing. Under section 167 (3) an officer may be brought before the Court for refusal to answer questions, but it is not clear to me whether this is limited to the questions put during the examination on oath referred to in the preceding sub-section.

7. The Chairman was examined on oath on 22nd June, 1959. At this period it had become clear that the Secretary, who was also Manager and the real controller of the companies, was not being entirely frank in his answers to my written queries, and there next occurred the destruction by him of material documents; Report, paragraph 241. My letter, referred to in the final sentence of that paragraph, is reproduced in Annex 1 hereto. I am in some doubt whether the destruction of documents in order

to avoid production is a refusal to produce documents within the terms of section 167 (3). There was some evidence that the documents had been destroyed after I had asked for them, which would have been clearly tantamount to a refusal, but destruction prior to a request, as asserted by the Secretary, is not in my view a clear case. It is noteworthy that the Act does not in terms require the preservation of documents either before or during an investigation, and it may be that some general provision would be desirable requiring specified minutes, accounts or records to be preserved for a certain time after the making and in any event during an investigation: for these companies' failures to preserve other records see Report, paragraphs 20, 21, 61, 98, 107, 163, 219 and 220.

8. A cognate matter which may need attention is whether an inspector is empowered to take possession of books and documents. The question did not arise in this case because the companies made no objection to the removal of books, etc., for study. The only duty under section 167 (1) however is to "produce" and it would have been highly inconvenient to have attended at the companies' offices every time books and documents had to be examined and compared.

9. Having formed a view as to the Secretary's reliability I thought it essential before examining him on oath to check numerous statements by reference to persons outside the company. I then had to consider whether I was empowered to do so. The Act gives no indication of an inspector's duty beyond requiring him to "investigate". Is he, for example, confined to documentary evidence and information from within the company? However, as procedure is provided in section 167 (4) for the examination of persons other than officers and agents of the company, it seems to be contemplated that he can seek unsworn information from such other persons and I felt entitled to take this course. But some specific authority so to do may be thought desirable; had I been confined to such information as this reluctant company was disposed to give, the investigation would have been stultified. A great deal of correspondence ensued (Report, paragraph 7). This searching out of information and evidence is work in the nature of that undertaken in other contexts by a solicitor or the police, but as the investigation demanded it, it seemed to me right that it should be done. It yielded satisfactory results (see especially Report, paragraphs 45 and 221. The search in the records of the Companies Court referred to in paragraph 44 was made for me by the solicitor's department of the Board of Trade).

10. The next phase was the examination of the Secretary, and this took place on the 14th and 19th October, 1959. His evidence necessitated further investigating which was virtually completed by mid-March, 1960. I examined the Secretary further on 3rd February, 1960, largely to afford him the opportunity of answering allegations of which I had a *prima facie* case against him. Many requested documents had been promised but were never forthcoming (e.g., see Report, paragraphs 57, 64 and 107), but in view of the time consumed in the investigation I thought it better not to make use of section 167 (3) to endeavour to secure them. One item I did wait for; this was an account of interest payments on certain debentures, which it was impossible to ascertain from the accounts. The information given in the Report, paragraphs 249-251, was requested in August, 1959, was frequently promised by the Secretary, and was furnished ultimately by the auditors on 5th April, 1960.

11. Thereafter the Report was completed. One matter arose which was outside the ambit of my authority: see Report, paragraphs 273 and 274. Had time not been so pressing I should have considered suggesting to the Board of Trade that they order an investigation of Peterscrest under section 165 (b) (i) of the Act on the footing that debenture holders are creditors, and it is, I think, worth considering whether the Board should also have power to order an investigation if one is recommended by an inspector in the case of a company allied to although not a subsidiary of the investigated company.

12. I should comment on the time taken in this investigation. Some reasons are indicated in paragraphs 7 and 284 of the Report, and in paragraph 9 above. A contributory reason lay in the appointment of one and not two inspectors; had anyone appreciated at the outset the extent of the matters which were to emerge on this general investigation I think it likely that the course might have been adopted of appointing a Chartered Accountant as co-Inspector. This investigation would have unquestionably been speedier had there been two inspectors to share the work and had the office organisation of a Chartered Accountant's firm been available to deal with the mass of documentation and correspondence involved.

13. After publication of the Report I was asked by the solicitors for the plaintiffs in an action pending between the old and new owners and officers of the company to make an affidavit as to alterations in a minute book (see Report, paragraph 60) for the purposes of an interlocutory application. This matter lay exclusively within my knowledge and I took the view that in the circumstances I ought to assist the Court in this regard, but that to do so by the voluntary act of making an affidavit at the request of one party was capable of being construed as a departure from the impartiality essential to such a quasi-judicial function. The Solicitor to the Board of Trade agreed, and I declined to make the affidavit: see letter annexed as Annex 2 hereto. It is to be observed that section 171 of the Act makes a Report admissible as evidence of opinion; it is perhaps for consideration whether it would be advantageous to make also admissible as *prima facie* evidence of fact.

14. In conclusion I would draw attention to the striking difference between this species of investigation and other investigations and inquiries of which I have had experience. In the latter a line is drawn between the administrative function of searching out and presenting evidence, and the quasi-judicial function of assessing evidence and reaching conclusions; and the two functions are discharged by different persons or groups of persons qualified by their skill in the one function or the other. In a company investigation of this sort one man has to combine the work of accountant, detective, solicitor and adjudicator. Which is the better course in the case of company inquiries may be a matter for debate. For my part I found the task fascinating, but I could not have discharged it without the advice and assistance of Mr. Deacon on accountancy matters. The important question in my view, on comparing the two procedures, is whether the individual who acts as a species of financial detective is well qualified to form an impartial view of the interpretation to be put upon the evidence. This is obviously a question which I am disqualified from attempting to answer.

(Signed) E. S. FAY.

3, Paper Buildings,
Temple, E.C.4.

22nd December, 1960.

ANNEX 1

9th July, 1959

Dear Sir,

I have your letter of 8th July last. I am disturbed to read in your last paragraph that two documents of du Cane Court Ltd. for which I asked have been recently destroyed. I take a serious view of the destruction, during an investigation, of any documents of a company under investigation. Moreover these particular documents were inspected some time ago by Mr. Deacon on my behalf and are clearly of material importance to my investigation.

In the circumstances I draw your attention to the provisions of section 167 of the Companies Act, 1948. I require you to ensure that no further documents of General

London & Urban Properties Ltd., du Cane Court Ltd., or Grove Estates (Twickenham) Ltd. are destroyed, and give you notice that any further failure to produce will be followed by the action referred to in sub-section (3) of section 167. This is without prejudice to any action that may be taken in the present instance, or under other provisions of the Act in any instance.

Yours faithfully,

E. S. FAY,

Inspector.

W. Livingston, Esq.,
Secretary,
du Cane Court Ltd.,
1, Manchester Square,
London, W.1.

ANNEX 2

27th June, 1960

Messrs. Paisner & Co.,
44, Bedford Square,
London, W.C.1.

Dear Sirs,

General London & Urban Properties Ltd.

Further to my letter of 17th June last, I have given consideration to the request contained in your letter of 16th June, and have also taken advice thereon.

I have reached the conclusion that it would be wrong for an Inspector to give voluntary evidence in respect of matters which he has ascertained in the exercise of the powers conferred upon him by the Companies Act.

Therefore, I regret that I am unable to furnish the affidavit which you require. It is right, however, to add that if the matter arose in circumstances where a subpoena could be served, different considerations would apply.

Yours faithfully,

E. S. FAY.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
TWELFTH DAY

Friday, 20th January, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN

MR. K. W. MACKINNON, Q.C., T.D.,
M.B.E.

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*) (*Questions 4253 to
4420 only*)

MR. J. E. HARRIS, MR. J. H. HILLS, MR. P. PHILLIPS, MR. N. R. TRIBBLE and
MR. J. R. SPAREY *called and examined*

4053. *Chairman:* Gentlemen, we are grateful to you for your memorandum and also for coming here to help us today. Mr. Harris, you are President of the Association of Certified and Corporate Accountants; Mr. Hills, you are a member of the Council of the Association and of the Parliamentary Law Committee; Mr. Phillips and Mr. Tribble are members of the Association, and also we have with us Mr. Sparey, the Assistant Secretary of the Association?—*Mr. Harris:* Yes.

4054. You have prepared a very careful and detailed memorandum and I do not propose to take you through the whole of it in detail but to raise points on which, it seems to me, further discussion might be useful. The first point I would like to raise with you concerns the minimum membership of private companies. You point out quite rightly that the present requirement is two or more persons, and that has been in many cases carried out by the expedient of getting a nominee to be the other signatory of the memorandum in addition to the person who is really behind the formation of the company. That, you think, is a fiction, and you

propose that one could have a single member only.—*Mr. Hills:* That is so.

4055. A private company could have a single member, but you suggest that it should be compulsory for private companies to have two directors.—Yes.

4056. And you suggest certain special arrangements to meet the case of the death of the sole shareholder.—Yes.

4057. May I ask you this; why should your second director not himself be a holder of any shares in the company?—There is no reason why he should not be a holder. But in the event of the death of the sole member, who is also the only director, the company would be unable to function; and therefore we have proposed a minimum of two directors—the second director may or may not be a shareholder—so that the business may carry on. We believe there are two angles of criticism to the rule of having two members. On the one hand one has the wholly-owned subsidiary which is thus compelled to have a nominee shareholder. The other angle is the small man who wants to form a private company and

when he does so he is told "You must have two members, but of course the other member may have just one share and be your nominee". That, we think, is a legal fiction at the beginning of the company which is not a good thing, and it is from that point of view—that in reality there is only one shareholder in many of these companies—that we suggest there need only be one shareholder. If the company wishes to have a second director who is also a shareholder, we should see no objection. We are not suggesting that a company must have only one shareholder, but that there need be only one.

4058. I think the case of a wholly-owned subsidiary is rather a case by itself. I think that is a case where it might be reasonable to have only one member, namely, the holding company. That would fit in with the central idea of the wholly-owned subsidiary: the holding company holds all the shares.—Yes. May I add this? There is the other angle which we regard as being equally important; the man who has formed a company is told he must have two members, but it is a legal fiction and that is not a good start.

4059. The great thing is to have somebody to carry on on the death of the original member. If you start with two members you are left with one on the death of the other; it is better than nothing.—*Mr. Harris*: I think we also had in mind the very large number of cases where people already trading wish for various reasons to turn themselves into limited companies. There the legal fiction is at its greatest and a pure nominee is brought in as a shareholder to comply with the existing law and the person concerned has no useful purpose as a shareholder.

4060. The thing is admittedly artificial, but do you not feel there is something repugnant about having a corporation with only one member?—*Mr. Hills*: Certainly, we have been brought up to believe that a company, registered or not, should consist of more than one person. But in recent years we have had the wholly-owned subsidiary and a large number of one-man companies being formed, and in those circumstances we

think the traditional approach should be reviewed.

4061. The kind of company that forms wholly-owned subsidiaries is generally a fairly substantial concern which will keep its books and records in order, but in the case of the small man trading on his own account do you not think it is going rather far to enable him to create a separate corporate entity consisting only of himself and to say, "I am the company and I am trading on my own account, I can do whatever I like"?—That in fact is what he does now; if he gets a nominee as a fellow-shareholder he feels no sense of responsibility towards that man, who has no real power; and I would have thought to overcome the legal fiction would have been a better way of dealing with it.

4062. If I may say so, I see considerable attraction in your suggestion that there should be two directors. The attraction would consist largely in the fact that you would have two directors who, unlike nominee shareholders, are under certain statutory obligations.—Yes. I think this would overcome our main objection to the man who is a small trader wishing to turn himself into a company being told, "You have got to have another member but he need only hold one share". That is a legal fiction.

4063. While we are on this subject, suggestions have been made on the other hand that two members might be made the minimum, both for a public and a private company; on the ground that it is a very common practice now to form your company as a private company then convert it into a public one, which enables you to avoid certain of the formalities attendant upon the formation of the company as a public company in the first instance. Have you any ideas about that?—No, Sir.

4064. That exhausts that subject so far as we can take it this morning. I think we have your views about it. Then the next matter is the limitation of the company's objects to those stated in the memorandum—in other words the *ultra vires* rule. I gather from your memorandum that you see no reason to interfere

with the *ultra vires* rule; you would keep it in force as it is at present.—Yes.

4065. Do you think anything could be done or ought to be done to meet the case of unfortunate persons who may be caught by the rule in some otherwise perfectly legitimate transaction with the company?—It is a terribly difficult and complicated subject. Our general view is that there is no call for amendment at the moment. We do appreciate, of course, that some people may be caught in that way. I think I may rightly say that some of our members express the view that the objects of a company should be limited to its real objects. But if we do that we come up against the fact that some foreign countries do interpret very literally the objects of a company. Other members take the view that a company should have all the powers of a natural person. But then the company is not a natural person. In the end we rather take the view that as the law at present stands, directors, members and persons dealing with the company are on guard and they must look and check; and we think that is a very proper thing, because if every company has power to do everything, then we would seem to be going almost full circle to the South Sea Bubble times—when a company was formed for an undertaking which would be revealed in due course—and one would have really no idea of what the main objects of a company would be. This is linked with our answers to heading 5 of your questionnaire (Exercise of powers of companies by directors and degree of control retained by shareholders).

4066. Those two matters are closely linked.—Very closely.

4067. I expect you will remember the form of memorandum of association to be found in one of the Schedules to the Companies Act. The objects are stated in one short paragraph, merely providing for the operations of a shipping company, with no additional objects beyond those ancillary to the main objects, and that was the prescribed form. As you know memoranda of association now go into many pages, most of which are the objects clause, covering objects of every kind. The suggestion is now made that these memoranda have become so wide that

one might just as well do for the companies what they would like to do and say they can do anything they like.—Yes.

4068. That, I think, is the way the abolitionists would view it.—Yes; but our view on that would be that one must not give the company too many powers or members of the company will not know what it is doing. True, many companies have now so much power that one cannot know what they are doing, that is something which has grown up and may continue; but we prefer to leave the thing as it is at the moment, whereby everybody should be aware.

4069. But are they in an ordinary transaction? If a company, to take an example, wants to buy fuel, the coal merchant never inspects the memorandum before supplying it. He chances his arm every time.—I think the majority view is that if the company were given all the powers of a natural person—and I must again stress we think it is not a natural person—then I think that leads us to say that our recommendations under heading 5 must be put into effect because otherwise the company could do almost anything.

4070. All would depend on the shareholders being given more detailed control over the directors than they have at present.—Yes.

4071. To return to the way I began this question. Would you be in favour of any special provision under which a third party dealing with the company in good faith should be protected even though the transaction afterwards turned out to be *ultra vires*?—Yes, but there is the position of the third party having knowledge and yet going through with the deal. Subject to that I think we do not take any objections to that at all. We have no desire to penalise anybody dealing in good faith with the company.

4072. One difficulty is that the memorandum is a public document, so that the third party I suppose would be deemed to have notice of its contents whether he had actually looked at it or not. The protection for third parties might take the form of a dispensing power given to the Court where it was thought that the third party was acting *bona fide*.—That would leave

the responsibility where it should be—with the directors.

4073. At all events your view is that the law as administered at present is from the practical point of view reasonably satisfactory and you feel one might go further and fare worse?—Yes.

4074. Then the next matter, quite a different one, concerns shares of no par value. You are in favour of implementing the recommendations of the Gedge Committee, are you not?—Yes.

4075. Have you any views to express about preference shares with no par value?—We did give consideration to that in 1953 and submitted evidence to the Gedge Committee and the Gedge Committee Report does in fact fall in line with what we then suggested. Preference shares, we feel, ought to have a par value. The dividend is usually expressed as being 6 per cent. or 7 per cent.—some percentage of a fixed sum. While it is true that the repayment value of preference shares varies nowadays, and will vary even more in view of the clauses now being put in to the effect that preference shares will be repaid at par or at a premium in accordance with the Stock Exchange price for the previous six months, nevertheless it is basically a par value share and ought to remain so.

4076. A number of other people feel the same way about that.—Yes; I would think that is the general view.

4077. The whole rights of preference shareholders are substantially measured by nominal par value of some kind.—Yes.

4078. That leads me on to the next point, quite a different one. It concerns the statutory prohibition of partnerships with more than 20 members, and you say in your memorandum that you do not wish to submit any recommendation under this heading.—No, my Lord.

4079. Your constituents are some of the people who might be concerned under these restrictions. They are professional people who normally practice in partnership and whose services are such that they have to be performed by a real person and not simply by a corporate entity, so that

this is a matter which concerns the constituents of your Association and I wondered whether you had any view you would like to express about it.—I would like to express my own view if I may. We do see the difficulty of the present limitation on professional partnerships—accountants, solicitors, and so on—and the need, perhaps, for larger partnerships. But to what extent are we to take this? If every type of partnership may have more than 20 members we could well run into difficulties. Non-professional partnerships do of course form themselves into limited companies, and there might then be some difficulty as to where a profession ends and where trading begins; and all in all we thought we would be making a recommendation only for the possible benefit of some of our own members if we suggested any alteration. That is my personal view, but we make no recommendation.

4080. I think it is true to say in some professions the growth of overheads and wages and expenses generally are tending to cause professional people to go into much larger partnerships than they dreamt of in the old days.—We wonder whether they are not sometimes too large; but that is for the partners to decide. In my opinion, Sir, it is better as it is, but we have no really strong views.

4081. I appreciate your position. Then there is heading 3, classification of companies, and you have a good deal to say about the much debated exempt private company. Your view is that the exempt private company should be discontinued in its present form. You proceed to suggest provisions that might be substituted, giving to certain companies some privileges in a modified form. As I understand your memorandum you make it a prerequisite of exemption under your plan that no body corporate should be a member of the company. Is that right?—*Mr. Harris:* Quite right.

4082. Now providing your candidates for exemption are so far qualified, then you think that it should be made obligatory for them to have their accounts audited by fully qualified auditors, that is to say by auditors with qualifications approved by the Board of Trade?—

Yes, Sir. It may be necessary to give you our line of reasoning in this particular matter. I think everybody would agree that there must be a distinction between the public company and the private company; the real problem is whether there should be some further category as was set up in 1948 and which is known as the exempt private company. It is the drawing of the line, the distinction between the exempt private company and the non-exempt private company which of course causes the main problem. As you already know, Sir, our suggestion is that, broadly stated, the category hitherto known as the exempt private company should be abolished but that private companies should be exempted from the necessity to file accounts provided they comply with the recommendations we have made. The main one, as you have already pointed out, is of course that no body corporate should be a member of the company. We have extended the scope of exempted companies in our recommendation compared with the present provisions defining the exempt private company. As we have stated in our memorandum we found those provisions have often been unworkable and have caused great difficulty so far as the directors of the company are concerned; they have never really been sure whether or not they were entitled to claim exempt status. So we thought, looking at it in the broad way, we should make a clean-cut provision to clear up the difficulties there have been in the last 12 years.

4083. We ought to clear up what sort of creation it would be, your new exempt company. First it will be distinguished by having no corporation in its membership, it consists wholly of individual members. In addition, would the members have to be limited as in the old non-exempt private company?—Yes, indeed.

4084. And they would not be allowed to make any offer of the shares to the public, and they would have to restrict the right of transferring their shares?—Yes.

4085. Those are the old requirements as far as I can remember them. I think you have said that you would also add a limit on the number of debenture holders?—Yes. Our proposed new category is

similar in all respects to the present non-exempt private company, except from the point of view of filing accounts, and except for the provision we would suggest that the number of debenture-holders should be limited and the company should be debarred from inviting loans or deposits from the public.

4086. What about directors' loans?—I think it would be better to prohibit them. I think the merit of simplicity is so great that, although one can argue a case against that point of view in that if one is envisaging a small family business and therefore giving it the right to exempt itself from the need to file accounts, you can argue that the directors ought to be able to make loans to themselves, provided those loans are disclosed in the balance sheet; nevertheless I think there comes a point where you have to limit the exemptions and our view was in general to simplify matters as much as possible.

4087. So your new form of exempt company would enjoy the exemption from filing of accounts, and they would also enjoy the rather minor privileges of the non-exempt private company, in particular not having to file a statement in lieu of prospectus; the latter are in a sense formal and not half as important as the one about filing accounts?—I agree, Sir.

4088. You say you would make a clean cut, and that you would do primarily by excluding corporate members; but can you really get out of the difficulty as easily as that? I do not know if you have a copy of the Act before you. Could you look at the Seventh Schedule, paragraph 1:

"The basic conditions as to the shares or debentures of the company whose exemption is in question are: (a) that no body corporate is the holder of any of the shares or debentures; and (b) that no person other than the holder has any interest in any of the shares or debentures."

Could you avoid adopting (b) or something very like (b)?—I think we could, Sir. I can imagine the case where a limited company forms another, appoints nominees as members and then finances it by way of debentures. I imagine that is the

type of case you have in mind which would not be caught on the recommendations as we set them out. But I think you would have to go behind that type of case and say what is the object of the law as it now stands; what object do we want to see achieved? Surely it is that public companies should be forced to disclose their accounts, and that the main reason for giving exemption to the exempt private company was to enable the small family business to enjoy protection, and to stop larger companies from using smaller companies set up as private companies as a device in order to avoid disclosing a part of their trading transactions. If we accept that line of thought, then assuming a company set up another company and appointed nominees as members, financed it and controlled it by way of debentures for example, then I submit, Sir, it would still be required, under the provisions of the 1948 Act as it already stands, to disclose the transactions and profits of the whole group.

4089. What I am getting at is this. You have got the basic provision that no body corporate is to be the holder of any shares or debentures. It was found necessary in the Act of 1948 to graft on that proposition a large number of sections. In fact I think the length of the Seventh Schedule is very largely accounted for by an attempt to deal with the problem of savings and exceptions. The circumstances in which a body corporate might be the holder of any of the shares varies enormously. You might have an executor trustee company holding for a deceased member, to take one example, and you might have family settlements of all kinds where it would be unreasonable to disqualify the company merely because some part of their shares was in the names of trustees of settlements or executors.—We do accept the difficulties that would be caused in some circumstances by a change in the regulations, but I must return to the basic thought from which we work and that was, having experienced the 1948 Act, we have found the difficulties to which we have referred in our memorandum, and we have found that it was unworkable in some cases. Whilst admitting that difficulties would flow from a simple line of approach, nevertheless on balance we

thought it would be preferable. We are widening the area of exemption in many ways.

4090. I should have thought you were restricting it. You are doing away with the exceptions in the Seventh Schedule which the 1948 Act thought it necessary to provide.—On the other hand where certain shares are held in trust which would be caught if it was thought the owners would not have the beneficial interest, that would be swept away under our proposals; so it would be wider to that extent.

4091. *Professor Gower*: When you say that no body corporate shall be the holder, do you mean holder or beneficial owner? —We mean holder.

4092. *Mr. Brown*: Any body corporate can hold shares simply by the process of putting them in the name of a nominee. —We felt that would not give rise to the disadvantage or abuse which at first sight might appear.

4093. *Mr. Mackinnon*: I would like to ask about the position of a company which was the sole holder of shares in the exempt company, whether it is on the register or whether it holds them through a nominee. I can understand your case that if the exempt company were a subsidiary then its results would have to be included in the group accounts of its holding company. But I do not see why you distinguish the case where the holding company is on the register from the case where it holds the shares through a nominee. That is the point that puzzles me.—I do not think the holding company would be affected only if it were on the register. If one looks at the provisions relating to the preparation of accounts, then in my view the holding of more than 50 per cent. of the shares of the company, even though they were in the name of a nominee, would in itself give rise to the need for the parent company to include the results of the subsidiary in the group accounts.

4094. What about a holding of 49 per cent?—Then it would not be a subsidiary company at the moment.

4095. But if the parent company was registered as the holder, the accounts of

the associated company would have to be published, under your proposals?—Yes; you would have that position.

4096. On the other hand if the parent company held the 49 per cent. through nominees, the associated company would be exempt from filing accounts?—That is a disadvantage we had in mind, but immediately one tries to cover that sort of point one returns to the principles adopted by the Cohen Committee in their recommendation of trying to cover all sorts of other points.

4097. I follow your explanation.—*Mr. Hills:* We do not suggest we have got the perfect answer.

4098. *Chairman:* You take the rather arbitrary and, if I may say so without offence, brutal method of approach and you say exemption must be by means of registered holding and you will not go behind the register; that may produce anomalies in some cases but that has got to be accepted, because if you attempt to get perfection you run into the enormously complicated provisions such as those in the Seventh Schedule to the 1948 Act. Is that it?—*Mr. Harris:* The more you try to go behind the register the greater the onus you are placing on the board in deciding whether or not they have exemption. In many cases we believe they are not in a position to know, they are not in a position to certify with honesty and complete confidence that they are entitled to the exemption.

4099. *Mr. Brown:* All these difficult questions you have touched upon would not arise if all private companies had to file accounts. Can you tell me why it is considered unfair to oblige companies to file accounts? I know you talk about the privilege of privacy for the small business. The fact is that he is getting the benefit of limited liability now, under some obligations which of course are attached, without the need to file accounts.—Yes. I imagine you have already heard some reasons, but there is one which possibly you have not heard. We do not believe that public opinion is ready for it. As a professional association we would like to see all accounts published. But we thought there were a sufficient number of reasons which at least gave some weight to the

generally expressed view that the small private company ought to be able to enjoy some protection against the large corporation, to offset the fact that a large company is able to make better use of information and therefore the information about the small one would be much more helpful to the large one than would be the information about the large one to the small. There is the position. We felt on balance we would like to go the whole way and suggest complete disclosure, but we do not feel the business world in general is ready for it at this stage.

4100. *Mr. Bingen:* But eventually that will be the solution?—In another 20 years perhaps.

4101. *Chairman:* What would you say about the suggestion that by the expedient of incorporating with unlimited liability you should be able to avoid the necessity for filing accounts?—I could not express a view on that personally, but if that were provided, surely you would have to deal with the large number of limited companies which are already in existence.

4102. Are they not getting the best of both worlds if they are getting limited liability and exemption from filing accounts?—Yes, they are indeed.

4103. *Professor Gower:* If you made it easy for a private limited company to convert into an unlimited one there would be no hardship on existing companies, they could either decide to file accounts or convert to unlimited companies; they would have the choice?—I should not think there would be any hardship. I must confess I have not given that suggestion careful consideration and I am extremely wary about expressing a view because of the possible ramifications in other ways.

4104. *Mr. Lawson:* If you accept the view that the conditions as regards filing accounts of private companies should remain as at present, do you not think as a minimum certain additional information could be filed. For example, you can have the position today that anybody can register a private company with share capital of £x. For all anyone knows that may well be lost, or it may have all been

advanced, or something of that kind. What would be your view about that?—It is difficult to decide where to draw a line. As I said previously we would like even at this stage to have gone the full distance, but if one draws the line the question is where to draw it. You have in mind the possibility of filing just the balance sheet?

4105. I do not know; I was putting it rather lower than you were. I was merely suggesting you might file the total of the reserves including the balance on profit and loss account, or the total of any deficiency, and perhaps a statement of net tangible assets; in addition one could adopt your own suggestion about prohibiting advances to directors.—I wonder if that would achieve any particularly useful purpose. I am thinking of a potential creditor who has been approached to put money in the business in some way or other. There is the question of the reserves and there is the question also of defining those reserves very carefully, and he would want to have capital reserves broken down in order to see, for instance, if the capital reserve is the result of fixed assets which were bought in 1938 being sold in 1958, or whether it is the result of a revaluation of assets. This is a problem which I think you would get into. I am not sure one would gain much from the limited amount of information which you have suggested.

4106. I see your point. The question is where to draw the line in detail.—As an association, if I may put the position generally, we would naturally support any recommendation which gave the people who wished to examine the accounts more information than they have at present. The difficulty is to say where to draw the line.

Mr. Phillips: It might be useful to require exempt companies to file a statement in their annual returns that in the opinion of the directors the company was solvent. If, after that, the company went into liquidation the directors would have to justify their statement in the annual return that the company was solvent. As Mr. Harris has pointed out, so much depends on how a balance sheet is valued; there may be a debit on profit and loss account.

4107. *Mr. Althaus:* With regard to an approach for finance by a company, would a prospective lender not expect to receive from the company greater detail of their position than he would get from what is filed?—*Mr. Harris:* Yes, I agree. I was thinking principally of creditors in the ordinary course of business.

4108. *Chairman:* Would you agree that the more one waters down the content of these exemptions the more disproportionate are the extraordinarily complicated provisions in the Seventh Schedule which concern the right to exemption.—Yes.

4109. After the long process of unwrapping the parcel and getting over various hurdles you come to some very qualified and dubious exemption: is this not on the whole undesirable from the point of view of legislation?—In essence I quite agree; but we have drawn the line as we have suggested because we thought there was a balance of advantage in favour of it at the present time.

4110. Unless the company has been given something worth having at the end of it all, it can hardly be right to burden the statute with what it has got to do to qualify for this thing.—Yes.

4111. One last question on this subject, which has, I think, provoked more discussion than anything else so far in this Committee: would you expect the category of exempt private company under the 1948 Act to be the exception rather than the rule among private companies?—I should say the majority of private companies are exempted.

4112. It does not surprise you that 80 per cent. of all private companies on the register are qualified as exempt private companies?—No.

4113. You would expect it to be the majority?—Yes.

4114. The next question is under the Committee's heading 5 (Exercise of powers of companies by directors and degree of control retained by shareholders). As to fundamental changes in the activities of the company, you express the view that there should be no introduction of fundamental changes without the approval of members; and that a new section should

be introduced requiring that the fundamental activities of a company be stated in the annual report of the directors and that no material change should take place in these activities without the approval of the majority of members in general meeting. Do you think it would really be practicable in the case of some of the larger companies, in view of their manifold diversification, to give an exhaustive statement of the fundamental activities of the company in their annual report?—*Mr. Hills:* Yes, my Lord.

4115. Some of these very big corporations must have dozens of activities and it would be very difficult to say which was a fundamental one for the purposes of the return, would it not?—I would not have thought so. Surely the directors are aware of what really forms the fundamental basis of the income of their company? Of course there are companies with very varied activities, and we might reach the stage where every company makes everything.

4116. Would you make this statement in the annual report subject to the provision of section 157 (2) which says in effect that the directors are not bound to disclose if in their opinion it would be harmful to the company?—We would not; our feeling is that section 157 has been ignored because of that proviso.

4117. Whether it is desirable from the point of view of the company or not you think it should be a duty on the directors to include a statement of all the fundamental activities of the company in the annual report?—It is rather difficult, but that is our stand.

4118. At all events this is a constructive suggestion which we have not seen before and no doubt in due course we will consider it. But that is the kind of difficulty which arises.—We do appreciate that.

4119. Then there is the question of what is a *material* change.—I would have thought from the number of times the word appears in the 1948 Act, and I believe in the previous Acts, that it has stood the test of time. It was ruled some years ago that a *material* contract is one which upon reasonable construction would

assist a person in determining whether he would become a shareholder in the company or one which would be calculated to influence a person on reading a company's prospectus as to whether or not he would apply for shares. That would be what we want; that is what we mean by *material*.

4120. You would treat the people who were shareholders at the time of the issue of the directors' annual report in respect of any year as if they were new people subscribing for shares on the basis of those statements?—Yes, that is it.

4121. *Mr. Lumsden:* May I ask about the case of an industrial holding company. The activities of such a company are presumably to acquire shares of any other company carrying on any kind of business. Such a company may acquire shares in a group of companies with an entirely different type of business from any already in the group. There would be a difficulty there in deciding whether that company had in fact made a fundamental change in activities or not.—There is some difficulty there. On the other hand an investor in an industrial holding company—one which sets itself out to take an interest in any type of industrial undertaking—would know and appreciate that.

4122. Are you not getting very near to an industrial holding company in the case of any large company which in fact operates as a holding company for a group?—Yes, Sir. But our objections are really not to the larger companies at all. In fact one would maintain, I think, that many of the activities of a large company are not material and we would not call them so; it is the company into which shareholders may put their money on the understanding that it was making X and later, perhaps overnight, may find that it is making Y.

4123. I see what you are getting at, but the difficulty is to define it.—Not if one uses this word *material* in the sense I have just suggested.

4124. *Chairman:* The next matter under heading 5 is disposal of undertaking and assets of a company, and you point out in your memorandum, paragraph 19, that it is common practice for companies to include in their objects clause power to

sell and dispose of their undertaking or assets, and you say that in the view of the Council the exercise of this power should be subject to the approval of the general body of members, except where the company has a considerable holding in the purchasing company. Would you include in that the disposal of a substantial part of the assets, or would you confine it to the particular case of the disposal of the entire assets?—Again we use this word *material* which crops up so often. We do say in our recommendation "prohibited from selling or disposing of the whole or a material part . . .". We have again based our use of that word *material* on the definition I have already given to you.

4125. I follow you. Whatever the word you use, *substantial* or *fundamental* or *material*, it is your view that disposal of that sort ought to have the sanction of the company in general meeting?—Yes.

4126. Subject to the practical difficulties of definition being overcome by some such formula as your definition of *material* or in some other way?—Yes.

4127. *Mr. Brown*: It might be *material* if it related to 50 per cent. or more of the assets of the company?—Yes.

4128. *Chairman*: You would have to have some qualification in the case of a company which had one large property, say a hotel, and they were in the habit of selling the hotel from time to time and buying a new one; so that in a sense what they were doing was in the ordinary course of their business which involved disposing of the whole of the assets.—If that sort of case arose then the board could say that they had been doing this sort of business for several years, that they were not doing anything different, and that the shareholders knew that and had no right to quarrel with it.

4129. *Mr. Watson*: Would the result of requiring a general meeting be that all the details of the transaction would have to be set out and three weeks' notice given of the meeting?—Yes.

4130. Is it not possible that that might conflict with putting through a satisfactory deal because the full blare of publicity would be directed on it before

it had been concluded?—It may be, of course; but if this provision is brought in then every person attempting to buy from the company would know that this blare of publicity must come before they could conclude the deal.

4131. You do not feel if the directors were to be put under the obligation to report immediately after having done a deal of this kind to their shareholders and to justify it that that might meet your point?—I do not think it would, Sir, because you say they have to justify it. Supposing they do not justify it, what can then be done about the contract?

4132. Presumably the contract would stand but the directors would lose the confidence of the shareholders.—But the shareholders might have lost the bulk of their assets.

4133. If it comes to selling a material part of the business there must be some consideration and the directors must act with due responsibility in carrying through a transaction of that kind?—Yes; but there was a case some years ago where the directors sold the company's gilt-edged securities and bought shares in worthless companies. The directors were not very interested in saying how they justified it and the shareholders lost their money.

4134. You suggest if they had been compelled to call a general meeting and to say that they proposed to do this in the first instance they might have been stopped?—Yes.

4135. *Chairman*: Then the next point under heading 5 deals with the issue of shares. Your recommendation is that a new section be introduced requiring the approval of a majority of the members before the issue of shares, or securities with conversion rights, or the giving of options to non-members. We have had a good deal of discussion on that topic, and one suggestion made is that where it is proposed to issue shares for cash these shares should be offered in the first instance to the existing shareholders, or the existing equity shareholders, *pro rata*, unless a decision of the company to the contrary is obtained in general meeting. Subject to an appropriate limitation so as to exclude minor issues of shares would

you agree with that as a general proposition?—We would, my Lord, yes.

4136. The next point is when there is no question of an issue for cash because the shares are to be issued for a consideration other than cash—the acquisition of assets of some kind—would you agree that again where a substantial amount of shares, say 20 per cent. of the existing issued capital, is concerned, it would be right that the directors should go to the shareholders for approval?—I would not agree with that, my Lord; but before any such issue is made and not merely issues in excess of 20 per cent. One can envisage the case where a member already has 49 per cent. of the shares and if he purchases a small part, say 2 per cent., he would get control.

4137. You would make it apply to any case in which the issue of shares under consideration could alter the control of the company?—Yes.

4138. So that would vary from case to case; you would not put a figure on it because it would depend upon the presently existing position?—Yes; that is why we would have said any issue whether cash or not. We do realise the difficulties of issues for other than cash. But our point is that even the smallest issue may in fact alter control.

4139. *Mr. Scott:* Might that not impose a very difficult onus on the directors, if they contemplated issuing shares outside the present list of members, say on the acquisition of a business. They would have to know who the shareholders of the business they were acquiring were and then work out what the total voting control would be when added to any shares they might already hold, and all sorts of complications would ensue. And I do not quite know what is meant by saying the control of the company would change. Take the case of a public company with, say, several hundred or a thousand shareholders. Would you have to aggregate all the people who together could control 51 per cent. of the votes? I can see the most awful difficulties in trying to apply that in practice even though the case you have illustrated is a simple one.—That is why in our general preamble we have said “may result in a change of control

of the company”, but in our actual recommendation we say that every issue must be subject to the sanction of the members; and while we do appreciate the difficulties to which you have drawn attention they would not arise if our recommendation were carried into effect.

4140. That would apply notwithstanding that when the shares were originally created by the company that was done on the terms that the shares should be at the disposal of the directors.—Yes, I think whatever authority may have been given many years ago.

4141. Or many months ago?—Or many months ago.

4142. Or many weeks ago?—I think it would not be beyond that. No capital should be issued unless the shareholders know what it is wanted for. And while it is true that for many years many companies have had unissued capital I think they should not issue such capital unless the members know what they want to use it for.

4143. *Mr. Brown:* Is it a question of the time involved in putting it to the shareholders?—Yes.

4144. It could probably not be done in a week?—I agree.

4145. *Mr. Scott:* You object to the present system whereby the directors ask the shareholders to create more shares so that the directors may have them available to take up new businesses as and when suitable opportunities occur. Frequently the circular to the shareholders says that the directors have no immediate intention of issuing these shares but they wish to have them available to accept opportunities for expansion when they occur. You think that is wrong?—I have no objection to that because I believe in some cases it might save stamp duty by putting the capital back to what it was before reconstruction. But when the actual issue is made that is the time to get at it.

4146. The whole point in putting the resolution in the form in which it is done nowadays is that the directors can have it available to make a quick deal with somebody without having to go back to

their shareholders to ask them to sanction it. You would object to that?—
I would object to that, yes.

4147. *Chairman*: The next point concerns directors' and officers' dealings in their own companies' shares. The point here is, I think, first that you think the register of directors' shareholdings kept under section 195 of the Act should be open at all times, like the register of members, and that the right to inspect it should not be restricted to the present period beginning 14 days before the annual general meeting of the company and ending three days after its conclusion. A good many people have expressed that view and I think we can pass from that. Your next point is that section 195 should be extended so as to include a statement of any options held by directors. My view up to the moment has been that options are already covered in section 195. The section extends to shares which are held in trust for the director concerned or over which he has any right to become the holder whether on payment or not. Would those words not include an option?—My answer to that is that we think in all probability it does, but we simply want to make it clear. When one has a put option on a share, for example, I am not sure that it is covered.

4148. You would like to make it clear that it does include options of every kind?—Yes.

4149. Then you express the view, as a number of other people have, that on the whole you consider it is better that corporate bodies should not be directors. Would you make an exception there in the case of the wholly-owned subsidiary? Would you allow the holding company to be director of its wholly-owned subsidiary?—I can see no objection to it, my Lord, with the exception that I do not like exceptions.

4150. You would prefer a general rule?—Yes, it is no hardship to the holding company. I think it is no hardship to the holding company to put a nominee or perhaps two nominee directors on the board of its wholly-owned subsidiary, and I think that would be preferable to having exceptions.

4151. You make no recommendation on heading 6 (d), disclosure of directors' interests. You do not think any amendment of the present law is necessary. We have had representations made by various people that the obligation to disclose interest is expressed in terms which are too wide, so as to include interest of a nature which could not possibly influence the director's judgment or put him in pocket to any appreciable extent—small holdings in large companies whose shares are quoted on the Stock Exchange, that kind of thing. It might be an onerous obligation on directors if it is pressed to the full extent if he had to make disclosure of interests of that kind. Do you think any limitation would be necessary or desirable?—I do not think it would be desirable, no; because once one starts to narrow this disclosure down one starts to raise problems. Surely it is no great difficulty for a director to do this. If one were to try to limit the obligation how would you limit it to allow for having interests without disclosure?

4152. *Mr. Mackinnon*: You might put the word *material* here in the section; would that not cover the situation?—And who is to decide what is material?

4153. May I refer you back to the meaning of the word *material* which you have given us?—Who decides what is material in the present case? In the case we dealt with before it would be up to the Court to decide what was material. Here we are at the board meeting, we are considering the contract, and it is up to the director who has interests in a company then surely to decide whether his interest is material or not, not an independent Court. The other directors will never know, will never be able to decide whether it is material or not; whereas if the directors have to disclose all their interests, then the board decides whether or not a particular interest is material and whether or not to take any notice of it.

4154. *Chairman*: But again the point might arise that if you hold shares in an insurance company you may indirectly, through that company, hold shares in an extraordinary range of concerns without even knowing.—Yes; but one is not aware of the fact and therefore there could be no disclosure.

4155. *Mr. Bingen*: You have also to bear in mind that enormous numbers of contracts are made which never come to the ears of the directors. The directors would not know the contract was being made.—They would not, because it had not come before them.

4156. But under section 199 the directors have to disclose their interests, and the only way they can do it is by preparing a list and handing it to the secretary of the company and keeping the list up to date, which is the way some companies do it.—But, forgive me—I am having to think aloud on this—in your case it could well be that a director of one company who has in fact a controlling interest in another company would not be aware of the fact that the first company is in fact contracting with the second; and in that case he would not divulge his interest.

4157. *Mr. Lawson*: Do you think there are any circumstances in which a shareholder should be told of outside interests which the directors have?—I suppose one could put up an argument for that, yes. It could be said that under section 199, providing the director has disclosed his interest, if the other directors are willing to act in collusion with him, there is not very much point in disclosing it in the first place. But that is a new suggestion to me and I have not thought about it.

4158. *Chairman*: The next point comes under the Committee's heading, shares with restricted or no voting rights, at paragraph 31 of your memorandum. You are fairly strongly opposed to voteless shares, as they are sometimes called?—*Mr. Tribble*: Yes.

4159. But as against that it is said that a shareholder as such has not any right of voting at all: his right to vote depends on the rights given to him by his contract of membership, and it is said there is no good reason for restricting the shareholder or intending shareholder as regards his right of contracting as he pleases.—Our members had three main points against the non-voting share. First of all probably the democratic principle that equity shareholders should be given a voice in controlling the affairs

of the company proportionate to their stake in the equity. Then our members felt that control in the hands of a few shareholders might prevent the effective use of the resources of the company by entrenching directors who were not running the company efficiently and preventing a take-over bid which might be in the interests of the equity shareholders. The third point was that the decision of a small number of voting shareholders might work against the interests of those of the large majority of equity shareholders. Those are the main reasons why our members felt the non-voting share should be abolished.

4160. You have really put it as a matter of public policy, something that is so much against the public interest that it ought not to be allowed, however much the shareholders have agreed?—Yes, I think that is true.

4161. We have been referred to more than one case in which the plan of having a small number of voting shares and a large number of non-voting shares has been applied with great success.—We have considered the arguments for the non-voting share, and the view we took was, on balance, that the arguments in favour of the non-voting share were not as strong as those against. One argument in favour of the non-voting share, for example, is that a board which is running its affairs well and then takes in some additional shareholders might be deposed by the very act of taking them in. Our feeling was that if the board is really running a company well it is unlikely to be deposed.

4162. Yes. It is, of course, a difficult topic; but some people take the view that there is really little to be said against them, provided they are clearly designated as non-voting shares.—I think it is true to say that some non-voting shareholders in the past have invested in non-voting shares without being aware of the fact that they were non-voting shares.

4163. That can be got over by making it a statutory requirement that every certificate of title to a non-voting share should be enlaced in conspicuous characters to the effect that it is a non-voting

share.—Yes, but the balance of the view of our members was that as far as the future is concerned, non-voting shares should be prohibited.

4164. You do not think the separate designation of them in express terms as non-voting shares would meet the case? —This suggestion was discussed and it was decided that it would be better to make a small radical change in the law as far as the future is concerned; though we recognise, as we state in our memorandum, that to do this retrospectively may be very difficult.

4165. *Mr. Brown*: Would your views on this issue differ between publicly quoted shares and the genuine private company, the family business which remains private? —I think our views are the same in both cases.

4166. *Mr. Althaus*: Would it be your experience that this problem does in fact arise very much in non-quoted companies? Is it not mainly quoted companies which adopt this practice, or do you find it is a general expedient? —I have no personal knowledge of that; I do not know whether any other member has.

Mr. Harris: I cannot recall any single case of non-voting shares in a private company with which I have been associated.

Mr. Phillips: I have had experience of cases where people put up money and they are allocated non-voting shares on the understanding that when their loan is paid off those shares are transferred to the directors, but meanwhile there are A shares and B shares; and the B shares have no vote.

4167. *Professor Gower*: And weighted voting is quite common in private companies? —Oh, yes.

4168. *Chairman*: What would you allow? Would you allow A shares with 100 votes each and B shares which have five votes? —*Mr. Tribble*: We feel that where there is equivalence of risk there should be equivalence of voting power.

4169. Would it not be difficult to apportion voting power satisfactorily if you were going to do it in accordance with

the risk or with the interest in the equity? —We do not feel it would be beyond the ingenuity of boards of companies to devise some method of allocating voting rights between the various types of shareholder.

4170. And it would prevent me getting the same share for 9s. without a vote and 10s. with a vote, when I did not want to have a vote at all? —In the future, yes.

4171. Well, it is a very controversial topic, and there are difficulties on both sides, but I think it is fair to say that the Stock Exchange do not regard voteless shares as very satisfactory counters? —I believe the Stock Exchange have suggested a change in the law to prohibit non-voting shares.

4172. *Mr. Bingen*: I thought you were saying earlier it should be made a statutory obligation for all equity shares in future to have full voting rights. Then later I gathered you had in mind that it should be left to company draftsmen to work out some scheme of voting according to the varying rights of different classes of equity shares. It would be difficult if there was a statutory obligation of some kind superimposed. —Our view is that where there is an equivalence of risk there should be no difference at all in the rights of the shares. There should be an equivalent vote. Where you have participating preference shares and that sort of thing, then obviously one would get different rights for each type of share held.

4173. So, in your view, the legislation would merely say, "No shares shall be issued with no voting rights at all", and you leave it to companies to arrange their own affairs? —Our suggestion is that all equity shares carrying equal risks should have equal votes, and that is the crux of our recommendation—equal risks, equal votes.

4174. I am wondering how that could be put into legislation. —It might be difficult to draft.

4175. *Chairman*: I should think, from the point of view of drafting, it would be an extraordinarily difficult task. —Yes.

4176. *Mr. Mackinnon*: You would clearly have to have some formula laid

down for the voting strengths of each class of share: if everybody is in the same class they must each have the same vote. I do not see how the draftsmen are going to work it out.—I think it would be impossible to lay down in the law a formula which would get over this point you made, because there may be so many different rights attached to so many different types of shares.

Mr. Mackinnon: This is the difficulty that we have: that is why I asked how you would ever arrive at a formula and, if you do, can you do anything about it by legislation?

4177. *Mr. Brown:* Your recommendation would cover the vast majority of cases which would arise, but you leave out of account the shares which would have to have voting rights which do not occur very often; and if this principle were adopted the Stock Exchange might have some say on the special classes?—Yes, indeed.

Mr. Hills: If I may have a word on this, we are rather dealing with exceptions when we talk about the different classes of shares, and it could well be that a provision on the lines we have suggested could lead to a general cleaning up of a company's capital. One reads of complicated schemes when the directors wish to do certain things with the capital: surely they could bring in a complicated scheme to tidy up the capital, and then there would be no problems for the very few exceptions that there are.

4178. *Chairman:* Leaving it to the companies to make suitable provision in their articles?—Yes, to reorganise and simplify their capital if it was difficult.

4179. And if they did not do it in a certain time, I should think the Board of Trade—to which everything comes back in the end—would have to scrutinise the articles and see what they could do?—Yes.

4180. I am beginning to wonder whether the game would be worth the candle.—Well, Sir, if I may say so, my personal view is that it would. You said that you might prefer to buy a share for 9s. without a vote than one for 10s. with a vote. That may be so with the accounts

you have in hand, but what is the position going to be in three years' time, when the company may not be in a good position—the directors have not been behaving properly, or they have mis-managed. I suggest, with respect, you might then view your right to vote rather differently. One feels that since the war it is unusual for a board not to do reasonably well, in this country, in almost any trade or industry; and the shareholders therefore turn round and say, "Why should we interfere?"—and I agree. But the situation might well be different in a few years' time.

4181. *Mr. Brown:* It would be analogous to saying, when your house is burnt down, you wish you had paid the premium on your fire insurance.—Exactly.

4182. *Mr. Lawson:* Do you think there are any instances in which shares should be deprived of their voting rights? The case I have in mind is where company A owns perhaps 25 per cent. of the shares of company B, and company B owns 25 per cent. of the shares of company A. If the boards are common, it gives great powers to those boards in respect of voting in the shares of the two companies. Have you come across that type of case?—*Mr. Tribble:* We have indeed, yes. Our feeling is that it would be extremely difficult to legislate so as to deprive shares of their voting rights. I think possibly in the case of trusts, where a trust holds the shares in its holding company, it might be easy to identify the shareholding, but without that ease of identification it would be extremely difficult to legislate.

4183. You can get into a situation where, if the companies' cross holdings are large enough and the rest of the shares are widely dispersed, the directors have complete power and can re-elect themselves indefinitely, and so on.—We wonder whether the best way of dealing with interlocking shareholdings is to deprive the shares of their votes—would there not be some other way of getting over this particular problem?

4184. Maybe, yes.—*Mr. Hills:* One sees frequently in new issues that a family or one member is retaining probably 60 per cent. or 70 per cent. The same

situation really arises there. One would have to take it a little further.

4185. That is really a different case.—But it is the same basic problem.

4186. *Chairman*: Perhaps we might pass from that. The next point is raised under the Committee's heading 9, protection of special classes of shares. Under that heading you say you are satisfied with section 72 of the Companies Act except that you consider the requisite share qualifications of members competent to apply to the Court to have the variations cancelled should be reduced from 15 per cent. to 10 per cent.—*Mr. Tribble*: Yes: our feeling on this was that 10 per cent. of the holders of any class of share could be a very large number. It could be a large percentage, to get 10 per cent. of the active shareholders together, and our recommendation really goes a stage further than that of the Cohen Committee, which extended the time from seven to 21 days in which an application could be made. We feel that 15 per cent. is rather a large percentage for this purpose.

4187. Have you had any actual experience of an application under this section?—No.

4188. It is clear that it is easier to get 10 per cent. than 15 per cent., especially when under a time limit; but in practice you have not come across any case in which a proposed application to the Court under section 72 was defeated because 15 per cent. could not be raised in time?—I do not think one would know about such a case. If someone could not get 15 per cent., how would one know that he had not been able to get 15 per cent. of the shareholders?

4189. But you have not had a case where you have failed to get the 15 per cent.?—No.

Mr. Hills: But if I may speak on this, we have at the back of our minds, as I mentioned a little time ago, the fact that with so many companies now one sees the directors or other controlling interests of the business have 60 per cent. or so of the shares. To get 15 per cent. of the total capital means 30 per cent. or so of the capital held by the public, and this was one of our reasons for reducing the prescribed percentage.

4190. There is this about it—the 10 per cent., as you wish to see it, or the 15 per cent., as it is now, would be asking the Court to let them have a second attack, so to speak, on the question of varying rights; because it postulates a variation based on a separate class meeting and so, according to the company's constitution, binding on the minority. The minority have been defeated under the machinery provided, and they now want the Court to overrule the decision of the majority of the class. Might it not be reasonable in those circumstances to make rather a high requirement as to the members needed?—*Mr. Tribble*: We felt the position of the minority shareholders should be strengthened, if possible, rather than weakened.

4191. That is the tendency one finds everywhere now. I was only putting it as a possible justification for a fairly high proportion, a fairly high number, of members. So there it is. Then the other branch of this heading is rather inelegantly described as "getting rid of preference shares by winding up or return of capital.". That is not a section 72 case, because section 72 deals with a variation of rights in cases where there is machinery by way of separate meeting for such variation.—Yes.

4192. Under the second branch of this, transactions of the kind I think Mr. Hills has mentioned might arise. You might have preference shares carrying a fixed cumulative dividend of 8 per cent. and repayable in a winding up at par, with no further right of participation in profits or assets?—Yes.

4193. A scheme for the reduction of capital in excess of the wants of the company is propounded, and then any capital returned has to be returned in accordance with the legal rights which are measured as in a winding up. Then the preference shares are paid off for the sum of £1 with their 8 per cent. dividend generally to the date of payment, and the holders have to go into the cold market and look for something as good as their 8 per cent. preference shares. It is suggested that may be regarded as unfair, and the question is how to get over that kind of thing—if, indeed, one does not say, "Leave it as it is".—Yes, our

feeling on that would be, I think, that in such a case it would be a good thing if the preference shareholders could be protected in some way.

4194. Did not Mr. Hills advert to discussions on the lines that in cases of this kind there should be some provision whereby payment should be made at market value?—*Mr. Hills*: That is the modern trend. A preference shareholder who probably has a vote and a dividend of 6 per cent. is given an extra $\frac{1}{2}$ per cent., loses his vote and is told that on winding up he will get par, or the average price over the past six months on the Stock Exchange, whichever is the greater. Whilst we have not given specific thought to this problem, my own feeling is that it would be a very useful provision, but I do not know what would happen in the case of a private company, where the shares are not quoted.

4195. It might be an excellent thing to bring it in in a new company, but one does get the difficulty in the case of an old-established company, one that has been in existence long before legislation of the kind we are considering—because it can be put as taking away a fairly valuable right from the ordinary shareholders, as owners of the equity after the legal claims of the preference shares.—I think I would agree with you there.

4196. So it might be impracticable to introduce it by altering the rights of existing companies?—Yes, one would look at the repayment value, or ought to do so—and I do not think I am going against our views on non-voting shares: I think the cases are quite distinct. The preference shareholders should be aware of the fact that their capital is repayable at par.

4197. Then if we could pass again to something quite different, the next point is under the Committee's heading 14, practice of carrying on business through associated and subsidiary companies. We have had a good deal of discussion on this topic, and the solution you suggest is in paragraph 42 of your memorandum: "Many holding companies do not disclose the names of subsidiary companies and members may thus be unaware of the identity of companies for which they have

indirectly provided capital. The Council considers that the names of subsidiaries should be given in the accounts of the holding company. Where, in the opinion of the directors, it would be harmful to the business of the company to make such disclosure a note to that effect should appear on the accounts." So there you rely on the opinion of the directors, and make it a matter for their discretion, whether information about any given company should be included in their annual accounts?—*Mr. Tribble*: Our feeling on this was that as time went on directors might not exercise this discretion. They might be averse to putting more notes than they need on the accounts, and this would lead to disclosure by very many companies. We did not think, as time progressed, there would be many left who did not in fact disclose their subsidiaries' names.

4198. Yes. My point is this, in connection with section 157 (2), it is suggested that the value of that is nullified by the fact that the directors themselves have the power not to disclose in cases where they think the disclosure would be harmful. You do not think the same objection would be raised if the directors had the same discretion here.—They would have to state on the accounts that it would be harmful to the business. They have to take some positive action if they are not going to disclose the names of subsidiaries; and we felt that would be a good thing.

4199. Do you feel that would be a useful bridge to use until a broader view is taken about this by directors generally?—Exactly.

4200. The requirement for disclosure such as is contained in paragraph 42 of your memorandum might in certain circumstances be harmful. It has been put to us that if this had to be done in all cases you might get difficulty over subsidiaries trading in particular foreign countries, for example.—Yes, I think many of us felt that directors are unnecessarily shy about their subsidiaries, and the harmful effect the disclosure of their names would have, but we quite appreciate that directors might be able to make out a case for non-disclosure, which was why we included the proviso

that "where, in the opinion of the directors, it would be harmful to the business of the company to make such a disclosure a note to that effect should appear in the accounts."

4201. I suppose you think the directors might legitimately consider that to disclose the fact that a company trading in some foreign country was a subsidiary of their company might be harmful in certain political conditions?—Yes. It might also be harmful at home in competitive conditions, as for example where the wholesaler became a retailer.

4202. Yes, and also where a company wished to embark on business in a different price range?—We feel there may be good grounds for non-disclosure in such a case.

4203. And these are illustrative of cases in which you think the directors might probably put your suggested note on the accounts?—That is right.

4204. *Mr. Brown:* Is this another case where the valuable word material might be brought in?—I should think we would prefer to put an obligation on the directors to state categorically in their accounts, by means of a note on the face of the balance sheet, that they have excluded the names of certain of their subsidiaries because they thought disclosure might be harmful to the business.

4205. It would not allow them to put it that they had excluded certain names because they thought they were not material?—There may be some such subsidiaries, some dormant or some so small that it would be unnecessary to show their names. I think we might agree on that.

4206. *Mr. Brown:* I would prefer something like "insignificant".—Insignificant, yes.

4207. *Chairman:* Thank you: Then in paragraph 43 you suggest that certain matters should be disclosed regarding associated companies, subject to suitable definition of what is an associated company: and these are (a) name; (b) capital employed; (c) earnings; (d) proportion of equity held; and (e) valuation. My question is this: Would you be satisfied by the various amounts mentioned being shown in the aggregate and not

individually for each company?—Yes, I think we would be satisfied with that.

4208. That might save a great deal of labour and a great deal of ink, I think, where some of the larger companies were concerned, if they did not have to deal separately with each one?—Yes, the investor is more interested in the total sum than individual sums of associated companies.

4209. *Mr. Bingen:* Could I ask whether in paragraph 43 where you ask for certain particulars of associated companies, you consider it should be in the form of a footnote, or are you recommending consolidation of all these figures in the accounts?—We are suggesting that the information should be shown as a footnote to the accounts or as an attached schedule to the accounts. We are not thinking at all of consolidating the accounts of associated companies.

4210. *Mr. Watson:* Would you include as an associated company a company which has the same board of directors as another but has no interlocking shareholdings?—I do not think one could do that. I would not have thought we had in our minds including that type of relationship in the definition of an associated company. I think we had in mind two cases, first of all where there is *de facto* control of a company because there is one large shareholding and a lot of small shareholdings; and the second case is where there are several large shareholders—it could be just two on a 50-50 arrangement, or three, four or five—I do not think one could go on beyond 20 per cent. That is the type of associated company we had in mind. We are concerned about the very small size of trade investments which appear at cost on the balance sheet, whereas very often dividends from that investment are very great. We had a case only this month, for example, where there was a trade investment shown on the balance sheet at £16,000 and a dividend from that investment which was £135,000. That is the sort of case we would like to have more information about.

4211. *Chairman:* Yes. The next points are under the Committee's heading 15, loan capital. There you very reasonably point out that the Act contains provisions

relating to the register of debenture holders, where it is to be kept and when it is to be open for inspection and so on; but there is no requirement that such a register must be kept, and you suggest that there should be legislation requiring a company to keep a register of debenture holders. May I put this to you: it occurs to me on reading these provisions that probably what was meant by the register of debenture holders there was the register which is almost invariably kept in respect of a series of debentures, or funded debt represented by debenture stock, as part of the terms of issue?—*Mr. Hills*: Yes.

4212. That would account for the fact that they imposed no obligation, the intention being that where there is a register of debentures under the terms of a given issue then it shall be dealt with as required by the relevant section. But I hardly think it could have been meant that there should be one register comprising everything for which the company was liable, provided there was the sufficient acknowledgment of debt to make it constitute a debenture.—Yes, I see the point.

4213. *Chairman*: In considering any amendment here we would have to be careful to see exactly what register of debentures or debenture holders was in view when the section was drafted.—Yes, we appreciate that normally a register of debenture holders is kept by virtue of the terms of the issue itself, but I think it would be useful for such a register to be kept in all cases.

4214. Then the next point is also on loan capital, in paragraph 45 of your memorandum, you say that where the debenture holder enforces his charge without appointing a receiver, there is no provision in the Act for the filing of bi-annual accounts and statements. As a practical proposition, does the holder of a debenture ever go into possession himself?—We were advised that was so.

Mr. Phillips: I think sometimes he may take possession of the property himself, if it is, for example, a building.

4215. It would have to be a specifically charged property?—Yes.

4216. And it would have to be charged by legal mortgage and not merely an

equitable charge, otherwise he could not go into possession without leave of the Court; so it must be an unusual case.—It is, but I have met occasions where, under a specific charge, the holder himself has gone into possession.

4217. Of course, if the holder does go in he is the mortgagee in possession, which is rather undesirable.—The point was he may be called upon at some time or other to account, but there is no necessity upon him to file the accounts.

4218. And do you think it would be a good thing if his position were equated to that of a receiver or manager?—Yes.

4219. Then there is the matter of take-over bids, to which you have given a great deal of attention. There is only one question I need ask you, and that is whether the new regulations of the Board of Trade under the Prevention of Fraud Act seem to you to meet the case, broadly.—*Mr. Hills*: Broadly, with respect, yes; but we have a number of suggestions or recommendations in our proposals here which are, in fact, not in the Board of Trade rules. I could, if you wish, point out the differences which we have from the Board of Trade rules, if that would make your task easier—or at least those which we think are of importance.

4220. If you could give us the important ones—I do not think we need to go through it in detail.—No, if I may give you what we feel to be the important differences, the first one is in paragraph 48 (a) (iii), that if a conditional bid be made unconditional (a) all members be notified by the offeror of the number of shares accepted, and (b) a further period of seven days be allowed for acceptance. I think I am right in saying that is not covered by the Board of Trade rules, and our object in asking for that is so that the members of the company can see whether or not the bidder has control, and members who have not yet accepted will have a further chance to do so. There was a case at the end of last year where a company extended its offer on the Tuesday and closed it on the Wednesday. We had that sort of thing in mind. Then in paragraph 48 (a) (iv) we have asked that all members be notified by the offeror if a conditional bid is not made unconditional; and we

have also asked that all documents be returned within seven days of such notification. The Board of Trade rules require only that the transfers shall be returned. One knows of a case where a bid was sent out to shareholders, and the shareholders signed a form which said, "I irrevocably accept the offer", and the only notification of the fact that the offer was not made unconditional was in the financial papers. Many members did not see that notice and were not aware that they were free to deal with their shares. As regards the recommendation in paragraph 48 (c), we think that directors ought to state what additional information is in their opinion required. It may be what the bidder proposes to do with the business or with the staff. Shareholders generally are not insensitive as to what is to happen to their staff in such cases, and we think it would be a good idea to have that put in. Then under paragraph 48 (d) (ii) if the purchaser is a subsidiary company the name of its holding company should be disclosed. We think that would be useful information to the offerees. In paragraph 48 (e) (ii) we have suggested that a letter should be received from a body approved by the Board of Trade affirming that the total sum due on a full cash acceptance is or will be available.

Chairman: Yes. I am much obliged.

4221. *Mr. Lumsden:* Could I ask about your recommendation in paragraph 48 (b) (i). Is it your view that a full prospectus in terms of the Fourth Schedule of the Companies Act should be required where securities constitute any part of the consideration?—Yes, something on those lines, but a full prospectus would not be necessary if the shares being offered are quoted on the London Stock Exchange.

4222. You did not intend necessarily a full Fourth Schedule prospectus?—Not necessarily, Sir.

4223. *Chairman:* I think we can pass from there to heading 17 and paragraph 53 of your memorandum. The suggestion you make there is, to me, a new one: that the dispensing power given to the Stock Exchange under section 39 of the Act should apply to a statement in lieu of prospectus as well as to a prospectus. It

seems to me quite a sensible suggestion, but there may be something against it which I have not appreciated.—*Mr. Tribble:* I think there is a precedent already in the Act under section 30 (1), which refers to the statement in lieu of prospectus when a company ceases to be a private company, and in that particular section I think this power of exemption is granted. We see no reason why this should not also be extended to the statement which is the subject of the Fifth Schedule.

4224. They cover so much of the same ground, do they not—the prospectus requirements and the statement in lieu of prospectus requirements?—Yes, they do.

4225. That, *prima facie*, seems to be a reasonable suggestion and, of course, will be looked into. Then in paragraph 106 of your memorandum you say "In bankruptcy the debtor whose assets are insufficient to pay 20s. in the £ suffers certain disabilities until he obtains his discharge from the Court. The Council is of the opinion that directors of insolvent companies which go into liquidation should in some cases suffer a similar disability." You have section 188, which is the disqualifying section, as well as section 332, which is the one you refer to.

—*Mr. Phillips:* What we felt about that was that the Bankruptcy Act makes it automatic that a bankrupt cannot be discharged without application to the Court. As far as the Companies Act is concerned, it is only on application to the Court that a director can be deprived of acting as a director; whereas we felt there should be some further obligation as far as the director was concerned, particularly in the case of the small company having limited liability. In cases where the business has been improperly or recklessly carried on, irrespective of whether it is solvent or not, then there should be a similar disability on the director acting as a director for a limited period—or automatic discharge after two years; there should be some sort of provision that, unless the whole of the affairs of a company were quite correct, the directors should be disbarred from holding directorships for a period, unless they go to the Court and get permission to carry on such directorships.

4226. What would be the vital actual event which would put the director into this position of disqualification?—That he has carried on a business with knowledge of insolvency, recklessly, that he has taken credit with the knowledge of insolvency.

4227. In the case of bankruptcy it is easy: you get adjudication which draws the line, and from that time the bankrupt is under all sorts of disabilities. But in the case of a director if the company is wound up the Judge may make some rather acid remarks as to the way the company has been carried on—but from what point of time would disqualification come into play, and does it have to be a matter for the liquidator?—Yes, as soon as possible after the liquidator has made his report, and on the application of the liquidator.

4228. You would have to get an order of the Court?—Oh yes, but those orders should be given far more frequently than they are now. They are only given now in a case of clear fraud and not in the case of reckless trading.

4229. Then really your recommendation comes to this, that the types of conduct which bring this disqualification into play should be more widely expressed, and where the Court has found a man guilty of this type of misconduct then disqualification ought to follow as a matter of course. Is that really more or less what you are saying?—That is so.

4230. Yes, we have had some other people who have put the same point, in rather a different way, but essentially the thing is to get a positive order which lays down positively that this disqualification has come into operation, otherwise the thing would be confused?—Quite.

4231. The last matter that I want to trouble you with occurs under the Committee's heading 21, Accounts, and it is your recommendation about revaluation of fixed assets and the use of any resulting surplus. There you state the problem of revaluation, and your recommendation, as I understand it, is that the directors should produce a revaluation of the fixed assets once a year?—*Mr. Harris:* Not necessarily, Sir. It is not necessarily a revaluation in the normally accepted use

of the word. Thinking of the basic problem, it is one, as we see it, of attempting to provide more information than is now normally given in a balance sheet. There are obviously several desirable reasons for wanting more information. It is not so bad with the public companies with quoted shares as it is with private companies—though that is often looked at from the other way round. The private company produces figures which are not necessarily as informative as the average public company, because superficially at least there does not appear to be the necessity for them. I think those who would not agree to valuations of the assets of a company based on a changing price level would agree that the normal basis of stating the value of fixed assets gives effect only to one purpose of the balance sheet, namely an account of stewardship. And our desire was to find some way of introducing the thin end of the wedge, an alternative basis, simultaneously with the existing basis of historic cost. We have suggested there are several different ones—replacement value, the historical cost, which we already have, the value for insurance purposes.

4232. A valuation based on what the asset contributes to the undertaking in the way of revenue, and so forth?—Yes, that is a much more difficult one to define. At least the basis of valuation there would differ from one person to another probably, and that is why we took the suggestion that there should be one alternative basis supplied as an obligation by the company each year. We do not think it would impose unnecessary hardship, but at the same time we feel it will give much more usefulness to the balance sheet, and possibly after experience of it, say in another 20 years' time if Company Law is once again looked at, as a result of that experience we shall be able to evolve perhaps a more uniform basis which would be helpful to the person reading the accounts.

Chairman: Thank you. I do not know if Mr. Lawson has any observations to make on what Mr. Harris just suggested?

4233. *Mr. Lawson:* Yes, I would like to follow that up, if I may. Am I right in thinking that you feel the best way of

giving this additional information about fixed assets is by way of a note in the accounts?—Yes.

4234. You are not particularly in favour of actually writing the assets up in the books?—No, we are not. We feel at this particular moment the historic basis is probably the best one to have laid down by any legislation, but the majority of the people using balance sheets have a need for additional information and therefore, at this particular juncture, the best way of meeting that need would be by demanding that some additional information be included by way of note.

4235. Yes, I see that. It would be much easier to do it that way because one need not specify what particular method might be used as long as certain additional information was given to show a true and fair view. That is really the point, is it not?—Yes.

4236. *Mr. Brown:* When the directors are faced with the task of putting the current valuation—and you put the responsibility on the directors—it would be just as important they should not overstate the value as understate the value?—Yes, indeed. They should give a value which, in their view, most accurately reflects the basis they have chosen.

4237. That is a very difficult point in many cases: would the auditor's certificate also endorse that valuation?—Yes, Sir. I think we have stated here that the basis as well as the figure should be given, and therefore it is a question of actual reporting—the auditors would not be asked to state whether the figure was, in their view, a right or a wrong one, but to verify that that was, for example, the replacement figure for insurance purposes, a replacement figure as quoted to them.

4238. *Mr. Lawson:* I have one or two more questions on accounting. Do you think the present law is right that the share premium account is for all purposes part of the capital? That is to say except for writing off issue expenses, and so on—you are satisfied with that?—Yes, we think it should be properly regarded as capital.

4239. You do not think it should be used for writing off goodwill or intangible

assets of one kind or another?—No, I do not think it ought to be used in any way differently from the way in which ordinary capital is used.

4240. Thank you. You touched on the difficult point of pre-acquisition profits in paragraph 60 of your memorandum, and I am not going into detail about that because it would take too long, but what kind of cases had you in mind? Would you confine your suggestion that pre-acquisition profits should be available on reconstruction or amalgamation to cases where a new company is formed to acquire two existing companies by an exchange of shares. Would you confine it to that, or extend it to the case where one existing company acquires control of another company?—We would confine it to the former category, where the shareholders after the reconstruction or amalgamation—whatever it may be—are substantially the same as the shareholders of those particular businesses before the event took place.

4241. And would you confine it to cases where it is purely an exchange of shares? Frequently, of course, one finds cases where part of the purchase price is shares and part is cash.—I think it would be preferable, yes. That would give the result which we are seeking.

4242. You do appreciate there are very great technical difficulties about such a proposal, because the purchase price, whether in shares or cash, does in fact include the assets represented by the pre-acquisition profits; and that is your difficulty.—Quite. We felt we ought at least to make a recommendation along these lines, because in our experience there have been cases where reserves have been generally unnecessarily frozen.

4243. We have a great deal of evidence that people would like to see this change made, but unfortunately we have not yet found anybody to tell us how to do it. That is what we are looking for.—Unfortunately we are only a body of accountants and not lawyers.

4244. *Mr. Lumsden:* To refer to the question of the share premium account,

on which you make your recommendation, I would like to ask how you interpret the present position and which position you are satisfied with. When shares are issued for cash there is no difficulty: you issue a £1 share for 40s., and you get a share premium of 20s. Where shares are issued for a consideration other than cash there appear at the moment to be two different views; one view being that you must value to the best of your ability the assets acquired and treat the shares as having been issued at that value, and if that value is 40s. you again set up a share premium of 20s. per share. The other view is that you can treat the property acquired as being worth the nominal value of the shares offered and set up no share premium account. Which would be, in your view, the more satisfactory approach and to which you would recommend no change in your paragraph 59?—I think one ought to accept the first course of action. The balance sheet after acquisition ought to reflect the position as expressed in the purchase agreement—in other words, if the value stated there and the consideration is equivalent to 40s. a share then it ought to be reflected that way in the balance sheet.

4245. There may be no price stated: it may just be that you buy, say, one share in company A for one share in company B, no attempt being made to value the share in company B.—But it would be fairly easy to calculate the price.

4246. But is it, or should it be, the duty of the directors to do so?—Yes, if the directors make an issue of shares for a consideration equal to 40s. per share, that would have been stated.

4247. Not necessarily.—In the majority of cases. I cannot think of cases where it has not been done.

4248. It has quite frequently occurred, but you would favour an attempt by the directors to value the asset *bona fide*?—Yes, I would.

4249. Thank you. The other point is paragraph 100 of your memorandum. You recommend that where third

parties advance money for wages and salaries and then have the right to rank preferentially in a liquidation, this should only be for a period of one month, instead of, I think, four months as at present. Is that suggestion not liable to be very harmful to a company which is perhaps going through a difficult period and may very well survive, provided its bankers are prepared to back it for a short period by advancing the necessary money for wages and salaries? If they knew they would get preference for only such a short period as one month they might be unwilling to do that, and drive a company to the wall, which might not necessarily otherwise go there.—*Mr. Phillips*: Our whole point on that is that these advances are in fact undisclosed charges to anyone giving credit. You see, during that time the company can buy new goods on credit without the supplier being aware that there is this large charge—which is undisclosed, of course. So we have found in some cases that a company goes into liquidation and in some cases 50 to 70 per cent. of the assets is taken away by these undisclosed charges. The bank may be advancing £500 a week, and that is £2,000 a month. The creditors would not have given credit, during the latter period at any rate, if they had known this amount was outstanding. Our point is if the bank wish to advance the money they should put it on a proper charge, so that anyone giving credit should know the position. If they do not do that they should be treated as an ordinary creditor. It has become lately quite a serious matter for creditors to find in almost every case—I think I can say that—the bank has a prior claim which is undisclosed.

4250. As to your suggestion of the bank taking a charge, I am unfamiliar with the law of England: I am not quite sure whether a charge would be effective in the event of liquidation ensuing within a short period.—It is for cash. Every time they advanced the wages they would take a charge, and that would be for money advanced.

4251. And that would be effective?—Oh, yes.

Mr. Lumsden: Thank you.

4252. *Chairman*: Gentlemen, we seem to have worked through all the questions which have occurred to members of the Committee, and it only remains for me

to say thank you very much indeed for coming and helping us this morning, and also for your helpful memorandum.—*Mr. Harris*: Thank you, Sir.

(*The witnesses withdrew*)

(Adjourned until 2 p.m.)

SIR ROBERT A. MACLEAN, MR. A. M. HODGE and MR. M. NEIL called and examined

4253. *Chairman*: Gentlemen, we are very much obliged to you for coming here today and for the memorandum you have provided us with. You, Sir Robert Maclean, are Chairman of the Council of Scottish Chambers of Commerce?—*Sir Robert Maclean*: Yes, that is so.

4254. And Mr. Hodge, you are a member of the Council's Committee on Company Law Amendment; and Mr. Neil, you are the Joint Secretary of the Council?—*Mr. Neil*: Yes, that is so, Sir.

4255. The first point I want to put to you concerns the much discussed *ultra vires* rule. It appears from your memorandum that you on the whole are of opinion that it should be retained. What is your view about the position of the third party who supplies goods to a company, and unbeknown to him the business the company is carrying on is *ultra vires*? As the law now stands he loses his goods probably and gets no payment on the grounds that the company had no power to enter into the transaction. Have you given consideration to the possibility of relieving such a person in some way without doing away with the *ultra vires* rule altogether?—*Sir Robert Maclean*: I shall ask Mr. Hodge if he would be good enough to deal with that, but may I just in a preliminary way remind the Committee that we represent some 7,000 firms and companies, and so far as we know no other body in Scotland has anything like this coverage of business, trading and manufacturing concerns. In fact it is almost a rarity to find a manufacturing or business concern which is not one of our members.

Our basic position is that no unreasonable restriction should be placed on businesses which are conducted in an

efficient and honest manner. That conditions the whole of our thinking, and in saying that we recommend no change in the present law dealing with this *ultra vires* rule, we believe that to be in conformity with that general proposition.

Mr. Hodge: We did, Sir, consider that point but the practical difficulties involved caused us to take the view that we did. We thought that as the memorandum governs the relationship between the company and its shareholders as to how far the directors can go in exercising their powers, on balance it would be preferable to retain the law as it is at present, even although a third party can be prejudiced.

4256. But the strict position in law as I understand it is this. There are really two sets of powers you have to consider. First there are the powers of the company *vis-à-vis* the public, broadly speaking, and the law now is that those powers are somewhat strictly limited to the objects actually expressed in the company's memorandum of association. Then secondly, and operating within that set of powers, are the powers of the directors delegated to them by the shareholders: those of course cannot exceed the company's own powers. But you were putting it rather as though there was only one set of powers, namely the powers delegated by the company to the directors.—I did not mean to convey that but having considered the position of outside creditors we felt that if you did away with the *ultra vires* rule entirely it would cause difficulties with regard to the administration of the company. There would be no limit then to what the company could do as a company.

4257. Does that trouble you, the idea of a company being put on the world without any definite objects at all?—

Rather like a company under Royal Charter, Sir?

4258. Yes.—No, Sir, provided the relationship between the company and the shareholders can be satisfactorily dealt with.

4259. What is really troubling, you think, is not the *ultra vires* rule as limiting the powers of the company, but the possible usurpation of excessive powers by directors, if there were not this overriding limit?—That is it.

4260. And would you or would you not like to see that state of affairs, that is to say the abolition of the *ultra vires* rule?—We considered that we did not want any alteration of the present law, Sir.

4261. You think, from a practical point of view things might just as well be left where they are?—Yes.

4262. Then the next heading, which concerns the limit set on partnerships for profit at 20 members, and you say you would not oppose the removal of this restriction in the case of professional firms?—That is so.

4263. There is one difficulty there which you may or may not have considered. How would you set about defining a profession as distinct from a trade?—We appreciated the difficulty, but it was in the case of professional firms this was put forward to us—the hardship that can arise where a professional firm such as chartered accountants are limited in the numbers of partners they can have.

4264. Then you get the cases like the optician who prescribes glasses in the back part of his premises and sells those glasses in the front part of his premises.—We appreciate the difficulties, Sir, but we did not go into that.

Chairman: Perhaps it would have to be done, like so many things, by some form of regulation by the Board of Trade who might make a list of professions.

4265. Mr. Bingen: Could we ask, Chairman, why it should be limited to professional firms? Is there any real objection to more than 20 people carrying

on industrial or commercial business, if they want to, as a partnership arrangement?—It was only raised with us in connection with professional firms.

4266. Chairman: I think the point was raised for the Committee's consideration largely on account of professional firms, and those were the people we had particularly in mind when we included this question.—Sir Robert Maclean: I think our position, too, was that the difficulty really arose with the professional firm. It was certainly not raised with the Chamber from the point of view of trading concerns.

4267. Mr. Bingen: Yes, but do you think the limitation to 20 in the case of commercial concerns is sound or unsound?—Our thinking on that, if I may speak as a businessman, is that I never heard of a case where a business partnership of as many as 20 persons was sought after or deemed desirable, either in manufacturing or commerce. The case of the professional firm is the more obvious and seems to be the one where action is called for. I think also one must bear in mind the basic difference between the two. In a profession you have the personal attention which a client, as distinct from a customer, rightly expects. In a trading or commercial concern, although personal contacts are of value and mean a great deal, very often these are not bound to be between customers and directors; very often there are sales managers and so on. We are dealing with a rather different kind of organisation, and although we have not specifically considered the point we did not see any need to alter what at present exists. If you put it to us, in theory why should you have any limit at all, I do not see that there is any obvious need to have a limit; but in practice I am not aware of the present system being at fault.

4268. Chairman: There is this point too, Sir Robert, that a trading concern probably incurs far greater liabilities than a professional partnership. The latter have to keep their office going and pay their staff and they might, I suppose, get sued for negligence or something of that kind, though they would probably be insured against that: so you are not considering a case of an enterprise which may be involved in large liabilities for which the

concern carrying on the business ought to be able to be sued with the minimum of difficulty and delay. Do you think that would be a valid point?—Yes, I agree very much with what you have said.

4269. But you go no further at the moment than to say you see no objection to professional partnerships of more than 20 members?—No. We would consider that limitation out-dated but we are not aware of any pressing need for its removal outside the professions.

4270. The next one is under heading 3, the classification of companies, and I gather your view to be that the privileges at present accorded to what are known as exempt private companies in regard to the filing of accounts and in regard to being permitted to make loans to directors should continue? Under heading 3 (b) you express the view that "the privilege which an exempt private company enjoys of not having to attach a copy of its balance sheet to its annual return has been examined and the advisability of the continuance of this privilege reviewed. It is agreed, however, that no change should be recommended."—Yes. We understand there are some 340,000 or thereabouts private companies. Some 265,000 of these—that is not far short of 80 per cent. of the total, are exempt private companies and for the most part these are small traders and the concession of not having to make their balance sheets public is in our view generally desirable. Admittedly a small trader by forming himself into a limited company acquires the benefit of limited liability, but we do not feel that that justifies his competitor in the shop round the corner having the right to see his balance sheet. And the case of the man who supplies goods or grants loans to the small limited liability trader we felt did not concern us here as such people need not lend money or supply the goods if they do not want to. Indeed it is customary business practice for such people to see the balance sheet by request and this seems a adequate protection for the community, especially if the law is changed so that the auditor of the exempt private company has to have the same qualifications as the auditor of the non-exempt private company, and that is our recommendation under heading 22 (c).

4271. Yes, so that that limits the privilege as regards accounts simply to the question of filing. The accounts are there, they have to be made up and approved by an auditor of full standing just as is the case in any other company, but they do not have to be filed?—That is our view.

4272. And you feel it is right they should not be filed, because competitors might glean information from them?—We do so in the context that the overwhelming number of such companies are small trading concerns and we feel that no good purpose would be served by making their balance sheets open to inspection.

4273. Of course it is said, and I believe it to be the case, that quite a number of these exempt private companies are in fact very large concerns indeed.—Yes, Sir, I know. One of my principal competitors is in that position. It has its advantages and disadvantages, and of course I would like to see his balance sheet but I think the advantage I would gain thereby is outweighed by the disadvantage to the community and the minor irritations that would arise through gossip, if you like, of small traders and so on.

4274. What is the disadvantage the community would suffer if the exemption were removed?—In many parts of the country we have the feeling that there could be knowledge of what is basically a private individual's affairs which should not be disclosed unless there is some reason for its disclosure. In other words the onus is not on that chap to show why his information should not be made public, but the onus is on others to show why it should be, and I cannot see any claim on balance which justifies the satisfaction of curiosity.

4275. We have had evidence from trade protection concerns, people who insure the credit-worthiness of prospective customers of their clients, people of that sort, and they say that—in the interests of convenience and so forth—it would be a very useful thing for them to be able to look at the filed accounts.—Such evidence of course carries weight and should not be dismissed lightly but it still seems to us that in the case of a supplier of goods or a supplier of credit or other banking

facilities, the remedy is in his own hands as he can see the balance sheet by request in, I should have thought, all genuine cases.

4276. It is put that even so it is more convenient and less embarrassing to be able to get the information they want from a public file rather than to go and extract it from the prospective customer.—I should have thought the margin of convenience did not match up to the inconvenience involved by an examination into or a disclosure of what are basically private facts in the case of a small trader.

4277. Of course people who did not like disclosure, if disclosure were now brought in, would have the option of trading as partners.—But why should they be deprived of the existing facilities? I find it very difficult to see that the case which the Trade Indemnity Company brought forward is on balance strong enough to warrant that.

4278. You say the privilege has been enjoyed over a very considerable number of years now and there is no sufficient reason really for withdrawing it?—I should not have thought it appropriate, Sir, to describe it as a privilege. It is a right, is it not?

4279. It is a privilege in the sense that it is an exception from a general statutory obligation.—I think there may be a tendency in talking loosely to consider a privilege as something which can be unjustified; but this is a right and I feel those who want to take it away should demonstrate a clear case; and our thinking on this matter was that we could not think of any such strong clear case. But we did see the objections to disturbance of privacy, therefore we thought this right should remain, provided the exempt private company subjected itself to audit by an approved and competent auditor.

4280. *Mr. Bingen:* You said, Sir Robert, that one of your chief competitors was an exempt private company and from your point of view you would like to know how he was doing. Supposing the concern were a public company, those facts would be known. Is there any reason as a matter of general principle why the facts about your company and another

company competing as private companies should not be known and advantage taken of them? I just find the argument difficult to follow.—My point, in mentioning the case of a large and powerful competitor of my own firm, was to make it clear that I saw both sides of this question, and that having seen both sides I still came down on the side that privacy should be maintained unless there was a strong case for public disclosure; and I cannot say more than that on balance I think the disadvantage to me and my co-directors is not very great. I think the advantage to the private person of being allowed to retain his private affairs to himself is greater.

4281. My point was simply this: if you saw the figures of your competitor and you found they were more efficient, that would put you on your toes. If you found they were less efficient there would be a case for taking over or something of that kind. You have not that knowledge apparently, at the moment.—I think the best way for me to gain that knowledge is from observation of the qualities they offer and their prices. That is the best test that a businessman always has of the efficiency of his competitor.

4282. Then you are not really subject to any disadvantage from not knowing the figures?—I am subject to the disadvantage of not being able to satisfy my curiosity but I do not think I am subject to any business disability.

4283. *Chairman:* It might be said, if the privilege were withdrawn from everybody and everybody had to file their accounts then it would be free for all and everybody could go and search against his neighbour as much as he liked?—Yes, that would be so.

4284. Would that not be better than legislation which draws a rather fine distinction between those who are privileged and those who are not, so that a person, who just misses the privilege by some accident in the position of his company or the people interested in it, has to disclose his accounts, and the man next door who is perhaps better advised or cleverer at dressing up his company escapes? There you get an inequality, do you not?—The right is there to

choose in the first place so that inequality, if there be one, is not imposed. It is very often a matter of free choice. And the anonymity which is conveyed by a large community is not the same as the strong interest in the doings of others that you find in small communities. This is a point which has a greater bearing on the smaller than the larger centres. I do not imagine for example that in London people are so interested in the affairs of their neighbours—busybodies are possibly less prevalent—but without drawing a line as to where the process starts to be irksome, I think such a line does eventually begin to appear when you get to a small community. Then the financial affairs of one's neighbour begin to assume great importance and disclosure could lead to embarrassment. I cannot see why a man's private affairs should be made public unless for some definite public benefit, and I and my Council cannot see what public benefit is going to be served by one local butcher knowing the balance sheet of the other local butcher, or whatever it may be. We are dealing with the fact that the overwhelming number of such companies are small private companies of the kind of which I am speaking. There may be cases of large concerns. If so, you may feel it appropriate to recommend special legislation in the case of the large concern. We speak here for the overwhelming majority which we believe to be composed of these smaller people and we do not feel that there is any need for that information to be declared public. Those who have genuine interest—that is, those who supply them with goods or those who supply them with credit do in fact get that information on request, or they cease to give them credit or supply them with goods: and if we are assured that such a small trader has to have his books audited by a thoroughly competent person, which of course is not required of a private trader today, we feel that he is fitting reasonably well into the community and should not be disturbed.

4285. *Mr. Lumsden:* I am not quite clear, Sir Robert, what value the necessity for having an audit would have, if the accounts or anything relating to the accounts had not to be filed because,

supposing the auditor's certificate were unsatisfactory, that would never come to the notice of anybody except the shareholders themselves, would it? Would it not be necessary to have some provision whereby the auditor had to sign the annual return or append a certificate to the annual return, that he had audited the accounts and was satisfied; that or some such provision has to be made to make your proposal of any value?—I am of course speaking from just the background of a businessman. I am not familiar with the finer points of company law and practice. I do envisage, and I am sure the members of my committee have envisaged circumstances which would enable a creditor or lender of money or supplier of goods to see a balance sheet prepared by a competent man, with such reservations on the face of that balance sheet as he thought proper to express. That advantage, if incorporated in law and practice would, I would have thought, have been sufficient to ensure that the interests of creditors and suppliers of goods were properly looked after. It would seem to me that our proposal would secure the lender of money and the provider of goods from a false financial position in a better way than now, and that is what matters.

Mr. Lumsden: I certainly agree that somebody who asks to see the balance sheet of course is more satisfied with it if it has been properly audited, but I do not think it would be any protection to the general community who did not specifically ask to see the balance sheet.

4286. *Professor Gower:* Speaking as a businessman you surely would agree it is not practicable for every supplier of goods to refuse to supply until he has inspected the balance sheet and profit and loss account? The local coal merchant clearly does not fail to supply coal before he has demanded the production of a balance sheet and profit and loss account.—I should have thought it was the normal commercial practice of a supplier of goods to make enquiries into his customers' affairs.

Mr. Hodge: We did consider the point of view of the creditor but we thought on balance the harm it would do the small

private company from his competitors knowing his accounts outweighed the question of the creditors, who could in these cases ask for a copy of the balance sheet.

4287. *Chairman*: I quite follow that. I do not think we can really pursue this point much further. You have put your point of view in favour of the retention of the exemption very clearly, if I may say so, Sir Robert, and I think you have given full recognition to the other point of view and it will be for the Committee to resolve the question as best they can.—

Sir Robert Maclean: As long as one bears in mind, when we are advocating that course we are coupling it with an audit of an acceptable status, Sir.

4288. *Mr. Lawson*: Would the damage which you suggest might be inflicted on private companies if they had to file their accounts be mitigated if they had only to file the balance sheet and not the profit and loss account?—*Mr. Hodge*: Would not a series of balance sheets, Sir, give a pretty good idea as to how they were trading?

4289. Not necessarily, because it would not show how much of those profits had been distributed to the proprietors and so on. I think you could visualise the balance sheet which would not show any clear indication of the trading.—*Sir Robert Maclean*: May I make one final point on that, Sir, that if the filing of the balance sheet or profit and loss account is insisted upon, we should imagine that there would be many fewer limited companies and that sole traders or partnerships would greatly increase; and we would rather have a limited company subject to efficient annual audit. As a businessman I would rather do business with such an organisation than with partnerships which are not subject to this annual discriminating review.

4290. *Chairman*: What would you say to the unlimited company? That is a possibility, is it not? It would be a possible solution or compromise on this particular question if you said the privileges and exemptions should be afforded only to the unlimited company?—Who would then become an unlimited company? Is it not a point

tending to be theoretical rather than practical? If there were such a state of affairs, why should a small trader become an unlimited company?

4291. It is an alternative to a partnership, a half-way house. You would have the advantages of incorporation, your concern goes on for ever. On the other hand you would be liable without limit for the obligations of that corporate entity.—I should have thought that would appeal to comparatively few sole traders and not to many partnerships.

4292. *Professor Gower*: Do you think the average small company incorporates mainly to get rid of unlimited liability? Surely in a sense it is a sham to pretend that a small exempt private company does trade with limited liability? If it is to get any substantial credit facilities the directors will probably have to give personal guarantees to the bank and so on, and what really happens with these small concerns is that they trade with limited liability to the general body of creditors but with unlimited liability to the banks and so on? Therefore they have not really got limited liability. Is that not a fair statement?—I have not any experience of that. I thought limited liability was an important factor in such experience as I have.

4293. *Mr. Watson*: It is a very normal thing in the banking world when a small private company seeks accommodation for the guarantees of the principals to be called for in support of the accommodation given to them.—I think, Sir, that would tend to support my view that those who lend money to a small company not only see the balance sheet but can take it further if they want; and I take it there is no disadvantage Mr. Watson's bank could suffer through this company's balance sheet not being filed?

4294. *Professor Gower*: No, not the bank, but the other trade creditors may suffer. These small private companies do in fact fail on a pretty large scale and when they fail the banks step in and recover because of their personal guarantees or their charges and the poor trade creditors whistle for their money. All they have to resort to is whatever remains and it is often precious little.—Perhaps, Professor

Gower. It is not my position to ask questions. I am here to try to answer them. But do you feel that, with limited liability withdrawn, failures would be fewer?

4295. I think if people who gave credit to limited liability companies were able to find out a little more about them they might suffer less.—*Mr. Hodge*: I think the difference between the guarantee to a bank and unlimited liability is very great. This specific guarantee of a fixed amount is a very different thing from saying that the company has unlimited liability.

4296. *Mr. Watson*: One would agree but the point has been made that the bank gets this additional security and the general creditors are not in that position.—I think all we can say is that we are putting forward the viewpoint of the Scottish Council, Sir. We realise that there is an argument on the creditors' side but we do feel the argument of the companies outweighs the other.

4297. *Chairman*: I do not think we can really carry that much further. There is just one other point on exempt private companies and that is the permission accorded to them to make loans to directors whereas the general run of companies is prohibited from doing that.—*Sir Robert Maclean*: We did not consider it on the Committee.

4298. Then perhaps we can pass from it. Then the next point arises under heading 5 (a), exercise of powers of companies by directors and degree of control retained by shareholders. You deal with one of the instances where that question arises, and that is the case of a fundamental change in the activities of the company and you say: "after a thorough review of the matter, however, it has been decided not to recommend any change in this field." That is to say, your view is that the law should not be altered so as to make it obligatory to get the prior consent of the shareholders before the directors can go in for a fundamental change of activity?—Our basic approach to this is that we do not live in a static society and the object of legislation should presumably be to give the greatest freedom to the management of companies compatible with reasonable attention being paid to

the interests of the public, the employees and the shareholders. We feel the law as it stands at present to be reasonably balanced. It should not in our opinion be necessary for directors to hold up decisions in a rapidly changing economy, and the Scottish economy has been going through quite a number of changes recently. We do not feel the directors should hold up the decision whether to develop this business interest or that—prior disclosure can be commercially unwise—but we do think it desirable for directors to report major changes to shareholders at the annual general meeting next following.

4299. You could conveniently do that by means of the director's annual report?—Yes.

4300. So that you would tell the shareholders at the first practical opportunity of what had been done, but you would not think it feasible to consult them in advance?—I think that should be left to the discretion of the directors because premature disclosure can be commercially inadvisable. Provided shareholders are kept informed and know that when directors need them they have such powers, I see nothing wrong with it. And if in general meeting it is the wish of the shareholders that the directors should not have such powers, I suppose a resolution could be made limiting them.

4301. Would there be any merit in amendment of the law so that the directors should, whenever practicable, consult the shareholders in advance, but when they did not consult the shareholders in advance they should include in their annual report or in some other document a statement of the reasons why they had found it impracticable to consult them: so that the directors would have to apply their minds to the question in each case—"now is this a matter we ought to ask the shareholders about first?"—It has certainly been the practice in my own company to consult shareholders in any major matter, and we deemed it practicable to do so in each case because we either held options or undertakings, or something of that kind. But it is not difficult to envisage circumstances where that would be undesirable and so long as

directors are left with the power to decide whether it is practicable or not to disclose at a prior stage I think the situation is preserved; and your comment that directors should explain in broad terms at the first convenient occasion thereafter seems appropriate.

4302. Of course this is a topic which has had some public attention called to it and one can take perhaps a rather extreme example to illustrate the question. I, having some money to invest, put it into a company which is a very successful and solvent chain of boot shops up and down Britain, a perfectly safe investment paying a regular dividend. Then I suddenly discover, never having been consulted, that the boot shop business has been disposed of and the proceeds invested in a very problematical diamond mine somewhere in Africa. Would I not as a shareholder have good reason for feeling aggrieved? I invested in a boot shop and it has turned into a diamond mine.—If the memorandum and articles of association gave the directors power to invest in a diamond mine I should have thought that went some way to meet your point, and we of course have asked that the law be left as it is in that particular regard. But when approaching this question we realise one can very frequently illustrate points where the principle shows up badly and one has to come to some decision on balance, and we felt that on balance directors are not given to wasting their shareholders' money. So far as my experience goes they tend to conserve it and look after it and they should not be unduly hampered in their freedom to do so. If it is commercially disadvantageous in their opinion to indicate that certain discussions are taking place or a certain offer has been made, we feel they should not be forced to disclose the fact and suffer that disadvantage.

4303. That of course is a point of view. You may well say it is unreasonable to restrain directors from doing something that the great majority of them would never think of doing, in order to catch the less scrupulous members of the body of directors in the country, and you attach importance to that?—I do attach importance to that and that was in the minds of the committee before reaching

its view; and speaking as we must from the Scottish picture we have not seen flagrant abuses of that. We thought on balance that the present system seemed to work, but perhaps I might turn in this connection to Mr. Hodge who may know more precisely.

Mr. Hodge: We also felt, Sir, it would be extremely difficult to define what a fundamental change was. And we are back again to the principle that there should not be restriction unnecessarily. We thought in this case it was not practicable to insist that the directors should always consult the shareholders.

4304. I think that really is as far as we can go on that point. The next one is under heading 5 (c) concerning the issue of shares. You say in your memorandum that "unissued shares should not be used for a purpose not visualised at the time of their creation except with the prior consent or subject to the subsequent approval of the shareholders". The purpose not visualised at the time, I take it, means a purpose not resolved upon?—Yes.

4305. So the situation you are dealing with is that the company has an amount of unissued capital which is not earmarked so to speak for any particular purpose or which the directors decide some time after its creation to apply in a different way from what was originally contemplated? Then—I am not sure if I have put your point right—you say the shareholders should be consulted.—Yes, but our point was nothing would prevent the company in general meeting from giving the directors *carte blanche* to make future issues for any purpose providing they had actually done it by resolution.

4306. Then it has been suggested to us that in that kind of case where there are some unissued shares and the directors resolve to issue them for cash, they ought to offer them in the first instance *pro rata* to the equity shareholders unless the shareholders otherwise direct by special resolution.—You would have to have a special resolution authorising the issue for cash?

4307. It depends how the article or provision was framed. What I think was contemplated by the people who made

this suggestion was that the directors could go ahead and offer the shares *pro rata* to the existing equity shareholders. If they did that they needed no reference to a general meeting, but if they proposed to issue them in some other way or to outsiders, we will say, then that had to be done only with the prior consent of the company in general meeting.—*Sir Robert Maclean*: Although the company in general meeting might not limit them to a specific purpose, it may give the directors powers to make such a decision.

4308. One would have to recognise it might be done in that way.—*Mr. Hodge*: That was our point. We thought the company in general meeting should be required to authorise the directors to issue shares, but have power to give the directors *carte blanche* if necessary. That would cover the case of an issue for cash, not offered *pro rata* to existing shareholders.

4309. Yes, I think that would probably be so where the company had given general authority to the directors to the effect that the shares should be at the disposal of the directors who might do as they thought fit. That would cover the directors making any allotment within that really unrestricted range.—We feel the company should have that power.

4310. That would cover the matter unless and until the resolution was revoked?—Yes.

4311. But the directors would not have to go backwards and forwards to the shareholders every time they were going to issue some more capital?—*Sir Robert Maclean*: That is so.

4312. And I take it you would limit the obligation to seek prior consent to issues of shares of some substance, not to the odd hundred required to qualify a director or something of that kind? Then, in the case of issues of shares for consideration other than cash, clearly there can be no question of *pro rata* issue to the shareholders but in such a case would you require their consent, if it was a substantial issue?—If the directors' qualification point arose—we did not consider that point in detail—my personal opinion is that ought to be covered by the company

in general meeting giving their directors power to issue shares which would cover that eventuality, even although the full right was not exercised for many years. But in principle we feel that all issues other than those to existing shareholders ought to be approved by the company in general meeting. But realising that it may not always be commercially wise to bring back a specific project for examination or consideration by the general meeting when it arises, we felt it should be within the power of the company to give its directors authority at a general meeting in advance to such extent as it deemed proper.

4313. The shares were not to be issued without the prior consent of the shareholders given either generally, or specifically in relation to the transaction; that is how it would work out?—Yes.

Mr. Hodge: And the position could conceivably remain as at present, even if our recommendation were carried out, if the company in general meeting gave *carte blanche* to the directors.

4314. *Mr. Watson*: Am I correct in understanding that would cover action by the directors in issuing shares for cash to other than their shareholders?—Yes, provided it had been authorised by the company in general meeting.

4315. *Mr. Scott*: That means provided it had been authorised at the time the shares were created, there would be no need to come back for special authority to the shareholders?—*Sir Robert Maclean*: If the shares are unissued, whether the directors exercise the authority at that time or later would not appear to matter as long as it did not conflict with the decision of the general meeting.

4316. You would see no objection to shareholders passing the resolution increasing the capital and saying the shares so created were at the free disposal of the directors to allot and issue as they saw fit?—It being understood of course that the general meeting has power to cancel that authority.

4317. *Mr. Bingen*: There is no real alteration in the present position then?—*Mr. Hodge*: No, except there could be a formal resolution if you wanted. You

could state the type of resolution required to be passed to give this authority. You could detail it if necessary.

4318. *Mr. Scott*: Where—in the constitution? May I get this clear? When a company starts life now it normally provides that the shares are at the free disposal of the directors. This is the initial capital. That is the standard position. Supposing there is some unissued capital left after the company has made its first issue, are the directors to be free to go on and issue the balance, or should they go for a further resolution giving authority to issue the balance?—That is an issue after the initial issue?

4319. After the initial issue, but part of the original capital.—I do not think we would object to the directors having to go for a further resolution from the company for authority to issue those shares in a given set of circumstances or at their discretion.

4320. *Mr. Bingen*: Would not the difficulty be in deciding when that position had been reached? The company would be formed with two or seven subscribers and the shares of those members would have been taken up; would the requirement then apply to any subsequent issue?—*Sir Robert Maclean*: There is a difficulty here, Sir, defining the means by which that objective should be secured. The objective is that the company should in general meeting be able to give the directors *carte blanche*, and I am afraid we have a little difficulty in recommending how that objective is best secured, but that is our objective.

4321. Do I assume the general view of Sir Robert and his colleagues is that by and large all issues other than a minor proportion of the capital should be offered as issues *pro rata* to existing shareholders?—No, we do not say that.

4322. You say, provided you have the standard form or article as we all know it today, all shares may be issued to such persons on such terms and conditions as the directors see fit? An issue not for cash but by way of acquisition of assets in exchange, would then be clearly within the competence of the directors. So you are recommending a continuance of the

present law, or practically so?—Yes, that is so.

4323. *Chairman*: That is how you would put it?—Yes.

4324. Then I think we can perhaps pass from that and the next one I would refer to is heading 6, Duties of directors, and there you deal with the awareness of the directors of their duties and you say: "It is considered that there is a case for instituting a way of codifying and bringing to the attention of directors their principal responsibilities and duties under the Companies Act. There might, for example, be a table annexed to the Act in which these duties were summarised." Do you think it would really be possible by legislation to define exhaustively a director's duties?—*Mr. Hodge*: No, Sir. What we had in mind was the smaller private company. Could there be something either appended to the Act or issued by the Board of Trade outlining the principal points rather on the same lines as the Board of Trade issues a pamphlet with regard to floatation of companies—it was the smaller private company we had in mind here, Sir.

4325. A sort of child's guide to company law? It is an attractive suggestion.—We realise the difficulty that may arise in a small private company, with people who are not aware of the fundamental bases under which companies trade.

4326. Might not that kind of thing be left to private enterprise?—Yes.

4327. *Mr. Bingen*: When you look at the Companies Act, you do not find anywhere clearly defined what are the duties and responsibilities of directors. If you take trustees, you have got the Trustees Act. I must say I have some feeling for the view that there should be a code of practice written into the Act.

4328. *Chairman*: I agree, and if it were practicable it would be an excellent thing.—All we wanted to do was to put forward the suggestion.

4329. *Mr. Bingen*: I do not know whether a director is a manager, a trustee, or a quasi-trustee. You get into an area of philosophy. You have got to look after

your employees, your customers, the public and all sorts of things. You do not find that anywhere drawn to your attention.

4330. *Professor Gower*: I think it is possible to do it in fairly general terms, and indeed attempts have been made. The new Australian Uniform Bill does go someway in this direction. It does not go very far, but it does make a start. It points out that directors must not make a personal profit without the consent of shareholders, and so on, and surely this kind of thing can be done. It might be argued that that is precisely the kind of thing that the average director does not realise in the case of a small private company.—*Mr. Neil*: When we were discussing this, someone introduced this by making almost word for word the same remarks as Mr. Bingen has just made, and it was because of a desire to deal with that that the suggestion was made. But on your point as to why should not some enterprising chap do this anyway, the point is that if it were a table to the Act there would be a greater likelihood that it would come to the attention of those people who were concerned. They do not have to go and buy a book, but they have all got to have articles of association and, perhaps, the solicitors might also say "By the way, don't forget to read the bit at the back."

4331. *Chairman*: This would be part of the Act, would it?—It might be a table annexed to the Act.

4332. It would need some very careful codification, and would be a very difficult task.—I agree, but, as Professor Gower said, I think something could be done.

4333. And if anyone was trying to bring a dishonest director to book he could refer not only to what was in the table but to what was not in the table. "It never said that I was not to do this." That is one of the difficulties, is it not? But it is still a suggestion that is well worth looking at. Then there is the question of shares with restricted or no voting rights, which is heading 7. Your view there expressed is that no restriction should be permitted on voting rights of ordinary shares so-called. Any

shares with restrictions as to voting rights should be designated non-voting shares. Am I right in thinking that what you mean by that is that it should not be allowable to have ordinary shares which are called ordinary shares but have no votes and, on the other hand, any shares with restrictions as to voting rights should be designated non-voting shares? That means that if you get a share on the market clearly described as a non-voting share, then you have no particular objection to it?—*Mr. Hodge*: But you could have a non-voting share whose rights were similar to the present ordinary share as to dividends and rights on winding up.

4334. Yes, but as to voting they carry no votes and the share certificate, or whatever it was, would contain a clear indication that they were not voting shares. Subject to that stipulation you see no particular reason for objecting to them?—*Sir Robert Maclean*: No. Our basic position is that we have no objection to the creation or issue of non-voting shares, provided they are clearly designated as such. In this matter, of course, I think I should declare a personal interest as I am Chairman of a company which has non-voting shares in issue, and I believe it is in the interests of all concerned to meet our requirements in this way.

4335. The next is heading 8, on protection of minorities, and you think on the whole that the protection afforded to minorities is adequate. You say that it is felt that the legal formalities necessary to enforce these rights, however, often prove cumbersome, vexatious and tardy in practice, and there is a case for introducing some simplified procedure whereby minorities might enforce rights more promptly. A system of compulsory arbitration, for example, might be considered, or an extension of the procedure available under sections 164 and 165 of the 1948 Act. Speaking for myself, and I think for some of my colleagues, I strongly deprecate the assumption that arbitration would be quicker or more expeditious, or cheaper or better in its result than recourse to the ordinary Courts. Still, there are some people who never can be converted to that point of view. The next one is heading 9, on the

protection of special classes of shares. Your recommendation there is that article 4 of Table A—that is the modification of rights clause—should be made binding on all companies by being included as a section of the Act. That is to say, where you have articles which create preference and ordinary shares, and the articles do include provisions protecting minorities by saying that their rights are not to be interfered with without the consent of a separate meeting, then you want to resolve the doubt as to the position of the shareholders by reading into the articles the usual provision for separate meetings. That is your suggestion there?—*Mr. Hodge*: That is right.

4336. There is only one point that I want to raise on that, and that concerns those cases in which special rights are attached to different classes of shares in the memorandum. Would it be your view that, as well as introducing the usual modifications of rights clauses into the articles of association of a company, you should also provide that the rights attached to shares by the memorandum might be modified in a similar way? I do not know if you have considered it, but the present position, as I understand it, is that where rights are attached to a special class of shares by the memorandum, then they can only be got rid of by a scheme of arrangement which does, of course, involve an application to the Court.—We did not give consideration to that, but the point we were considering was where the power to alter was in the articles only. I do not think we intended this to take the place of section 23 (2).

4337. I raised it because it is a point which a good many of our witnesses have referred to, and some say it gives a superfluity of protection and is merely an inconvenience which ought to be done away with; others say it does give additional protection and there is no ground for disturbing it. You would rather take the latter view?—We have not really considered it.

4338. We can pass from that. The next one under heading 11 is disclosure of ownership and control. Your suggestion is that, where the total of holdings through

a nominee or nominees on behalf of an individual or group reaches 10 per cent. of the capital of a company, the beneficial owner should be required to declare his interest to the company. A suggestion on similar lines has been made to us by various witnesses, and there have been a good many alternative suggestions too. Would you not agree that the practical difficulties of requiring such disclosure are rather formidable?—We would agree completely, Sir. Perhaps I should, however, say that since this evidence was submitted we have received some views in favour of non-disclosure.

Sir Robert Maclean: I have certain reservations of a minor character. It is my own experience, as a man of business, manufacturing and selling products through wholesale or retail channels, that occasionally, possibly by reason of death, someone comes to you and says "Can you help us here. We have death duties to meet". There are several members of a family involved, and on a temporary basis we lend the company money. We have taken a temporary interest in that concern, it might be wholesale or it might be retail, but we certainly would not do so if it were disclosed that we were doing it, as we only do it to oblige the people concerned and in our own interests, of course, to preserve an outlet. But it is not a normal part of our activities and we would only do it to assist a friend in need, and we withdraw from it as soon as we can. From time to time—and I speak from the point of view of a large manufacturer—we temporarily assist someone to start up in the distributive side by means of taking an interest in the equity for a period and then withdrawing. If all that sort of thing had to be disclosed compulsorily, we would have to stop doing it and many people would not get their start in life. If you did it for one, the other chap who is not so efficient, is liable to say "Why didn't you do it for me?" and that kind of thing would have to come to an end. I do not say it is an important consideration in the national picture, but there are many small people up and down the country who have quietly benefited from this kind of thing.

4339. That is an example of the legitimate use of the nominee system, so to

speaks.—Commercially, of course, it is undesirable for people in our position.

4340. Then you suggest that, where the holding through a nominee or nominees on behalf of an individual or group reaches 10 per cent. or more of the capital of the company, the beneficial owner must declare his interest. The sanction you provide for that is total forfeiture of voting rights. Would not that be rather extreme, because the owner of the beneficial interest might have no ulterior motive at all, but he would have just infringed this provision. Do you not think it would be rather a severe penalty to deprive him of voting rights altogether?—*Mr. Hodge*: Here we found difficulty in trying to suggest any suitable penalty. I would agree with what you have said.

4341. This kind of penalty could be used by a rival faction in the company to its own advantage.—Yes.

4342. *Mr. Bingen*: Are you suggesting permanent or temporary forfeiture of voting rights, and can they purge their offence by disclosure?—Temporary forfeiture was suggested. But we appreciate the difficulties involved.

4343. *Mr. Brown*: How do you disqualify those whom you do not know?—Yes, I appreciate that.

Mr. Neil: I think it was envisaged in practice that if, for example, a group, which had in breach of the Act in these terms remained anonymous, came along and tried to move a resolution to sell the company's property for example they would then not be able to use their votes on that resolution; in other words, this was designed to make it more difficult for some group to acquire control without the directors becoming aware of what was happening. I agree it is difficult to know where that would stop, but that was the general idea.

4344. By coming along they would have disclosed their ownership.—Not in the terms of the Act.

4345. *Chairman*: This suggestion has also been made on this topic, that this question of nominee holdings should be left for enforcement by the Board of Trade under section 172 and section 173 of the

Act, on the footing that these sections should be suitably modified to meet cases of this sort, and that the Board of Trade could be put in motion by the directors of a company, instead of requiring a resolution of the company itself. Do you think there is any future in that?—*Mr. Hodge*: Yes.

4346. Of course, the criticism always is that by the time the Board of Trade has moved itself the mischief, or whatever it was, has already been done. But do you think that a middle road might be reached in that kind of way?—*Mr. Neil*: The suggestion of using these sections is to enforce a disclosure, or deal with a non-disclosure in these terms, is it?

4347. If the directors had reason to believe that somebody was accumulating shares on behalf of someone else, who was the beneficial owner, then the directors would apply to the Board of Trade for a suitable investigation into the matter.—It was never considered, Sir, but it seems a reasonable alternative.

4348. Admittedly, it might put the board of directors in a somewhat invidious position.—I can imagine that, too.

4349. That has been suggested as an alternative, and a number of other suggestions have been made, but I think they are nearly all affected by the same kind of difficulty. You have not heard of any other suggestions, I take it, by way of alternative to your suggestion?—I do not remember any alternative being seriously discussed. In fact, it has caused a good deal of thought as to how it could be enforced.

4350. *Professor Gower*: But you still stick to your recommendation that 10 per cent. holders should disclose, if a practical means could be found?—That was the general view.

Mr. Hodge: But we have, as I said, had a contrary view expressed to us.

4351. *Professor Gower*: That was why I asked. I was not quite clear whether you still stuck to your guns or not.

4352. *Chairman*: The next is heading 14, on the practice of carrying on business through an associated or subsidiary company, and you say that the possibility of

requiring companies to disclose names of associated and subsidiary companies in the annual report should be examined. So far as one can do it at meetings such as this, it has to some extent been examined and there seems to be a fairly strong body of opinion in favour of the view that some degree of disclosure would be desirable. But as one might expect, there is, I think, a considerable conflict as to the extent of the disclosure which could reasonably be asked of the company, and which could reasonably be given by the company without prejudice to its own interests. Have you yet been able to examine the question so as to give us any views upon it?—We thought that there might be disclosure but that there should be powers of exemption by the Board of Trade, or otherwise, in cases where it was not in the company's interest to make a disclosure.

4353. Or possibly where the particular subsidiary company was so insignificant a part of the whole undertaking that disclosure of that might be dispensed with?—Yes.

4354. *Mr. Scott:* Is the suggestion that it should not be in the directors' power to decide whether the name of a subsidiary company should be omitted, and they would have to get the permission of the Board of Trade?—Yes.

4355. Would the Board of Trade be better able to judge than the directors, themselves, as to whether it would be reasonable to grant exemption?—The directors could put forward to the Board of Trade their reasons.

4356. There would be nobody to argue the contrary before the Board of Trade, would there?—No, I appreciate that point.

4357. If we are considering commercial reasons surely the directors, with the greatest respect to the Board of Trade, are better able to form an opinion on a matter like that than the Board of Trade are.—I agree with that. There might, however, be reasons in addition to commercial reasons.

4358. If there were, of course, that would possibly help, but is it not rather unfair that the directors should be able,

as it were, to hide behind a decision of the Board of Trade, which could only be reached, really, on the basis of information supplied to the Board of Trade by the directors?—I think that is right.

4359. Would it be equally effective to leave the decision to the directors? If you admit commercial reasons as justifying the omission of the name of a subsidiary company from the accounts, would not the directors be the people to decide it?—Yes, I would agree with that.

4360. *Chairman:* That happens at present under section 157 (2) on the directors' report, where the directors are given power to exclude information where they think it would be harmful. The next point is heading 16 on take-over bids, and what I would like to ask is whether you are, broadly speaking, satisfied with the Board of Trade's new regulations.—Yes, we are.

4361. I think I can pass to heading 24, which concerns companies' names, and the particular matter with which you are concerned is the use of the words "bank", "bankers", "banking" and so forth by quite unsuitable companies. I think your observations command general acceptance; that is to say, some restriction ought to be put on the use of those names. Then, I think you also suggest that the Registrars of Companies and of Business Names should produce a short code describing the principles on which the use of certain words is permitted, such as National, Scottish, and Highland. Might it not really be difficult to settle in advance an exhaustive code, and might it not be better to leave the Board of Trade to deal with individual problems as they arise? In fact, I think the Board of Trade have sent out at least one note stating the way in which they will, as a matter of practice, exercise their discretion. You see, it is easier for them to list names that they have actually had, and say "These are objectionable", than to say "Furthermore, these other names are objectionable, too."—*Mr. Neil:* We have had cases reported to us where the person concerned was unable to ascertain from the Board of Trade in which circumstances they might use these names; that is to say, in a specific case they have asked, as a result

of a refusal, under what circumstances could these names be used, and apparently they have been unable to get an answer. I think that is what gives rise to this.

4362. They proposed certain names?—They proposed a name incorporating, say, Highland and it was turned down, and they then asked under which circumstances they could use that name. They said "What do we have to do to alter our memorandum, so that we can use that name?" and they were unable to get a satisfactory answer. I think that is how this arose.

4363. A word like Highland would be a word having a geographical significance, or something of that sort?—That is it, Sir.

4364. Would they refuse if the business was carried on in Penzance, or somewhere like that?—I understand so, but we have had cases reported to us where the people did not know under which circumstances they could have got it.

4365. In other words, the Board of Trade would not answer a hypothetical question?—Yes.

4366. That is very sound.—But in practice it caused difficulty.

4367. I see no objection whatever to having a code, if it were possible to compile a code containing in advance anything like all the objectionable words that people might want to use. I do not think we can do much about that. I think it is a thing that has to work itself out, and I am certainly under the impression that the Board of Trade have fairly extensive lists of names which they will not take. They cannot be expected to list names which they will take.—It is not just a question of names which they will not take—it is the circumstances. You mentioned those words like Scottish and Highland, which are presumably restricted because they have a geographical connotation. But it is difficult to discern any principle in the decisions which have been made. In relation to Highland, one might have thought that you could use that if your registered office was north and west of a line drawn, say, from Helensburgh to Peterhead, but that does

not seem to be the criterion. If one could have some insight into the working of the Registrar's mind in those circumstances, it would help. I think that was the basic point.

4368. The difficulties were recognised in the 1948 Act, because prior to that the section about names did set out a list of particular names which were objectionable, and the Cohen Committee said that would not work satisfactorily in practice, so in the 1948 Act the discretion was I think made absolute. Any name could be refused which was considered objectionable by the Board of Trade, so obviously the difficulties of listing names are fairly great.—I am sure they are formidable, Sir, yes.

4369. The next point concerns section 201, which requires the particulars of directors' names, and so on, to be put on their circulars, letters, etc. What you say about section 201 is this: "The provisions of section 201 of the Companies Act, regarding publication of names of directors, should be more strictly observed and should apply to companies incorporated prior to 1916." I call your attention to that because we have had a number of witnesses who have said that it is quite obvious that it was a 1914 war-time measure which has outlived its usefulness, and it ought to be repealed. Have you any observations on that?—*Mr. Hodge:* We have had the view expressed that there should be disclosure of directors' names on correspondence, and circulars, but not on trade catalogues.

4370. Other people have taken that view. They have not said that the section should be repealed, but they have limited the documents on which names should appear to more reasonable dimensions.—We would agree to that suggestion, not on trade catalogues, but it should still be continued on correspondence.

Sir Robert Maclean: There is a feeling in some quarters, that after a period of quietness there has been a more marked development of foreign-owned business enterprise in this country, which we welcome as individuals, but we would like to know where we stand and I think this might help a little towards that. We do not regard it as a point of fundamental importance.

4371. You think it may be useful?—It may be useful in helping us to know a little where we stand. We would anticipate a continuance of development of foreign-owned enterprise in this country.

4372. *Mr. Bingen*: My recollection is that this Act was passed during the first war to prevent Germans, naturalised or otherwise, calling themselves the All-British Trading Company and things of that kind. Now Sir Robert is saying that he does not object to the continuance of the directors' names on the note-paper, but he sees no point in their being on trade catalogues. But he drew attention to the fact that there is now foreign capital here. That, surely, is directed to the question whether you should disclose ownership rather than the people you are putting in as managers or directors. You may have an American or a Swedish company, and all the directors may be British, and if the names of the directors are on the note-paper it does not help one way or the other. What you want to know is who owns the company today, as opposed to the directors who may well be British, or one may be American and one Swedish.—I do not say it would solve any sort of problem. I merely thought it might be a pointer to know whether the directors are British or foreign. I think to know the names of the directors is a helpful thing with literature of this kind, particularly because we can expect a small influx of foreign firms here. I do not think it gets to the root of the problem, but I see no objection to the disclosure of the names of the directors at all.

4373. *Chairman*: I should have thought this section might be of use in dealing with small traders who before were carrying on in partnership and converted themselves into a company. It might help in that kind of case. It might be pertinent, from the point of view of somebody dealing with them, to appreciate that the company was the same as the old partnership, and he could identify in that way the person or persons with whom he was dealing.—We also concur in that view.

4374. *Mr. Althaus*: With regard to Mr. Bingen's point, might that not lead to reciprocal action in other countries,

which is one of the things we are trying to avoid?

4375. *Mr. Bingen*: I was not suggesting you should do anything. I was arguing against the necessity for the original wartime restriction, especially in view of Sir Robert's point that he was really interested in foreign-owned concerns.

4376. *Chairman*: Anyhow, your view is that that section is better left with the modification Mr. Hodge has mentioned, rather than repealed?—We think the balance of advantage lies there, but we have no deep feelings about it.

4377. I think the only other point I have got comes under heading 26, dealing with management and administration. You say that provision should be made so that where proxy votes are sought a circular giving full and adequate information and a two-way proxy should be sent to shareholders. First of all, is it not now the practice, if proxy forms are sent out, to accompany them with some kind of statement saying what the voting is going to be about?—*Mr. Hodge*: I thought it only applied to companies which had a Stock Exchange quotation, that they had to send out a proxy allowing votes either for or against.

4378. What I was looking at was the proposed statutory requirement that there should be a circular giving full and adequate information. I was trying to make the point that in practice the directors have to send out an explanatory statement when they send out notices of meetings and proxy forms.—I agree. The point here was that in addition, the Stock Exchange requirement, which I understand is that a proxy should permit either voting for or against, should be introduced as standard in unquoted companies as well.

4379. But I think it would be difficult to give statutory effect to the provision about the circular. Admittedly, there would have to be a circular, but one could not legislate in advance in every particular case, and say that the circular must contain this, that and the other. We do not want to commit directors to sending out, under pains and penalties, some document with the complication

of a prospectus, and I was only suggesting the view that perhaps the contents of such a circular would have to be left with the directors to deal with according to circumstances.—Yes, I agree, Sir.

4380. *Professor Gower*: The Americans do prescribe what has to be included in the proxy statement on each occasion. I understood that you were suggesting that, instead of leaving it to the directors just to make a statement which they think is most likely to induce the shareholders to vote as they want, the law should provide that certain specific information, such as the shareholding of the directors and their associates, as the Americans do, should be given in all cases. Is that not so?—We do want full and adequate information, but we did not go to the length of specifying exactly what must be included.

Chairman: Can anyone tell us whether notices of meetings in the United States are sent by parcel or letter post?

4381. *Professor Gower*: Would you argue that at the moment circulars give full enough information, in the sense that you are using the expression?—It is a difficult question to answer.

4382. *Mr. Watson*: I would like to ask Sir Robert a question if I may. It refers back to non-voting shares. In your comments on that you refer to the fact that, in your own company, you have non-voting shares, and this is a matter on which the Committee has been getting widely divergent views. Some, like yourself, approve of them, and others will not have them at any price; they want them abolished and the existing ones enfranchised. Would you feel able to develop your statement and give the Committee some reasons for your view that they are desirable?—*Sir Robert Maclean*: I will try to do that. In my mind, the right to issue non-voting shares is of the greatest importance in helping to keep alive family businesses of fair to large size. There are two aspects of this; one is the death duty aspect, and the other is the expansion aspect. It is the case that the burden of death duties, which can amount to as much as 80 per cent. of the balance sheet value of a

proprietor's or part-proprietor's shares, can destroy family control. This situation is met by non-voting shares which can be sold to others for cash, which in turn is used to pay death duties. I know of no other method by which this can be achieved. To my mind this question resolves itself into whether or not a family business is a desirable feature of our economy, and I believe that it is. Personal contact, especially in the case of older craft industries, like woollen textiles, knitwear, carpets and so on, is of great value both in securing orders from long-term customers at home and overseas—and, of course, the more orders you get the better; it is of advantage to employees, shareholders and the State alike. It is a noticeable thing that in the industries I have referred to in this way, it is my experience that these family businesses tend to be the more efficient. Of course, the death duties' situation can to some extent be met by handing over blocks of shares to children, but is it really desirable that children not yet out of their teens, or still in their early 20s, should find themselves possessed of large blocks of shares before they really understand the obligations that go with such ownership. In addition to these factors, and of at least equal importance, is the expansion of such businesses. Unless fresh capital can be secured, either by restricting dividends or by the issue of non-voting shares for cash, developments in the national interest are likely to be frustrated. May I close by reminding the Committee that anyone buying non-voting shares—if they are clearly designated as non-voting—does so with his eyes open.

4383. The actual mechanics of the selling of non-voting shares, I presume, is through the capitalisation of reserves to existing shareholders in the firm, and the sale of shares to outside parties?—Those are the circumstances I envisage, yes. In addition, although that covers the death duty angle it does not, of course, cover the equally important point of development of the business, where it may simply be the issue of non-voting shares—as some of our most successful British companies have done—direct to the public for cash.

4384. Would you go so far as to say that, in your own experience with your own company, you possibly could not have reached the stage of development you have reached, had you not resorted to the use of non-voting shares?—I would say that most definitely. We could not and would not have reached our size and become one of the leading manufacturers in the carpet industry employing upwards of 3,000 people, unless we had been able to make use of this method of capitalisation.

4385. You have no contact at all, presumably, with your non-voting shareholders, other than to send them their dividends and reports?—We are bound to do certain things such as that, but of course we do send them other literature such as magazines and that kind of thing. But I am always glad to see them if they come to see us or write to us. We treat them exactly as we treat the ordinary shareholders, except in the one matter of voting.

4386. You do not invite them to attend the annual general meeting?—I am sorry, I cannot say whether we do or not, but I see no objection to having them there.

4387. You would not turn them away if they turned up?—I certainly would not. I would be very glad to see them.

4388. *Mr. Scott:* May I refer once more to the question of *ultra vires*. I was perhaps a little surprised that your recommendation was that there should be no change, but you say that you think the objects and activities of a company should somewhere be disclosed. Of course, that happens at present. But in the memorandum of association of a modern company there are probably 30 clauses, most of which are powers to do all sorts of things which the draftsman has thought of. Sometimes, just by accident, he has failed to mention—and it is usually a question of a slip-up in the drafting—something which is afterwards held to be *ultra vires*, and third parties can be thereby injured, because according to the law they had notice of the fact that this transaction was unauthorised. Is not that an unreal attitude nowadays? Nobody looks at the memorandum of association of a

company to see what its powers are, do they?—I have never done so. One might be entitled to deduce from that that everyone has never done so, but I do not know that one can go from the particular to the general in that way.

4389. Would you not say that that doctrine had rather outlived its day?—We feel that no unreasonable restriction should be placed on businesses which are conducted in an efficient manner. That is the basis of our whole approach, and you realise that we are not a professional or technical body. We do want to have articles as wide as possible, and we thought, basically, that that position existed with the present memorandum.

Mr. Hodge: Your point, as I understand it, is that third parties could be prejudiced?

4390. And that a great deal of unnecessary work in drafting long and elaborate objects clauses, which companies take to themselves in the way of powers, should be unnecessary.—One point was put forward in this connection that if there were no objects required for the company, that would mean there was no shareholder control of what the company might do.

4391. I think you could always impose restrictions on the directors, so far as the shareholders' authority was concerned.—The thought I have just mentioned was at the back of people's minds.

4392. But you would agree that, if a suitable means could be found for isolating a third party from any interest or concern with that, even if he happened to be a shareholder himself, he could still deal with the company as a third party and not be affected by notice of limitation of the company's powers?—Yes, provided the point was met which I have just made with regard to the shareholders' control over the powers of the directors.

4393. The shareholders would still have power over the directors, but would not have power after a transaction had been started, even if the directors had entered into it wrongfully. If a company was in the furniture business, and it bought another company carrying on the same business, and the other company which became a subsidiary company had wider

powers in its articles—to carry on building operations, for example—do you suggest that the parent company, because it was not allowed to go outside its own objects, should be restricted from doing so through its subsidiary company, and should therefore prevent that subsidiary from acting in accordance with its powers? That frequently happens in practice. The subsidiary may be carrying on the same business as the parent when the parent buys it. Can a company look at the memorandum of the subsidiary which it has acquired, and say "This is good. We can now go into some different enterprises through our subsidiary." Do you see any objection to that?—Personally, I do not. We did not discuss that point. The subsidiary company would purely be using the powers it already had?

4394. Yes.—I see no objection.

4395. That is an indirect way of increasing the powers of the parent company, without reference to the shareholders. But you see no means of trying to restrict that?—No, Sir, I think it would be difficult.

4396. *Professor Gower*: I wonder whether I can refer to this question of non-voting shares. I can quite see that, while there is a power to issue non-voting shares, the most attractive way of expanding a family concern is to issue them, but do you really go so far as to say that, if there were no power to issue non-voting shares, a concern like yours would not have expanded; that you would deliberately have remained small rather than capitalise in some other way? There are, after all, other ways apart from issuing non-voting shares. You can issue preference shares, you can issue loan stock, or you can bring in the Industrial and Commercial Finance Corporation, which normally remains impartial; or you can issue shares to someone and have a voting agreement with him so that you agree on voting for directors. Do you really go so far as to say that, if the power to issue these shares were taken away, family concerns would deliberately fail to expand?—*Sir Robert Maclean*: The simplest way to deal with the problem is by the issue of non-voting shares.

4397. That is the easiest way?—And that, of course, is a virtue. I do not hesitate to say that I would not have gone on developing my business in the way I have, except for non-voting shares, and I think there are many efficient businesses in the same position.

4398. Of course, you would agree, I think, that it does not always follow that the family concern will always remain efficient, and if that situation arises there is no means of changing the management unless they want to go?—We are all bounded by the experience we have, and my experience in the industries I have mentioned is that the family businesses are more efficient.

4399. There was a case not many years ago of a company which clearly had not been very efficient as a family concern. There were lots of non-voting shares and a small number of voting shares held by the family. The family ultimately sold out to a foreign third party and received a very substantial premium on the normal price of the shares for so doing, which was not shared by any of the other shareholders who owned 97 per cent. of the equity. Do you not think that is an objection?—Had those non-voting shareholders ever understood they would share, then I think there would have been an obvious case for feeling wronged. I, myself, am not aware of that case.

4400. Surely, while they remained efficient nobody would want to boot the family directors out even if the public did hold voting shares? It is only if they become inefficient that the public would want to remove them, and if they become inefficient ought they not to be removed?—I do not see how it is going to help the death duty position one little bit, nor do I see how it is going to deal with the problem of growth which occupies my mind. I am not saying your point is not a factor. If the company became as inefficient as that the tendency would be for the family to sell out while they could. The balance of advantage is on those two particular points of expansion of such a business and the method of continuing the family interest in it. After all, there are vast numbers of family businesses.

4401. Yes, it is all right while a family owns the business. What you are saying is that, when the family cease to own the business, the family ought to go on controlling the business without any outside control at all.—How did these shareholders get into their position, if I might ask?

4402. There are a variety of ways in which they could have got into that position. It could have been by an issue of non-voting shares to the public; alternatively the percentage of voting shares held by the family might well have increased proportionately as they went on issuing bonus non-voting shares and sold them and bought the voting ones. There are a variety of ways in which this can happen.—As a private investor I do not think I have ever been much interested in whether the shares I wanted were voting or non-voting, and I would not hesitate to buy a non-voting share. In fact one generally buys them a little cheaper. In the free market, the ordinary man assesses the risk he runs and he does get that degree of higher yield on a risk which he accepts with his eyes open, quite freely under no pressure. He is not forced to buy them. He may be given them or he may be an existing shareholder so that the issue does not affect his voting at all. I cannot see that he has any grumble, any more than a preference shareholder who bought shares at a time when he did not envisage the severe drop in the value of money, and now finds himself in possession of a security or an asset which is only worth a third or a quarter of its pre-war value. I do not see that the rights of the non-voting ordinary shareholder are unfair—if you care to use that word—any more than the rights of the preference holder are unfair. They are both entered into openly, not furtively.

4403. I was not really arguing that it is particularly unfair on the individual shareholder. The argument I was putting forward was that it is not desirable, in the general public interest, rather than that there is any particular unfairness to the individual investors. I quite see your argument that, if the person knows what he is buying, he cannot complain if he gets his fingers burned. The argument I

was putting forward was that the organisation of our companies presupposes that those who manage them are subject to the control of those who own them, and the issue of non-voting shares is the easiest way of avoiding that situation, because it enables people to manage without outside control.—I cannot see the difference between the non-voting ordinary share and the non-voting preference share.

4404. The preference shareholder is only entitled to his money back. He does not share in the fluctuating value of the business, as the equity shareholder does. He really is a lender of money. He just expects to get his money back, and a rate of interest in the meantime. I agree the difference may be a fine one, but surely our company law is based on the assumption that the managers will be subject to the owners. Where the owners and the managers are the same people, that is fair enough. Obviously, there is no outside control. But should you allow a situation to arise in which the managers will have a minute stake in the equity of the business and yet have complete control? Does this make for efficiency?—I do not see any difference between a non-voting ordinary share and a non-cumulative participating preference share, or very little difference, and I find it very difficult to draw a sharp line, as you appear to do, between something which is called ordinary and something which is called preference. The management of a company must fulfil its obligations under the Companies Act, looking after as it should the legitimate needs of its employees and customers, and it is answerable only to those who hold ordinary shares in the company.

4405. Ordinary voting shares?—Ordinary voting shares in that company, unless circumstances as regulated by the articles or its memorandum give preference shares a vote; then in many cases if dividends are passed it eventually gives holders of debentures, which is capital in a form, an interest. All these are legitimate steps on the downhill slope, if you care to see it so; and I see nothing at all wrong with that differentiation between stages nor in ordinary non-voting shares.

4406. *Mr. Brown:* May I ask one further question on the same subject? I

think your Council's approach to the whole matter we are discussing today is that there should be no unreasonable restriction on businesses as long as they are efficiently run. On this basis, for the management of a family retaining control with a reducing interest in the equity, where is the sanction which will remove that control if it is not efficiently run?—There is bankruptcy, taking the extreme case, that brings business activity to an end very sharply.

4407. Would that be preferable to somebody else taking the business over and running it?—That is the position that any business is in whether it has non-voting shares or voting shares. I do not see where non-voting shares or voting shares makes any difference.

4408. It makes all the difference in the world.—It does not. Somebody controls that company.

4409. Where the ordinary shareholders have votes they can say this director is no good and remove him. Where they have no votes they cannot.—The shares with the votes will be able to do that any time they like.

4410. But the position is created where that is impossible because the people who are running the business have the voting shares and will not sell them.—*Mr. Hodge*: I think one might make the point if there were legislation saying there should be no non-voting shares that you would prevent the issue of non-voting shares in cases where they were completely justified.

4411. Can you say if a case is completely justified when there are plenty of examples of very efficient managements being succeeded in some families by less efficient ones?—But if the inability to issue non-voting shares prevents expansion, as Sir Robert has said, or might prevent expansion of a business, would not that be justification?

4412. That is the argument on the other side. It does not alter the argument on this particular side.—*Sir Robert Maclean*: So what?

4413. Do you not agree it is a bad principle? Does it not alter your whole

approach to the subject if an inefficient business cannot be turned into an efficient one by non-voting shareholders? Does it not alter your whole approach that no unreasonable restriction should be put on business if it is efficiently run? There is no means of securing there would be an efficiently run business in the future in the circumstances you are mentioning.—Can you explain the difference?

4414. *Mr. Bingen*: One could surely answer that, if a company which has voting shares and non-voting shares is becoming inefficient, the people who own the voting shares must see the writing on the wall, and if they are interested they will either get out or sell out. The position is not as rigid as is suggested by those who oppose non-voting shares.

4415. *Professor Gower*: They may not realise how inefficient they are.

4416. *Mr. Lawson*: May I make another point in favour of Sir Robert's argument on the side of the really efficient family business? If they issue voting shares what is to prevent them being bought out by a take-over bid from somebody who may be ambitious in a certain direction but whose management may not be as good as the management which is already there? That is the other side of it. Therefore you will get, will you not, the situation that the family just will not issue ordinary shares under those conditions because they would deprive themselves of the family business.

4417. *Mr. Mackinnon*: Surely the real point at which we should be looking is whether there are many cases of vested interest in voting resulting in inefficient businesses going on for ever. I cannot believe there are very many of them because people who own the voting shares in the business will jolly soon do something about it. What we should look at really is the possibility of a limited number of cases where this might produce inefficient companies and assess that against the advantages that Sir Robert and the others have been putting forward. It seems to me there is a balance. We must not assume the

argument all in favour of hopelessly inefficient voting shareholders.—I am indebted to you for your comments.

4418. *Mr. Bingen*: Broadly speaking in this country regulation of companies is under the Board of Trade and those which have a quotation are additionally under the Stock Exchange in the sense that there are a large number of rules and regulations with which they have to comply if they want a quotation. People have said that the Board of Trade are slow, this particular field is one section of the multifarious range of activities they have to oversee, and we are going to have evidence on the question as to whether there is any need for some new body here such as the Securities and Exchange Commission in the United States. I would like to ask whether you and your colleagues have given any thought to the question as to whether administration of company affairs by the Board of Trade and the Stock Exchange is satisfactory or whether you see any need for the creation of any new statutory body?—Sir, we have not discussed this and too much should not

be read into the fact that we have not discussed it. I think it is fair to say had there been a pressing feeling that way it would have been discussed because people are invited to make a comment on matters which seem to press. From personal experience I have not found the present administration irksome but I am not my company's secretary. I do not feel we can contribute very much to that point but our members have not raised it.

4419. So far as you are concerned, you are satisfied, subject to what you say in the memorandum, with the way in which the Board of Trade supervises the operation of company affairs and with the Stock Exchange regulations in regard to quoting securities?—That is so.

4420. *Chairman*: Well, gentlemen, those are all the questions we have to put to you and I would like to say again thank you very much for coming here to help us and for your memorandum. We are very much obliged to you.—Thank you very much.

(The witnesses withdrew)

APPENDIX XXXIV

Memorandum by The Association of Certified and Corporate Accountants

Introduction

1. The Council of the Association of Certified and Corporate Accountants (hereinafter referred to as "the Council") submits this memorandum to the Company Law Committee in response to its invitation dated 15th January, 1960.

2. Although the Council is mainly concerned with the accounting aspects of the law relating to companies, members of the Association are commonly engaged in administration and management and are called upon to advise on matters of constitution and the day-to-day conduct of companies. From this collective experience the Council makes the submissions which herein appear.

3. The Council holds the view that the Companies Act, 1948, has on the whole worked well in practice. The Council has been particularly concerned with those provisions of the Act, which have proved to be ineffective and inadequate to meet current conditions or are unnecessarily burdensome upon companies. The recommendations that follow are, therefore, not necessarily confined to matters of finance and accountancy.

4. The memorandum follows the order of subjects listed in the questionnaire issued by the Company Law Committee.

1. Incorporation of Companies—Memoranda of Association

(a) Requirements as to minimum number of members, and other conditions of incorporation

5. The requirement existing since 1907 that not less than two members are necessary for the formation of a private company has proved to be a legal fiction, since many private companies are in fact owned by one person only. The Council considers that the time has come to recognise the futility of a provision which may easily be evaded by the issue of a single share to a nominee and even when (as in the case of an exempt private company) that second person is allowed to have a beneficial interest in the share, the company is virtually still owned by one person. It is proposed, therefore, that the minimum number of members for a private company should be one instead of two.

6. If this recommendation is adopted, the Council holds the view that private companies should be required to have at least two directors, so as to provide for the continuity of the business and for some safeguard for creditors in the event of the decease or incapacity of the sole member. It is felt that most sole owners of companies will exercise the same considerations in the appointment of a second director as they do in the appointment of an executor or executrix for their personal estate. The same individual may well be appointed in both cases. As a consequential provision, the Council suggests that in the event of the death of a sole member, the holding of the annual general meeting may be postponed until thirty days after the date of grant of probate, letters of administration or other power, subject to a maximum period of nine months.

7. The statutory declaration required on the formation of a company may be given by a solicitor or by a person named in the articles as a director or secretary of the company. The Council feels that this declaration may be and is, on occasions given by persons who have no proper appreciation of its significance, and that the declaration should be made by either a solicitor or an accountant qualified for appointment as auditor of a company by section 161.

RECOMMENDATIONS

(i) That in section 1 (1) the words "any two or more" be amended to "any one or more", that in sections 31, 176, 222 and 224 (1) the references to a private company be deleted, and that in section 131 a proviso be introduced to the effect that in the event of the death or incapacity of a sole member the annual general meeting may be postponed until thirty days after the date of grant of probate or letters of administration of such member's estate or other power, subject to a maximum period of postponement of nine months.

(ii) That in section 15 (2) the words "or by a person named in the articles as a director or secretary of the company" be amended to "or by an accountant qualified for appointment as auditor of a company by section 161 of this Act".

(b) *Limitation of objects to those stated in the memorandum: obsolescence of ultra vires rule in view of universality of modern objects clauses; effects of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

8. The Council holds the view that in general the present law is working well and requires no amendment.

(c) *The Company as a legal entity distinct from its members—"one-man" companies*

9. The Council does not wish to submit any recommendations under this heading other than those referred to in paragraphs 5 and 6 of this memorandum.

(d) *Shares of No Par Value. (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)*

10. The Council believes that the introduction of shares of no par value would assist in the simplification and comprehensibility of balance sheets and would facilitate the subdivision and consolidation of shares. It therefore supports the introduction of legislation as recommended in the majority report of the Committee on Shares of No Par Value.

RECOMMENDATION

That the recommendations of the majority report of the Committee on Shares of No Par Value be implemented.

2. Prohibition of Partnerships with More Than Twenty Members

(Section 434 of the Companies Act, 1948)

11. The Council does not wish to submit any recommendation under this heading.

3. Classification of Companies

(a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

(b) *Nature and merits of distinction between exempt and non-exempt private companies (sections 127 and 129 of the Companies Act, 1948)*

12. The introduction by the Companies Act, 1948, of the exempt private company, as an attempt to meet the problems discussed in paragraphs 50-53 of the Report of the Committee on Company Law Amendment, 1945 (Cmd. 6639), has met with widespread criticism, more from the aspect of defining such companies than from any real difficulties experienced since 1948 in the conduct of those companies, numbering about a quarter of a million, which have continued to claim exemption from the obligation to file accounts annually. The main difficulties are that, first, the exempt private company concept necessitated the introduction of provisions as long and as complicated as the

Seventh Schedule and, second, that directors of the exempt private company may never be certain that the company is satisfying the requirements of the Act necessary for it to retain exempt status without an inquisition to ensure that no person other than the holder has any interest in any of the shares or debentures, subject to the prescribed exceptions.

13. The Council holds the view that law which is so complex as to be difficult to understand and even more difficult to comply with is undesirable, and that the experiment of exempt private company status has not proved effective and should be discontinued in its present form.

14. A large proportion of companies now enjoy the privilege of exempt private company status and if this were removed the question arises whether private companies as a whole should be required to file accounts with the Registrar in a similar manner to public companies. The Council feels that when a body corporate is the holder of any share in a private company, the company should be subject to the same obligations as a public company in the matter of filing accounts and that a private company should not be permitted to invite loans or deposits from members of the public. The privilege of privacy which has always been enjoyed by the small family business, however, should be retained, provided that these companies comply with the provisions of the Act as to the preparation of annual accounts and their audit; that these accounts are circulated in accordance with section 158 and that a declaration to that effect is filed with the annual return.

15. While the Council holds the view that the maximum number of members of a private company should continue to be fifty, it considers that the present maximum of fifty debenture-holders applicable to exempt private companies should apply to all private companies, subject to the same exclusion for employees and past-employees as in the case of shares. Money derived from the issue of debentures is often part of the permanent capital structure of a company. Companies should not be permitted, therefore, to exceed without limit the number of "investors" now allowed by section 28, by the issue of debentures on terms that may not differ to any significant degree from those attaching to shares.

RECOMMENDATIONS

(i) That section 129 and the Seventh Schedule be repealed and that all references to the exempt private company in the Act be deleted.

(ii) That a new section be introduced providing that a private company shall not be required to comply with section 127 provided that there be filed with the annual return:—

(a) a certificate that no body corporate is the holder of any share in the company

(b) a statement signed by the auditors that the balance sheet and documents required to be annexed thereto have been circulated in accordance with section 158

(c) a certified copy of the auditor's report and

(d) a certificate in the terms of section 129 (2) (c) of the present Act.

(iii) That section 28 (1) (c) be expanded by substituting the words "shares, debentures, loans or deposits" for the words "shares or debentures".

(iv) That in section 28 (1) (b) after "fifty" be added the words "and the number of its debenture-holders to fifty" and after the word "members" in line six be added the words "or debenture-holders".

(c) *Unlimited companies and companies limited by guarantee*

16. The Council does not wish to submit any recommendation under this heading.

4. Donations by Companies for Charitable and Political Purposes

17. The Council does not wish to submit any recommendation under this heading.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) *Fundamental changes in company's activities*

18. The Council is of opinion that, it is wrong for the directors of a company to introduce fundamental changes in the activities of a company without the approval of members.

RECOMMENDATION

That a new section be introduced requiring that the fundamental activities of a company be stated in the annual report of the directors and that no material change take place in these activities without the approval of the majority of members in general meeting.

(b) *Disposal of undertaking and assets*

19. It is common practice for companies to include in their objects clause power to sell and dispose of their undertaking or assets. In the view of the Council the exercise of this power should be subject to the approval of the general body of members, except where the company has a considerable holding in the purchasing company.

RECOMMENDATION

That a new section be introduced providing that a company be prohibited from selling or disposing of the whole or a material part of its undertaking or assets without first obtaining the approval of a majority of members in general meeting. There should be an exception to this requirement where the company holds at least a 75 per cent. interest either directly or indirectly in the acquiring company.

(c) *Issue of shares*

20. The Council deprecates the issue of securities without their first being offered to members, particularly if such securities are issued for cash. It is appreciated that the acquisition of assets by the issue of securities is a proper means of expansion, nevertheless the Council is of opinion that any issue which may result in a change of control of the company should be subject to the approval of members.

RECOMMENDATION

That a new section be introduced requiring the approval of a majority of the members before the issue of shares or securities with conversion rights, or the giving of options to non-members.

(d) *Borrowing money and charging property*

21. The Council does not wish to submit any recommendation under this heading.

(e) *Lending money otherwise than in the ordinary course of business*

22. The Council does not wish to submit any recommendation under this heading.

6. Directors' Duties

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

23. The Council does not wish to comment on the wider aspects of this question. The Council notes, however, that section 198 requires disclosure by a director of such matters relating to himself as may be necessary for the purposes of section 195, 196 and 197, whereas only that information required for purposes of section 195 is

required to be *in writing*. The Council sees no reason why the information required by sections 196 and 197 should not also be in writing, especially as such information is required by auditors in the discharge of their duties.

24. The Council considers that a duty should be imposed upon directors and the secretary to give to the company in writing the information required to be contained in the Register of Directors and Secretaries.

25. The Council considers that in section 196 (2) the estimated money value of any other benefits received otherwise than in cash should be more clearly defined by confining disclosure to such benefits received by directors as are chargeable to United Kingdom income tax.

RECOMMENDATIONS

(i) That in section 198 (2) the words "section one hundred and ninety-five" be deleted and the word "sections" be substituted.

(ii) That section 200 be expanded so that directors and the secretary shall give information to the company *in writing* to enable the company to comply with the section.

(iii) That the following words be added at the end of section 196 (2) "that are chargeable to United Kingdom income tax".

(b) *Are Directors generally aware of the legal duties arising from their fiduciary position?*

26. The Council does not wish to comment.

(c) *Directors' and officers' dealings in their own companies' shares*

27. The Register of Directors' Shareholdings is required to be available for inspection by members and debenture-holders during the period beginning fourteen days before the annual general meeting of the company and ending three days after its conclusion. The Council considers that the Register of Directors' Shareholdings should be available in the same manner as the Register of Directors and Secretaries, i.e., at all times and to all persons during normal business hours.

28. Section 195 requires the maintenance of a Register of Directors' Shareholdings to provide full information as to the dealings by a director in the shares and debentures of any of the companies in a group, with certain exceptions as to wholly owned subsidiaries. The Council holds the view that the same requirement as to disclosure should also clearly apply with regard to options and suggests that section 195 be amended accordingly.

RECOMMENDATIONS

(i) That section 195 (5) be re-drafted on the lines of section 200 (6).

(ii) That section 195 be amended to make it clear that disclosure of dealings in options is also required.

(d) *Disclosure of Directors' interests*

29. The Council holds the view that no amendment of the present law is necessary.

(e) *Should bodies corporate be allowed to be Directors?*

30. Although the practice of appointing bodies corporate as directors is not common, the Council takes the view that it is undesirable for the reason *inter alia* that bodies corporate cannot be made fully subject to the same sanctions of law as individuals.

RECOMMENDATION

That a section be introduced prohibiting a body corporate from being appointed a director of a company.

7. Shares with Restricted or No Voting Rights

31. The Council considers it to be a contradiction in terms that equity shares otherwise with equal rights and carrying equal risks in the capital of a company, should be issued without votes or with restricted voting rights. The Council is of opinion that this should be prohibited, either with or without requiring existing equity shares with any such disability to be given equivalence of voting rights within a specified period, say three years, after the passing of the Act.

RECOMMENDATION

That a section be introduced providing that all equity shares issued after an appointed day shall have votes and that all equity shares carrying equal risks shall have equal votes.

8. Protection of Minorities

Adequacy of existing remedies. Winding up under "just and equitable" rule section 225(2) of the Companies Act, 1948; the remedy afforded by section 210

32. While recognising the difficulties of affording protection to minority shareholders, the Council is of opinion that section 210 has proved to be inadequate in practice. Although the tendency of the Courts in recent years has been to give this section a wider interpretation, the fact that it is linked closely with the winding up provisions of the Act and imposes a serious burden upon an applicant seeking a remedy under the section, has for the most part rendered it ineffective. The Council suggests that section 210 be amended on the lines of sub-sections 1, 2 and 3 of clause 201 of the Companies Bill (Northern Ireland), 1960 which are based on the Report of the Departmental Committee on Company Law Amendment in Northern Ireland, 1958 (Cmd. 393). The Council considers that this goes as far as is desirable to meet the equities of the case.

RECOMMENDATION

That section 210 be amended on the lines of sub-sections 1, 2 and 3 of clause 201 of the Companies Bill (Northern Ireland), 1960.

9. Protection of Special Classes of Shares

Modification of class rights (section 72 of the Companies Act, 1948)—getting rid of preference shares by winding up or return of capital

33. The Council is satisfied with section 72 except that it considers the requisite share qualifications of members competent to apply to the Court to have the variations cancelled should be reduced from fifteen per cent. to ten per cent. It considers that adequate protection against frivolous applications is afforded to companies by sub-section (4).

RECOMMENDATION

That in section 72 (1) the words "fifteen per cent." be amended to "ten per cent."

10. Board of Trade Powers to Appoint Inspectors

34. Section 164 enables members to make application to the Board of Trade for the appointment of inspectors to investigate the affairs of a company, provided application is made by not less than two hundred members or members holding not less than one tenth of the shares issued. Since dissatisfied members seldom possess administrative facilities for circularising members, the practical difficulty of doing so discourages members from seeking to obtain the support of such relatively large proportions as those specified. The Council suggests that the requirement should be reduced to one hundred members or members holding not less than one twentieth of the shares issued. The effect of this proposed amendment to section 164 would similarly

strengthen the hands of members desirous of invoking an investigation into the ownership of a company under section 172.

RECOMMENDATION

That in section 164 (1) (a) the words " two hundred " be amended to " one hundred " and " one tenth " be amended to " one twentieth ".

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies)*

35. The Council is in sympathy with the views expressed in paragraphs 77-85 of the Report of the Committee on Company Law Amendment, 1945 (Cmd. 6659), but appreciates the difficulties of devising a practicable method of ensuring full disclosure. The Board of Trade already has power to investigate the ownership of a company under sections 172 and 173. The suggestion put forward by the Council in paragraph 34 would strengthen the hands of members applying for an investigation. The Council further suggests that an application by the directors of a company should be an alternative to an application by members in section 172 (3), with the proviso contrary to section 172 (6), that the expenses be defrayed by the company.

RECOMMENDATION

That section 172 (3) be amended to provide that an application for an investigation may also be made to the Board of Trade by the directors of a company and that the expenses of such an investigation shall be defrayed by the company.

(b) *Control through nominee Directors*

36. The Council does not wish to submit any recommendation under this heading.

12. Share Transfer and Registration Procedure

37. The Council welcomes the examination of share transfer and registration procedure which is being undertaken by a Joint Committee appointed by The Stock Exchange, London, and trusts that it may result in simplification and expedition thereof.

38. Section 110 (1) (b) requires the date at which each person was entered in the Register of Members to be recorded in that Register. The Council considers that the date of becoming a member should be defined as the date of approval of the allotment or transfer by the board of directors.

39. The growing practice of designating accounts, with, for example, a letter or a number is an undoubted convenience to shareholders. It is, however, felt in some quarters to be a contravention of section 117 which should therefore be clarified in this respect. Also, the application of the phrase occurring in the middle of this section " or be receivable by the registrar " should be made clear.

RECOMMENDATIONS

(i) That section 110 (1) (b) be amended to read " the date at which approval of the allotment or transfer of the shares was given by the directors ".

(ii) That in section 117 the word " registrar " be replaced by the word " secretary " and that the following proviso be added: " provided that the designation of an account in the register of members, in such terms as do not indicate that the holder is a trustee, shall not constitute notice of trust within the meaning of this section ".

13. Multiplicity of Directorships Held by One Individual

40. The Council does not wish to submit any recommendation under this heading.

14. Practice of Carrying on Business Through Associated and Subsidiary Companies

41. The growing practice of carrying on business through associated companies leads the Council to express the view that the Committee may wish to consider some means of ensuring disclosure of the names, capital employed, earnings of, and equity shareholding, in such companies and the inclusion in the Act of a definition of the term "associated company".

42. Many holding companies do not disclose the names of subsidiary companies and members may thus be unaware of the identity of companies for which they have indirectly provided capital. The Council considers that the names of subsidiaries should be given in the accounts of the holding company. Where, in the opinion of the directors, it would be harmful to the business of the company to make such disclosure a note to that effect should appear on the accounts. The Council further suggests that where the financial year of a subsidiary does not coincide with that of the holding company the date to which the accounts of the subsidiary are made up should be stated on the accounts.

43. The Council is reluctant to add to the length and complexity of the definition of a holding and a subsidiary company in section 154, but considers that the date when a company becomes a holding or a subsidiary company should be clearly stated. This clarification will facilitate compliance with a number of provisions, notably paragraph 15 (5) of the Eighth Schedule.

RECOMMENDATIONS

(i) That consideration be given to the inclusion in the new Act of a definition of the term "associated company" and to the disclosure, in the accounts of a company, of the following information regarding an associated company:—

- (a) name;
- (b) capital employed;
- (c) earnings;
- (d) proportion of equity held;
- (e) valuation (see also paragraph 58 and accompanying recommendation).

(ii) That a new section be introduced requiring a holding company to annex to its balance sheet a statement showing the names of all subsidiary companies, subject to the proviso suggested in paragraph 42. In the case of any subsidiary company whose financial year does not coincide with that of the holding company, the date to which the accounts of the subsidiary are made up should be stated whether or not group accounts are prepared.

(iii) That in section 154 the date when a company shall be deemed to be a subsidiary of another shall be the date on which the company first satisfies the requirements of this section.

15. Loan Capital**(a) Debentures and Debenture Stock**

44. The Companies Act, 1948, contains provisions relating to the Register of Debenture-holders, i.e., where it is to be kept, when it must be open to inspection and who may obtain copies of it, but there is no requirement that such a Register must be kept. The Council recommends that it be made compulsory for companies to maintain a Register of Debenture-holders which should be kept in the same manner as the Register of Members.

RECOMMENDATION

That a new section be introduced making it compulsory for a company to keep a Register of Debenture-holders, on the lines of the first part of section 110 (1).

(b) Trust Deeds—Duties of Trustees and Receivers

45. When a debenture-holder enforces his charge without appointing a receiver, there is no provision in the Act for the filing of bi-annual accounts and statements as appertains when a receiver is appointed. The Council considers that this omission should be remedied.

RECOMMENDATION

That section 374 (1) be amended to apply also where someone other than a receiver or manager is appointed to enter into possession of the property of a company.

(c) Registration of charges

46. The Council considers that where an ordinary resolution increasing the borrowing powers of the directors has been passed by a company in general meeting, it should be made obligatory to register such a resolution with the Registrar, so that a search of the file will disclose the full borrowing powers of the company. This objective could perhaps better be achieved by requiring a special resolution for such authority.

RECOMMENDATION

That a provision be introduced requiring a special resolution when it is desired to increase the borrowing powers of the directors.

16. Take-over Bids

47. "Take-over bids" are acknowledged often to be justified on sound economic and financial grounds in a progressive industrial community. It is important, therefore, that no legislation is introduced which is inflexible or impedes business progress. Nevertheless, the Council is of opinion that the present methods of undertaking such operations are, in some cases, unsatisfactory.

48. The booklet entitled "Notes on Amalgamations of British Businesses" prepared by the Issuing Houses Association sets forth a code of desirable conduct, and the "Draft of the Licensed Dealers (Conduct of Business) Rules, 1960" issued by the Board of Trade under section 7 of the Prevention of Fraud (Investments) Act, 1958, lays down specific rules for licensed dealers. The Council does not wish to restate in full the contents of these documents but is of opinion that taken together, in the light of present experience, they can form the basis of a comprehensive code for the future control of such operations. The Council feels, however, that certain requirements should be given the force of law applicable to all persons concerned with take-over bids, whether licensed dealers or not, and these are set out in the recommendations below.

(a) Procedure

RECOMMENDATIONS

- (i) That where the offer is sent direct to members of the offeree company:—
 - (a) the terms of the bid be delivered to the directors of the offeree company not later than the day on which it is sent to members
 - (b) the directors be given at least seven days in which to comment on the bid, stating any material changes in the position of the company since the last balance sheet or report and the information in (f) below, the bid to remain open for at least twenty-one days after such comments have been sent to the members.
- (ii) That where the bid is made through the directors of the offeree company:—
 - (a) the directors make their comments on the lines of (i) (b) above
 - (b) the offer shall remain open for at least twenty-one days thereafter.
- (iii) That if a conditional bid be made unconditional:—
 - (a) all members be notified by the offeror of the number of shares accepted, and
 - (b) a further period of seven days be allowed for acceptance.

(iv) That if a conditional bid be not made unconditional:—

(a) all members be so notified by the offeror, and

(b) all documents and certificates be returned to acceptors within seven days of such notification.

(v) That if the bid be for part only of any class of capital, all holders of that class be given the opportunity of accepting, with *pro rata* scaling down of acceptances if necessary.

(b) *Securing disclosure of information on which shareholders can form an opinion*

RECOMMENDATIONS

(i) That if securities constitute any part of the consideration, full particulars thereof on the lines of the prospectus provisions of the Act be given with the bid.

(ii) That the amount of any securities of the company already held or controlled directly or indirectly by the offeror or the ultimate purchaser be stated.

(iii) That it be stated whether or not the bid is conditional on the acceptance of any proportion of the securities for which the bid is made, and if so, what proportion.

(iv) See recommendations (a) (i) (b) and (a) (ii) above and (c), (d) and (e) below.

(c) *Function of Directors*

RECOMMENDATIONS

(i) That they ensure that all relevant information in their possession be made available to members and also state what additional information is in their opinion required.

(ii) See recommendations (a) (i) (b) and (a) (ii) above.

(d) *Disclosure of identity of bidder*

RECOMMENDATIONS

(i) That full details be disclosed of the name and address of:—

(a) the offeror,

(b) the ultimate purchaser, if other than the offeror.

(ii) That if the purchaser is a subsidiary the name of its holding company be disclosed.

(e) *The financing of such transactions*

RECOMMENDATION

That if any part of the consideration is or may be cash, the offer shall state:—

(i) when and by whom it will be paid,

(ii) that a letter has been received from a body approved by the Board of Trade affirming that the total sum due on a full cash acceptance is or will be available.

(f) *Disclosure of Directors' Interests—compensation for loss of office (sections 191–194 of the Companies Act, 1948)*

RECOMMENDATIONS

(i) That disclosure be made of directors' interests in or contracts with:—

(a) the offeree company and whether or not they are accepting in respect of securities held by them,

(b) the offeror and associates,

(c) the ultimate purchaser and associates (see recommendation under (d) above).

(ii) That compensation for loss of office or other benefits payable to the directors be disclosed.

(g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority (section 209 of the Companies Act, 1948)*

49. The Council does not wish to submit any recommendation under this heading.

17. Prospectuses—Statements in Lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders*(a) Adequacy of protection afforded to investors by existing law*

50. The Fourth Schedule requires that a prospectus shall show profits and losses for five financial years immediately preceding its issue and the assets and liabilities at the last date to which the accounts were made up, these requirements applying to the company, to its subsidiaries and to any business which it proposes to acquire. Similar requirements are contained in the Third and Fifth Schedules relating to a statement in lieu of prospectus. Accountants engaged in the investigation of companies find that balance sheets relating to recent years are of considerable assistance to them in measuring trends and changes in the capital and assets structures. A profit and loss account without the balance sheet has limited use for such purposes. The Council considers that a statement of assets and liabilities should be given in the prospectus or statement in lieu of prospectus as at the end of all the years for which profits and losses are required to be disclosed.

51. The Council also suggests that where a company is a subsidiary of another company that fact should be stated in the prospectus or the statement in lieu of prospectus, together with the name of the holding company and the proportion of the equity owned by the holding company.

RECOMMENDATIONS

(i) That the Third, Fourth, and Fifth Schedules be amended so that a statement be shown of assets and liabilities as at the end of each financial year for which profits and losses are shown instead of as at the last date to which accounts were made up.

(ii) That a new paragraph be included in the Fourth and Fifth Schedules, requiring that where a company is a subsidiary of another company, that fact be stated and that there also be stated the name of the holding company, and the proportion of the equity owned by that holding company.

(b) Usefulness and necessity of the existing provisions

52. The prospectus provisions have been added to with the passing of each successive Companies Act, with the result that they are now complex and confusing. Prospectuses themselves suffer from the inclusion of too much information, often in very small print, which can mislead rather than assist investors. Apart from the specific suggestions for amendment made in paragraphs 50 and 51 the Council would welcome any attempt that is made to re-arrange and co-ordinate the main statutory provisions relating to prospectuses and statements in lieu of prospectuses.

RECOMMENDATION

That opportunity be taken to review the sections and schedules relating to a prospectus and statement in lieu of prospectus with a view to their simplification, re-arrangement and condensation.

(c) Certificates of exemption (section 39 of the Companies Act, 1948)

53. The facilities afforded to companies to secure exemption from some of the prospectus requirements of the Act by obtaining a certificate from a Stock Exchange appear to have worked well in practice and the Council sees no valid reason why they should not be extended to the provisions relating to a statement in lieu of prospectus.

RECOMMENDATION

That a new section be introduced on the lines of section 39 with such alterations as may be necessary to render it applicable to a statement in lieu of prospectus.

18. Control over Business of Dealing in Securities

54. The Council does not wish to submit any recommendation under this heading.

19. Unit Trusts and "Open End Mutual Funds"

55. There has been a considerable increase in recent years in the size and number of unit trusts as they are one means by which the "small" investor can spread his risks. Despite their growing importance, unit trusts are subject to no specific legislation, except for certain sections of the Prevention of Fraud (Investments) Act, 1958. The Council takes the view that this is unsatisfactory and that unit trusts should be subject to a new Act which should cover the whole field of their activities as is the case with companies under the Companies Act, 1948, and in particular that the audit should be conducted by a person qualified to act as an auditor under section 161.

RECOMMENDATION

That unit trusts be governed by a new Act covering the whole field of their activities including a provision for audit on the lines of section 161.

20. Reduction of Capital and Purchase by a Company of its Own Shares

56. Section 27 sub-section (3) provides that a company which is a subsidiary of another and was a member of that other at the commencement of the Companies Act, 1948, may *continue* to be a member; on the other hand, if Company A holds shares in Company B no matter when acquired or for how long held, and after 1st July, 1948, A becomes a subsidiary of B, it may no longer hold shares in B but must dispose of them before becoming a subsidiary of B. This is illogical and the Council proposes that shares held by a subsidiary in its holding company should in all cases be disposed of or cancelled within twelve months of the commencement of the Act or the date on which the member company becomes a subsidiary.

RECOMMENDATION

That section 27 be amended in order to give effect to the proposals outlined in paragraph 56 above.

21. Accounts

Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies? Are all the existing provisions necessary and useful in present-day conditions?

57. The Council is of opinion that in general the accounting provisions of the Companies Act, 1948, have worked reasonably well, but holds the view that disclosure of some additional information in the accounts and changes in the existing provisions as outlined below are now desirable.

(a) Revaluation of fixed assets and use of any resulting surplus

58. The accounting problems inseparable from the changing values of money have engaged the attention of the Council over the years. To whatever extent and for whatever reasons accountants are, for the most part, wedded to historic costs, the fact cannot be ignored that members and others are misled by asset figures as disclosed in many balance sheets. Members of companies cannot relate the earnings of the companies to the value of the assets and are at a disadvantage when approached by a bidder. These are matters to be deprecated. The main difficulty in suggesting that companies be required by law to disclose the current value of assets lies in the problem of deciding what is meant by the term "value". Many definitions, all of which are valid under different conditions and in different circumstances, can be advanced. In the recommendation made by the Council below, it is implied that the responsibility for computing and disclosing the current valuation of assets shall be placed upon the shoulders of directors. It is recognised that this is open to certain objections and cannot be regarded as an entirely satisfactory solution to the problem. At the same time, it is submitted that the proposal does go some appreciable way towards meeting

the situation, and moreover, it is not inconsistent with the manner in which other company accounting problems have been dealt with in the past with, for the most part, satisfactory results.

RECOMMENDATION

That in the Eighth Schedule a sub-paragraph be added to paragraph 11 requiring a statement of the value at the date of the balance sheet which, in the opinion of the directors, may be attached to any asset or class of assets and the basis upon which such valuations have been made, e.g., insurance valuations, replacement costs, calculations from indices of costs, professional valuers' estimates. Provided that where in the opinion of directors the disclosure of a valuation of any asset or class of assets would be misleading or is impracticable, a statement to that effect should be made. For the purposes of this recommendation investments in associated companies and trade investments should be regarded as fixed assets.

(b) *Share premium account*

59. The Council does not wish to submit any recommendation under this heading.

(c) *Use of pre-acquisition profits of subsidiaries*

60. In the operation of paragraph 15 (5) of the Eighth Schedule, a defect has been experienced in cases of reconstructions and amalgamations, where the shareholders remain substantially the same. In such circumstances revenue reserves, sometimes of substantial sums, have had to be "frozen" as capital. The recommendation below is designed to remedy the defect.

RECOMMENDATION

That in the Eighth Schedule paragraph 15 (5) a proviso be added to the effect that where there is no substantial change in the ownership of a company as the result of a reconstruction or amalgamation, revenue reserves existing at the date of reconstruction or amalgamation need not be regarded as capital.

(d) *Description of reserves*

61. The Council does not wish to submit any recommendation under this heading.

(e) *Definition of profits*

62. The Council does not wish to submit any recommendation under this heading.

(f) *Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948*

63. The Council does not wish to comment.

Other matters

64. Much of the wording of the Eighth Schedule is complex and some of the paragraphs need re-drafting in more comprehensible and consistent terms. Recommendation (i) below would, in the submission of the Council, simplify some of these accounting requirements.

65. Another defect in the Act is the apparent assumption that all assets fall under the heading of either "Fixed" or "Current". The Council suggests that where an asset cannot appropriately be described as "Fixed" or "Current" it is made clear that it may be included separately, provided the nature of the asset is clearly stated.

66. Requirements in relation to "Trade Investments" are contained in the Eighth Schedule, but no attempt is made in the Act to define a trade investment. The Council suggests the definition set out in recommendation (iii) below.

67. Paragraph 15 (4) of the Eighth Schedule prescribes the information to be given by a holding company when group accounts are not submitted. The disclosure of this information is unnecessary when the holding company is itself a wholly-owned subsidiary of another body corporate. The Council accordingly makes a recommendation designed to rectify this anomaly.

68. The practice of disclosing turnover for the year or period to which accounts relate is gradually becoming more prevalent and it is the opinion of the Council that the law should now require such disclosure since this would afford *inter alia* some measure of assistance to members in assessing the performance and management of a company. Where in the opinion of the directors it would be misleading or harmful to the company to make such disclosure, a note to this effect should be made on the accounts.

69. It is important, however, that a consistent basis of calculating turnover should be adopted from year to year and that any change should be the subject of a note on the accounts.

RECOMMENDATIONS

(i) That the wording of the Eighth Schedule be reviewed, particularly in paragraphs 5 and 15 (5), with a view to simplification and that the following amendments be made:—

Paragraph 12 (1) (c) amend "as United Kingdom income tax" to "with United Kingdom taxation" and in the penultimate line, "income tax" to "taxation".

Paragraph 12 (1) (d) amend "provided" to "set aside" (to avoid association with the term "provision" defined in paragraph 27 of the Schedule).

(ii) That in the Eighth Schedule, paragraph 4, a proviso be inserted to the effect that where an asset cannot appropriately be described as "Fixed" or "Current", it may be included separately, provided the nature of the asset is clearly stated.

(iii) That a definition of the term "Trade Investment" be included in section 455 as "an investment which is made primarily for the purpose of promoting the trade of the acquiring company not being an investment in a subsidiary company".

(iv) That in the Eighth Schedule, paragraph 15 (4) a further proviso be added excluding from the operation of the paragraph a holding company which is itself a wholly-owned subsidiary of another body corporate.

(v) That a new section be introduced requiring the disclosure of turnover for the period covered by the accounts with such adjustment as may be necessary in the case of group accounts for inter-company transactions, provided that a holding company or wholly-owned subsidiary need not disclose its own turnover. Provided also that if in the opinion of the directors such disclosure would be misleading or harmful to the company disclosure need not be made but a note to this effect should be made on the accounts.

22. Audit

(a) Qualifications and appointment of auditors

70. Some minor re-drafting is necessary in section 159 since sub-sections (1) and (2) appear to conflict. The Council proposes that the words "Subject to sub-section (2) of this section" be added before "Every company" in sub-section (1) and in sub-section (2) the words "deemed to be" be added after "shall be" on line 2.

71. The Council considers that the time has come to include in the Act the names of the four accountancy bodies recognised by the Board of Trade under section 161 (1) (a). This would have the effect of bringing the Companies Act into line with other Acts which specify the qualifications required for the appointment of auditors.

72. Section 161 (2) leaves it open for an employee of an auditor to be an officer of a company. The Council is of opinion that this impinges upon the principle of independence of the auditor and should be prohibited.

RECOMMENDATIONS

(i) That section 159, sub-sections (1) and (2) be amended on the lines of the suggestion in paragraph 70 above.

(ii) That section 161 (1) (a) be replaced by a paragraph specifying the names of the four accountancy bodies now recognised by the Board of Trade under this section, i.e.,

The Institute of Chartered Accountants in England and Wales,
The Institute of Chartered Accountants of Scotland,
The Association of Certified and Corporate Accountants,
The Institute of Chartered Accountants in Ireland,

together with a proviso to the effect that any of these bodies may be removed from and any other body of accountants established in the United Kingdom may be added to this provision by regulation requiring an affirmative resolution of both Houses of Parliament.

(iii) That section 161 (2) be extended to prohibit the appointment or re-appointment as auditor of a company of any person who has in his employ an officer of the company.

(b) Duties and responsibilities of auditors

73. The heading to the Ninth Schedule has resulted in auditors' reports being unnecessarily long, and when auditors find it necessary to embody qualifications in their report, these tend to be obscured. This is a fundamental criticism, since such qualifications should be conspicuous in the report. So far as the auditors' report is concerned those examining the accounts of a company are interested to know whether the auditors are, in their opinion, satisfied that the requirements as set out in the Schedule have been complied with. If so, a short and simple statement to that effect is adequate. If not, the respects in which they fall short of compliance are matters of vital interest.

74. The Council therefore suggests that the heading to the Ninth Schedule, i.e., "Matters to be expressly stated in Auditors' Report" be deleted and the Schedule be re-drafted so that the auditors' report may, in appropriate cases, be confined to a simple statement.

75. There seems to be doubt as to whether the term "vouchers", as employed in section 162 (3) includes such documents as title deeds to property. This should be made clear.

RECOMMENDATIONS

(i) That the heading to the Ninth Schedule be deleted and the Schedule be re-drafted so as to enable auditors to report to members in short and simple terms whether or not they are satisfied that the requirements of the Schedule have been fully complied with in relation to the company.

(ii) That in section 162 (3) the words "and vouchers," be amended to "vouchers and other documents relating to the business".

(c) Exemption of "exempt" private companies from the provisions of section 161 of the Companies Act, 1948

76. The Council is convinced that the exclusion of about five-sixths of companies now on the register from the provisions of section 161 (1) is no longer justified. Whether or not the proposal in paragraphs 12 and 13 is adopted, i.e., that the distinction between exempt and non-exempt private companies is removed, the Council considers that all companies should be required to appoint auditors qualified as prescribed, and does not anticipate that the relatively few companies that have not yet appointed auditors qualified in accordance with the provisions of section 161 (1) will experience any difficulties in making such appointments.

77. In the same way the Council is of opinion that a person who is in the employment of, or who employs, an officer or servant of the company should not be qualified for appointment as auditor, but the Council considers that a private company which is not obliged to file its accounts (see paragraph 14) should not be precluded from appointing as auditor a person who is a partner of an officer or servant of the company.

The Council feels that the existing exception in favour of a partner of an officer or servant of the company has often been of benefit to small family businesses, and there is no evidence, so far as the Council is aware, that it has been misused.

RECOMMENDATIONS

(i) That the proviso to section 161 (1) be repealed and that the proviso to section 161 (2) be amended in accordance with the recommendations contained in paragraph 77 above.

(ii) That provision be made to preserve the existing rights of persons who have been appointed or re-appointed as auditors prior to an appointed day.

23. Provisions as to Returns

78. The Council submits certain specific recommendations below on the provisions as to returns, but in addition, would welcome a full survey of the forms now in use with a view to their simplification. Some of the returns might with advantage be re-designed and some duplication, both in the information required and in the requirements as to registration, could be eliminated.

79. Where renounceable allotment letters are issued the information filed will in many cases be considerably out of date, particularly where the shares change hands frequently. The persons registered as holders at the conclusion of the renunciation period will then be very largely different from the original allottees whose names appear in the Return of Allotments and in any case the names of the holders as finally registered will appear on the company's next Annual Return. It is, therefore, suggested that names, addresses and descriptions of allottees be omitted from particulars filed.

RECOMMENDATIONS

(i) That section 52 be clarified so that shares allotted as fully or partly paid-up otherwise than in cash are returned under section 52 (1) (b) only and not also under section 52 (1) (a).

(ii) That no contract in writing need be filed under section 52 (2) in the case of an allotment of bonus shares.

(iii) That in relation to section 124 (1) and the Sixth Schedule, Part I, Clause 3 (f) commissions paid since the date of the last return only be required.

(iv) That section 200 (4) be subject to a proviso excluding any change in any other directorship of a director. (N.B.—This change would be notified to the Registrar in the next annual return.)

(v) That section 52 (1) (a) be amended by the addition of the following:—"Provided that where renounceable allotment letters are issued in respect of such allotment the return above referred to shall omit the names, addresses and descriptions of the allottees".

24. Company and Business Names

Effectiveness of present provisions (see sections 17 to 19 of the Companies Act, 1948, and the Registration of Business Names Act, 1916). Similarity of names; misleading names

80. The Council does not wish to make any recommendation under this heading.

25. Foreign Companies

81. The Council does not wish to make any recommendation under this heading but it has been advised that under Brazilian law (Article 71 of Law No. 2672 of 26th September, 1940) a simple procedure is provided for the assumption of Brazilian nationality by a foreign company under a ministerial decree of nationalisation. It is

understood that several United Kingdom companies have wished to take advantage of this provision but they have all found themselves in the same difficulties with regard to the provisions of the Companies Act, 1948, since the decree cannot be effective to remove the company from the Companies Register in this country. It may well be that other foreign countries either have enacted or will enact similar legislation in view of the obvious advantages. No procedure exists whereby the registration of a company to which the Act applies can be transferred from the United Kingdom to another country except by a private Act of Parliament. The alternative of forming a new foreign company is often so costly in terms of stamp duty both on issued capital and on the transfer of the assets as to be virtually ruled out as a practical proposition.

82. The Committee may wish to consider this matter.

26. Internal Management and Administration

(a) Annual and other General Meetings

83. Since section 133 (3) permits the normal period of notice of a meeting of a company to be reduced by agreement of all or a large majority of the members entitled to attend and vote, it is desirable that the agreement of the auditor should also be required having regard to the provisions of section 162 (4).

84. It is suggested by the Council that the Board of Trade should be given power under section 131 (1) to allow an extension of time for the holding of the annual general meeting in appropriate cases.

85. In the opinion of the Council it is desirable that a provision should be included in the Act, making it obligatory for a company to give notice to members of any business to be transacted at a meeting other than that specified in clause 52 of Table A.

86. The Council is also of opinion that the period of notice required for *all* ordinary and extraordinary meetings of a company should be twenty-one days.

87. In line with the proposals set out in paragraph 34 the Council suggests that the requisite proportion in section 132 be reduced from one tenth to one twentieth.

88. Section 138 gives a member entitled to more than one vote the right to vote more than one way. The Council considers that this provision should be clearly extended to members voting by proxy who are not present at the meeting.

RECOMMENDATIONS

(i) That in section 133 (3) (a) the words "and the auditor" be inserted after "thereat" and in section 133 (3) (b) the same words be inserted at the end of the paragraph, provided that the agreement of the auditor shall not be required in the case of any wholly owned subsidiary of a holding company of which he is also the auditor.

(ii) That in section 131 (1) an additional proviso be introduced giving the Board of Trade power, on application by the company, to extend the time for holding an annual general meeting.

(iii) That a new provision be introduced making it obligatory for a company to give particulars in the notice of a meeting of all business to be transacted at the meeting except ordinary business, followed by a definition of "ordinary business" on the lines of that at present included in clause 52 of Table A.

(iv) That in sections 133 and 141 the necessary amendments be made to provide that the notice for all meetings of a company shall be twenty-one days.

(v) That in section 132 (1) the words "one tenth" be amended to "one twentieth".

(vi) That in section 138 the words "whether present in person or by proxy" be added after the word "member".

(b) Mode of passing extraordinary and special resolutions

89. As the only difference that now remains between a special and an extraordinary resolution is the period of notice required for the meeting at which the resolution is to be considered, the Council is of opinion that all acts requiring the sanction of either type of resolution should in future be capable of authorisation by a special resolution.

RECOMMENDATION

That all references to an extraordinary resolution be removed and be replaced where necessary by the term "special resolution".

(c) Securing proper disclosure of information in circulars requiring proxy votes

90. The Council does not wish to make any submission under this heading other than that in paragraph 85.

(d) Exercise of voting rights, in cases of interlocking shareholdings, unit trusts and in other special cases, e.g., by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company

91. The Council does not wish to submit any recommendation under this heading.

27. Winding Up

92. The Council wishes to make recommendations under the following headings:—

- (a) Committee of Inspection.
- (b) Meetings of Creditors.
- (c) Preferential Payments.
- (d) Winding-up Rules.
- (e) General Matters of Administration.

(a) Committee of Inspection

93. The Council feels that section 253 (2) is impractical and since it is seldom complied with it should be amended.

94. It is the practice of the Court to appoint named representatives of the creditors of the company to serve as members of the committee and in the case of a vacancy the liquidator is required by section 253 (7) to summon meetings of creditors or contributories to fill the vacancy. The Council is advised that where this is the only business to be transacted at the meeting it is always most difficult and often impossible to get a quorum of creditors. In bankruptcy proceedings however the Court is empowered to appoint a duly authorised but un-named representative to serve as a member of the committee and the Council feels that the adoption of such a procedure in cases of compulsory winding-up is desirable.

RECOMMENDATIONS

- (i) That section 253 (2) be amended to read:—

"The liquidator may call a meeting of the committee as and when he thinks necessary and shall do so at the request of a member of the committee".

(ii) That the Court be empowered to appoint a creditor or his duly authorised representative as a member of the committee.

(b) Meetings of Creditors

95. Where in the case of a members' voluntary winding up the liquidator is of opinion that the company cannot comply with the declaration of solvency made by

the directors but is insolvent he is required by section 288 to convene a meeting of the creditors and lay before the meeting a statement of assets and liabilities and nothing more. It remains a members' winding up and the person appointed by the members remains liquidator and the creditors have no control over the liquidation or the liquidator. Their only remedy is to petition for the compulsory winding up of the company. Such a meeting should have the same powers as one called under section 293 and creditors at the meeting should be empowered to appoint, if they so wish, another liquidator with or without a committee of inspection. The liquidation should, thereafter, be deemed to be a creditors' voluntary winding up.

96. Under section 289 a liquidator is required to summon meetings of the company and under section 299 meetings of the company and of the creditors at the end of the first year from the commencement of the winding up and each succeeding year thereafter for the purpose of laying an account before the meetings. The Council is advised that this proves to be an expensive procedure if there are many members and/or creditors, and since there is no provision for any resolution to be passed, in practice it is seldom that any member or creditor attends. The Council feels that it would be more practical for the liquidator to send annually a summary of receipts and payments to creditors in the case of a creditors' winding up and to members and creditors in the case of a members' winding up.

97. At present under section 293 (3) (a) the directors are required to lay a full statement of the position of the affairs of the company and a list of creditors with an estimate of their claims before the meeting. The Council feels that this requirement is inadequate and that all other relevant information with regard to the trading of the company and the causes of its failure should also be required.

RECOMMENDATIONS

(i) That section 288 be amended so that when a liquidator is of opinion that the company cannot comply with the directors' declaration of solvency he should forthwith convene a meeting of creditors. Such a meeting should have the same powers as one called under section 293 and creditors at that meeting should be empowered to appoint, if they so wish, another liquidator with or without a committee of inspection. The liquidation should from the date of the meeting be deemed to be a creditors' voluntary liquidation.

(ii) That sections 289 and 299 be amended to require the liquidator to send annually a summary of receipts and payments to creditors in the case of a creditors' winding up and to members and creditors in the case of a members' winding up.

(iii) That section 293 (3) be amended to provide that a copy of the company's statement of affairs and a list of creditors with an estimate of their claims should be supplied to every creditor at the meeting.

(iv) That the directors give such a meeting all other relevant information with regard to the trading of the company and the causes of its failure.

(c) *Preferential payments*

98. The Council is of opinion that the priorities created by section 319 are in particular and in general unfair and oppressive upon the unsecured creditors; that some of the preferential items have substantially increased in charge; that some originated when economic conditions were different from those prevailing today; that in many cases preferential claims consume the whole, or substantially the whole, of the net sum available for distribution, with the result that the unsecured creditors receive nothing. The Council considers that the prior rights at present conferred by section 319 should be reviewed and reduced, especially those appertaining to rates and taxes, and makes the following suggestions towards that end.

99. Under section 30 of the Finance Act, 1952, certain contributions under the P.A.Y.E. regulations are preferential. The Council feels that it would be desirable to

include all preferential provisions in one section of the Companies Act. The Council is of opinion that, since the Board of Inland Revenue has statutory power to follow up arrears of P.A.Y.E. contributions, the present period of twelve months specified in section 30 of the Finance Act, 1952, should be reduced to six months and should be brought into the provisions of section 319 of the Companies Act, 1948.

100. It is felt that the existing practice whereby third parties advance money for wages and salaries and then have the right to rank preferentially in a liquidation under the provisions of section 319 (4) is unfair to the unsecured creditors. In many instances such claims take the whole or the bulk of the available assets. It is suggested that this right should be limited to a period of one month before the commencement of the winding up.

RECOMMENDATIONS

(i) That the preferential period for rates under section 319 (1) (a) (i) be limited to the half year rate prior to the relevant date, plus the proportion of the current rate up to the relevant date.

(ii) That the preferential periods for taxes under section 319 (1) (a) (ii) should be as follows:—

(a) Income tax due for the twelve months prior to the relevant date (apportioned on a time basis if necessary) *or* at the option of the Board of Inland Revenue for the fiscal year ending on 5th April prior to the relevant date. The present practice of selecting the most favourable of a number of years should be discontinued.

(b) The profits tax for the period of twelve months prior to the relevant date (apportioned on a time basis if necessary) *or* at the option of the Board of Inland Revenue for the accounting period of twelve months to which the accounts of the company are made up next before the relevant date.

(iii) That under section 319 (1) (a) (iii) the preferential period for purchase tax be limited to the quarter which ended prior to the relevant date and for the period from the end of that quarter up to the relevant date.

(iv) That section 319 (1) (b) be amended to allow for the following two categories and their respective periods:—

(a) Where wages and salaries are paid weekly or for terms of less than one month the period should be four weeks.

(b) Where wages and salaries are paid monthly or for longer terms the period should be two calendar months.

(v) That in view of difficulties arising from the definition of holiday pay in section 319 (8) (b), the following amendments should be made to section 319 (1) (d):—

(a) That all holiday pay shall be deemed to accrue as from 1st October in any year.

(b) Where the normal period of holiday pay does not exceed twelve working days holiday pay should be deemed to accrue at the rate of one day for each complete month of service as from 1st October prior to the relevant date.

(c) Where the normal period of holiday pay is more than twelve working days then the accrual shall be increased proportionately.

(vi) That in view of the statutory regulations now in existence in respect of national insurance contributions specified in section 319 (1) (e), preference for a six months' period prior to the relevant date be given.

(vii) That all preferential payments be detailed in a single section of the Act.

(viii) That the present period of twelve months specified under section 30 of the Finance Act, 1952, be reduced to six months.

(ix) That the preferential rights conferred by section 319 (4) upon third parties who have advanced monies to pay wages and salaries should be limited to advances made within a period of one month before the commencement of the winding up.

(d) *Winding up rules*

Rule 159

101. The Council feels that the requirement that the remuneration of a liquidator must be calculated as a percentage on realisation and distribution is in many cases unfair. Thus if a liquidator succeeds in reducing the claims of the creditors, especially preferential creditors, he can receive no special reward since the amount distributed is the same, but the rate of dividend received by the creditors may well be substantially increased as a result of the diligence of the liquidator.

102. The Council also considers that the power granted to the Board of Trade under rule 159 (2) is too wide.

RECOMMENDATIONS

(i) That the Committee of Inspection in a compulsory winding up be entitled to fix the remuneration of the liquidator on a percentage basis or any other reasonable basis or on a combination of both bases as in a creditor's voluntary winding up.

(ii) That the power granted to the Board of Trade under Rule 159 (2) be exercisable only on application by a creditor as is the case in Bankruptcy.

Rule 163

103. The Council feels that the provision whereby a member of the committee or his employer is in reality prohibited from trading in the ordinary way with the liquidator for or on account of the company is in modern conditions too rigid and unreasonable since with many proprietary lines the member of the committee or his employer may be the only source of supply.

RECOMMENDATION

That the liquidator be entitled to trade with a member of the committee and his principal provided that the member discloses his interest to the liquidator and to the remaining members of the committee of inspection who by a majority (the interested member abstaining from voting) approve of the trading.

Rule 172 (2) and rule 174

104. The Council is advised that it is almost impossible in practice to get a committee together for the sole purpose of auditing accounts, so much so that the Board of Trade are prepared to accept a statement that no quorum was present. The Council is of opinion that an audit of the liquidator's cash book by the committee of inspection is in fact valueless and unnecessary since a thorough audit is carried out by the Board of Trade.

RECOMMENDATION

That the audit of a liquidator's accounts by the committee of inspection be discontinued.

(e) *General matters of administration*

Personal liabilities of directors and restriction on future activities of directors of a company which has failed

105. The Council is of the opinion that there are no provisions in the Act, which sufficiently restrict or prevent the abuse of limited liability. Section 332 refers only to cases where there has been an intent to defraud and should be amended to embrace actions of a reckless character in relation to the affairs of the company.

106. In bankruptcy the debtor whose assets are insufficient to pay 20s. in the £ suffers certain disabilities until he obtains his discharge from the Court. The Council

is of the opinion that directors of insolvent companies which go into liquidation should in some cases suffer a similar disability.

RECOMMENDATIONS

(i) That the provisions of section 332 of the Companies Act be extended so as to include under sub-section (1) the carrying on of a business recklessly in addition to carrying on with intent to defraud.

(ii) That the provisions of section 332 be further extended so as to include a provision whereby the Court shall have power to order that a person referred to in sub-sections (1) and (3) of the section be prohibited from holding the office of a director in any other company for such period as the Court may direct.

Power to summon persons suspected of having property of a company

107. The Council is of opinion that the alternative procedure of written interrogatories militates against the effective operation of section 268.

RECOMMENDATION

That the words relating to written interrogatories be deleted from section 268.

Adoption in winding up of certain recommendations of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment

108. The Council is of opinion that it is desirable for certain aspects of winding up practice to be brought into line with relevant procedure applicable in matters of bankruptcy. Certain of the recommendations of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment 1957 (Cmd. 221) could be adopted with advantage in compulsory liquidation and also where relevant in voluntary liquidation.

RECOMMENDATION

That the Companies Act, 1948, or the Companies (Winding up) Rules, 1949, be amended by the adoption of the following recommendations of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment:—

- (a) Postal vote of committee—the recommendation contained in paragraph 43;
- (b) Vacancy in the committee—the recommendation contained in paragraph 45;
- (c) Mutual credit and set-off—the recommendation contained in paragraph 85;
- (d) Pre-preferential payments—the recommendation contained in paragraph 97;
- (e) Taxation of costs in compulsory winding up—the recommendation contained in paragraph 166 (2) (b).

Stamp and premium on liquidators' guarantee bonds

109. The Council is of opinion that the stamp and premium on liquidators' guarantee bonds should be chargeable to the estate in every case, without any sanction being required. These are at present chargeable in bankruptcy (under sanction) but not in compulsory liquidation.

RECOMMENDATION

That the stamp and premium on liquidators' guarantee bonds be chargeable to the estate in every case without any sanction being required.

Assets fee

110. The Council feels that the present regulation whereby the official receiver charges a fee on the assets as estimated by the directors in the statement of affairs lodged with the Court in compulsory liquidation is unwarranted. The assets are very often considerably over-valued and the charge calculated thereon can be oppressive on the creditors. No similar charge is made in the case of bankruptcy and the Council can see no reason for the charge being made in compulsory liquidation.

RECOMMENDATION

That the Board of Trade regulation charging an asset fee on the estimated assets as shown on the statement of affairs be annulled.

Charge on monies withdrawn from the Companies Liquidation Account

111. Having regard to the fact that, apart from the special cases referred to in the Act, no interest is allowed on monies paid into the Companies Liquidation Account, the Council is of opinion that the present charge of 1½ per cent. on amounts withdrawn is an unfair charge on the funds otherwise available for distribution to creditors.

RECOMMENDATION

That the charge upon monies withdrawn from the Companies Liquidation Account be discontinued.

28. Problems of Administration and Enforcement of the Law

In particular are any difficulties caused by provisions which appear obsolete or inappropriate in modern conditions?

112. Section 143 (1) allows exempt private companies to forward copies of certain resolutions to the Registrar which are either printed or in some other form approved by him. It would be a convenience and result in economy if this facility were extended to all companies and all resolutions.

113. Section 113 (2) provides that any person may obtain a copy of the register of members at a charge not exceeding sixpence for each hundred words and this copy must be prepared and sent to the member within ten days. The Council considers that power should be given to the Board of Trade to extend this period in appropriate cases. There is no obligation placed upon the applicant for a copy to send a remittance with his application and, in many cases, he will not be aware of the full charge. The recommendation (ii) made below is designed to rectify this position.

114. The various charges prescribed by the Act for copies of and extracts from documents have remained unaltered for a long time. These charges are not at present economic and are not in line with current costs. Recommendation (iii) below proposes amendments that are long overdue and the Council feels that this opportunity should be taken to bring the maximum charges into line with present day costs.

RECOMMENDATIONS

(i) That sections 63 (2) and 143 (1) be amended to permit all companies to forward copies of resolutions to the Registrar either printed or in some other form approved by him.

(ii) That in section 113 (2) the words "the requirement" be amended to "a remittance for the estimated cost" and the section be expanded to include:—

(a) a time limit within which the company must send the applicant an estimate of cost,

(b) a provision giving the Board of Trade power to extend the period of ten days in appropriate cases.

(iii) That the maximum amounts which may be charged for copies of and extracts from documents be increased to amounts which are in line with current costs.

July, 1960

APPENDIX XXXV

Memorandum by the Council of Scottish Chambers of Commerce

Note. In the Memorandum which follows, the paragraph numbers used are those given in the note of heads of evidence issued by the Jenkins Committee. Where a number is omitted from the sequence, no comment is offered under that head.

In submitting the following observations the Council wishes to record the general view that, should further statutory restraints on companies be deemed necessary the general principle should be followed that no unreasonable restrictions should be placed on businesses which are conducted in an efficient and honest manner.

1. Incorporation of Companies—Memoranda of Association

(b) Memoranda of Association of Companies—limitation of objects—obsolescence of ultra vires rule in view of the universality of modern objects clauses

Consideration has been given as to whether an attempt should be made by legislation to require more particular definition of the main objects of a company in Memoranda of Association or alternatively whether, in view of modern practice of having clauses expressed in the widest possible terms, the requirement for a statement of objects should be dispensed with altogether. It is thought, however, that the objects and activities of a company should somewhere be disclosed—if not in the Memorandum of Association, possibly, in some way, in the annual accounts. No change is recommended in the present law.

(d) Shares of no par value. (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)

It is recommended that the issue of no par value shares be permitted.

2. Prohibition of Partnerships with More than Twenty Members

The removal of this restriction in the case of professional firms would not be opposed.

3. Classification of Companies

(a) Distinction between public and private companies

The present classification into public companies, private companies and exempt private companies is clear enough to those versed in company matters. It is felt, however, that there should be a new name for the "private" company which is a wholly-owned subsidiary of a public company and that the term "private company" is a misnomer in such a case.

(b) Distinction between exempt and non-exempt private companies

The privilege which an exempt private company enjoys of not having to attach a copy of its balance sheet to its annual return has been examined and the advisability of the continuance of this privilege reviewed. It is agreed, however, that no change should be recommended.

4. Donations by Companies for Charitable and Political Purposes

No change is recommended in present practice.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) *Fundamental changes in company's activities*

It is appreciated that the powers of directors and their relationship to shareholders is a subject that has attracted much public interest in recent years, and various aspects of this have been carefully scrutinised. An opinion was strongly advocated that where a fundamental change in a company's activities is contemplated (for example, where there is a choice between winding the company up and distributing its assets on the one hand, or continuing in a completely different type of business or as an investment company on the other), the matter should be submitted to the shareholders for their decision. After a thorough review of the matter, however, it has been decided not to recommend any change in this field.

(c) *Issue of shares*

Unissued shares should not be used for a purpose not visualised at the time of their creation except with the prior consent or subject to the subsequent approval of the shareholders.

6. Duties of Directors

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

(b) *Are directors generally aware of the legal duties arising from their fiduciary position?*

It is considered that there is a case for instituting a way of codifying and bringing to the attention of directors their principal responsibilities and duties under the Companies Act. There might, for example, be a table annexed to the Act in which these duties were summarised.

(e) *Should bodies corporate be allowed to be directors?*

No. The concept of the *personal* responsibility of directors is considered to be basic in company administration.

7. Shares with Restricted or No Voting Rights

No restriction should be permitted on voting rights of ordinary shares, so-called. Any shares with restrictions as to voting rights should be designated "non-voting shares".

8. Protection of Minorities

It is appreciated that existing legislation does provide protection for the rights of minorities. It is felt, however, that the legal formalities necessary to enforce these rights often prove cumbersome, vexatious and tardy in practice and that there is a case for introducing some simplified procedure whereby minorities may enforce rights more promptly. A system of compulsory arbitration, for example, might be considered, or an extension of the procedure available under Sections 164 and 165 of the 1948 Act.

9. Protection of Special Classes of Shares

It is recommended that Article 4 of Table A, which lays down requirements for a meeting and a quorum where a change or a modification of class rights is proposed, should be made binding on all companies by being included as a section of the Act.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders*

There is a case for re-examination of the position of nominee holdings on the basis that where the total of holdings through a nominee or nominees on behalf of an individual or group reaches 10 per cent. of the capital of a company, the beneficial owner should be required to declare his interest to the company, and a note to this effect should be put in the Annual Return. Provision should be made for penalties for breach of this requirement by way of total forfeiture of voting rights.

12. Share Transfer and Registration Procedure

This procedure should be simplified.

14. Practice of Carrying on Business Through Associated and Subsidiary Companies

The possibility of requiring companies to disclose names of associated and subsidiary companies in the Annual Report should be examined.

15. Loan Capital

The procedure of the floating charge as applied in English law and practice should be introduced into the law of Scotland.

16. Take-over Bids—Procedure

It is recommended that the proposals contained in "Notes on Amalgamations of British Businesses" recently issued at the suggestion of the Governor of the Bank of England by the Executive Committee of the Issuing Houses Association in co-operation with the Accepting Houses Committee, the Association of Investment Trusts, the British Insurance Association, the Committee of London Clearing Bankers and The Stock Exchange, London, should receive some official endorsement as it is appreciated it would be difficult to codify them in actual legislation.

20. Purchase by a Company of its Own Shares

No recommendation is made on the general provisions in this regard, but the observation is recorded that the fines under section 54 of the 1948 Act, which deals with offences under this heading, are inadequate. In this connection the point is made, *obiter*, that penalties under the Act in some cases are inadequate in modern conditions.

21. Accounts

General

It is recommended that a new Act should require that fuller information should be given as to the amount and value of investments in "Associated Companies". For this purpose an "Associated Company" would be defined as one in which more than, say, 20 per cent. of the equity was held.

(d) Description of reserves

The term "reserves" is believed to be open to misinterpretation by the lay mind which tends to envisage that items so described are held in cash. It is suggested that consideration should be given to some alternative nomenclature which would more readily suggest the true nature of the fund.

22. Audit

(b) Duties and responsibilities of auditors

A suggestion that a time limit should be prescribed for the completion of audited accounts by private companies was considered, but no change in the present law is recommended.

(c) Exempt private companies

The privilege which exempt private companies enjoy of not requiring to have a professional audit should, for the greater protection of shareholders, be abolished. All companies, including exempt private companies which are actually trading, should be required to have their annual accounts audited by an auditor who is a member of a professional body approved by the Board of Trade for the purpose of conducting audits under the Companies Act.

23. Provisions as to Returns

On the liquidation of a company certain returns require to be made to the Registrar. It is understood that such returns are sometimes not made timeously and that the position of creditors and other interested parties is prejudiced by the lack of information called for in these returns. There appear to be no adequate sanctions for the enforcement of the regulations which themselves are adequate. It is recommended that power should be given to third parties with an interest to initiate enforcement proceedings to compel the submission of returns required under the Act.

24. Company and Business Names

Special treatment for word "bank"

The opinion is expressed that the use of the name "bank" may sometimes mislead inexperienced members of the public who associate the name with institutions such as the joint stock banks and the savings banks. It is recommended that the words "bank", "bankers" and "banking" should be specially protected and their use in a business name only allowed with the permission of the Board of Trade.

Publication of code of principles regarding the use of certain words

It is difficult to understand the principles which the Registrars of Companies and of Business Names follow in their approval or rejection of certain words for incorporation in business names. It is suggested that the Registrars should produce a short code describing the principles on which the use of certain words is permitted or refused, such as "national", "Scottish", "highland", etc.

The provisions of section 201 of the Companies Act regarding publication of names of directors should be more strictly observed and should apply to companies incorporated prior to 1916.

26. Management and Administration

(b) Mode of passing extraordinary and special resolutions

The distinction between extraordinary and special resolutions should be abolished. The period of notice in both cases should be twenty-one days.

The typewriting of resolutions of all private companies (except subsidiaries of public companies) should be permitted.

(c) Securing proper disclosure of information in circulars seeking proxy votes

Provisions should be made that where proxy votes are sought a circular giving full and adequate information and a two-way proxy should be sent to shareholders.

27. Winding-up

Appointment of Receiver

It is recommended that the procedure for the appointment of a Receiver in the case of companies in difficulties as an alternative to liquidation should be applied to Scotland also. It is further recommended that an application to the Court for liquidation by a creditor (as distinct from a security holder) should have as an alternative plea the appointment of a Receiver. At present a creditor can petition only for liquidation.

Appointment of Provisional Liquidator

Doubt is expressed about the equity of the present requirements for the appointment of a Provisional Liquidator. At present a petition may be presented and a provisional appointment made (subject to caution) without notice to the company which is the subject of the order. It is recommended that consideration should be given as to whether there should be a requirement for a short period of notice—say forty-eight hours—to the company concerned.

Submission of returns in liquidations

It is anomalous that in a voluntary liquidation the liquidator should be required to submit annual returns and to hold certain meetings whereas under a compulsory liquidation this is not so. It is considered that the requirements for annual returns, meetings, etc., in compulsory liquidations should be on the same basis as in voluntary liquidations.

April, 1960.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee

THIRTEENTH DAY

Friday, 3rd February, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MRS. M. NAYLOR (*Questions 4421 to 4640
only*)

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. R. SMYTH (*Questions 4421 to 4767
only*)

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. P. J. SYKES and MR. T. D. D. DIVINE *called and examined*

4421. *Chairman:* Mr. Sykes and Mr. Divine, for the purposes of the record, you are barristers-at-law, and are here as representing the special committee set up by the General Council of the Bar to prepare the written evidence which this Committee now has before it?—*Mr. Sykes:* Yes, my Lord.

4422. Your special committee has produced a very interesting memorandum raising a number of points, including a number of drafting points, and as to those I would say that at this stage this Committee would not be disposed to go word by word through the drafts, although they are always valuable for the purposes of showing how the ideas put forward might be worded.

The first of your points is the question of *ultra vires*, which has been much debated before this Committee and, as I understand it, your scheme is not to abolish the *ultra vires* rule, but to provide protection for a person who acts in reliance on some act or thing done by the company which, to put it rather loosely, to all

appearances was validly and properly done.—Yes, my Lord.

4423. So it is a kind of estoppel?—Yes, I think that would really be a fair way of looking at it. Of course, in a sense it would seem to be logical to do it that way, but I think a sort of estoppel, as your Lordship has said, would be the correct view.

4424. On this question I would like to ask Mr. Scott to put some points.

Mr. Scott: May we deal first with the position of third parties? You do agree, do you not, with paragraph 12 of the Cohen Committee's Report which you quote in your memorandum, in which the view is expressed that the rule is often a pitfall to third parties?—Yes, certainly.

4425. And you quote the case of *Jon Beauforte* as an illustration of that?—Mr. Scott, may I say this—but perhaps I should address this to the Chairman—that if Mr. Divine dissents from anything I say, it would be appropriate, I apprehend, that he should say so at the time

rather than doing it piecemeal. Certainly there will be points later, but not perhaps at the moment, when Mr. Divine and I will disagree very violently.

4426. So far as third parties are concerned it is probable, is it not, that the rule was not originally designed to protect third parties? I suppose the theory could be that the third party was able safely to deal with a company, let us say, carrying on a gold mining business, because he knew that its assets could not be dissipated in some highly speculative venture outside its memorandum. Is that possibly the underlying thought as to how the third party might be protected by the *ultra vires* rule?—That may be, Mr. Scott. My own guess would be that really it was originally rather directed to protecting the shareholders from the directors embarking on some totally alien operation. I would very much doubt, although this must be a guess, whether in the early days the question of the creditors was ever really thought of.

Mr. Divine: I agree.

4427. At any rate, the present practice of drafting memoranda of association in wide terms so as to include a large number of somewhat improbable objects sometimes, usually providing that each object is to be construed separately, has largely defeated the original idea, whatever it may have been?—Mr. Sykes: Yes, I would agree, notwithstanding the protest of, I think, Lord Wrenbury in 1917 about confusing powers and objects.

4428. It is almost impossible to distinguish them sometimes; they overlap. As the Chairman has said, you do not recommend the complete abolition of *ultra vires* as far as third parties are concerned? You recommend that third parties should still be affected by the rule, if they had actual as opposed to constructive notice that a transaction was not authorised?—Yes.

4429. And you recommend that so far as notice to a third party derived from the memorandum of association is concerned, nothing short of actual knowledge of express prohibition in the memorandum should constitute notice?—Yes, we do.

4430. That would be a most unusual provision to find in a memorandum of

association, would it not, and presumably it would only be put in in special circumstances, relating to a particular activity? You could hardly have a list of things that a company may not do, as opposed to a list of things it may do?—I would agree, but the only case that occurs to me might be the memorandum of an investment holding company which might say, and I think sometimes it does, that the company shall not deal in land, or words to that effect. That is the only express prohibition that I can think of, or that I know of.

4431. Chairman: In family trusts one used to find a prohibition in the clauses against investing in land in Ireland. I suppose an investment company conceivably might have a similar prohibition?—Yes, it might, my Lord. I have never seen one but obviously that could be so. I have seen this kind of thing in investment holding companies, prohibitions against investing in shares and securities of companies registered in particular places, or other than companies registered in, possibly sometimes, a fairly narrow area.

4432. Those would be restrictions imposed on the board for the benefit of shareholders. It is rather difficult to see how the example you have just mentioned could affect a third party. For instance, if a company is debarred from investing in a certain range of investments, if they instructed their brokers to buy something outside the range, would you suggest that the brokers would be affected by notice?—I would not suggest that—but perhaps you ought to direct your question to Mr. Althaus! I would, however, have thought not. I would have thought the brokers should be allowed to carry on without regard to the contents of the memorandum.

4433. Mr. Scott: Could a restriction in a memorandum of association really be a very effective means of notice to a third party?—It would be effective, would it not, if he read it. Our recommendation, as I understand it, is only if he has express notice of it.

4434. Do you think there might often be difficulty in establishing whether or not a third party had express notice, whether in the memorandum or otherwise?—Frankly, I do.

4435. I think in the case of *Jon Beauforte* the supplier of coke had actual notice that the coke was being supplied for *ultra vires* purposes, because the note-paper and correspondence referred to the panel and veneer business?—That accords with my recollection.

Mr. Divine: Yes, that is so.

4436. And that was deemed to constitute actual notice?—*Mr. Sykes:* Yes.

4437. As opposed to the constructive notice which the third party also had, under the memorandum of association?—Yes.

4438. What would you suggest should be the result, if it is only during the course of a transaction that the third party becomes aware of the fact that the transaction is an unauthorised one? For instance, supposing the contract has been signed, and perhaps partly performed; is the contract then to continue as a valid one, or must it be terminated forthwith and the third party left to his remedy in damages?—I would say, personally, once the contract had been entered into, assuming it was a hindering one, *prima facie* that it should go on. It would be too late, as it were, then to stop it.

4439. And if the shareholders subsequently learnt of it, they would have no remedy to stop that particular one?—But they would, under our suggestion, have a remedy against the directors.

4440. I was dealing just with the position of the third party. If a third party happened also to be a shareholder in the company concerned, would you say that he would be deemed to have had actual notice of the contents of the memorandum?—I think the authorities go to that length at the moment, as far as I remember, that a shareholder is deemed to have notice of the whole of the constitution. Is that right, Mr. Divine?

Mr. Divine: Yes, but under our proposal if he had not got actual notice he would be protected.

4441. You would not suggest that a shareholder should be regarded as having actual notice of the contents of the memorandum simply because he was a shareholder: so that if a shareholder

contracts with a company, he is not to be fixed, as it were, with notice of the memorandum merely because he is a shareholder also?—*Mr. Sykes:* No.

4442. Your view is, is it not, that the rule as illustrated in the *Jon Beauforte* case sometimes works considerable hardship?—Yes.

4443. Would you see, in fact, any objection to the total abolition of the rule in favour of any person, whether a shareholder or not, who enters into a contract with a company? Quite a lot of evidence submitted to us has pointed to that, and indeed it was in accordance with the recommendations of the Cohen Committee.—A total abolition of the *ultra vires* rule?

4444. Yes, in favour of third parties?—I personally am rather against it, because I feel there should be some limitation, really, on what the company may indulge in. I mean, if it has a completely free hand as regards third parties, one does not know, in some cases, to what lengths the directors might go in business operations which really they should not.

4445. Possibly they should not from the point of view of the shareholders, but if they entered into a contract with a third party, especially in view of the very wide terms in which articles of association are normally drawn, is it right that that third party should be, as it were, put on his guard? Once the principle that he is affected by notice is admitted, one always gets the difficult case of whether he had or had not had notice, or whether it is incumbent upon him to make a few enquiries. I am trying to see whether, in fact, there is any real objection to the complete abolition of the rule insofar as third parties are concerned?—I can only say that my personal view is that I feel it might open the door somewhat wide and, as it were, encourage directors to indulge in operations which, as I say, are beyond their powers, as against the shareholders if you please, and that I would have thought that a thing not to be encouraged.

Mr. Divine: I would not agree there. I think it would be a very good thing to

get rid of the doctrine altogether so far as third parties are concerned. The difficulty, I feel, is that indicated in our memorandum, that if something which is *ultra vires* is an internal matter in the company that must be in the constitution, and the third party must not only know but must be deemed to know that the directors have no power to do it, just as if it was something in the articles that limited the powers of the directors; so then you are back where you started unless you can, as it were, put a handage by statute over the eyes of the third party and say he is not to be deemed to know. That is why we suggested that there should be a provision put in to that effect. One cannot, however, simply sweep the *ultra vires* doctrine as regards third parties away without it creeping in again at the back door, so to speak, and then you are back where you were.

4446. There is an analogy, is there not, in the case of limitation of borrowing powers, for example, where it is said that no third party dealing with the company should be concerned to see whether the limit has been exceeded?—*Mr. Sykes*: That is in the articles, yes.

4447. Also the articles may impose a limit on directors' powers. Is that not a sort of analogy? Could one not introduce the same thought, that you can, as it were, put a bandage by statute over the eyes of the third party so that he is not concerned, and it is purely an internal arrangement. As, indeed, third parties do not need to seek to see the resolution by which a managing director was appointed and therefore authorised to sign a contract. There are similar points, are there not, where a third party is not concerned to go behind and look at the regulations of the company? This would be perhaps a bit more extreme.—But if it could be worked out, I should be in favour of it.

4448. Good. Now we will just consider the question of the position of shareholders. Your suggestion is that they should have the right to restrict the directors' power to carry out transactions beyond the range specified in the memorandum, but that such a restriction should be, largely at any rate, an internal one. You suggest that members should have

power by special resolution to widen the powers of the company, and presumably to ratify any transaction that had been entered into, before which it was unauthorised at that time. But the rights of the minority who disagree should be increased, so that the holders of 5 per cent. instead of 15 per cent. as at present, should be entitled to apply to the Court to quash an alteration of objects?—Yes.

4449. Normally the Court would not interfere with any resolution which had been passed, unless some fraud or injustice had been imposed on the minority. Is that right?—Yes.

4450. Is there any particular reason for saying that in the case of a special resolution altering the company's objects the minority should be able to apply to the Court to annul it?—On the section as it stands, which I regard as quite fatuous, if I may say so—yes, and for this reason: I would apprehend that if an appropriate minority applied to the Court under section 5, unless the company could satisfy the Court that the proposed alteration was within the terms of subsection 1, the Court would restrain it.

4451. Yes; that is as section 5 is drafted at present, but if one is considering the topic completely anew, not trammelled by what section 5 already says, would you think it reasonable that a minority should have the right to apply to the Court and to upset a resolution duly passed by the majority, unless there were some fraud?—I would not, but that is on the footing, as I say, that subsection 1 disappears and that the company is given a perfectly free hand to alter its objects.

4452. Yes, that was the basis on which I was framing the question. The Court would never have any reason for granting such an application, would it, because it would always be in wide terms, and only an enabling provision?—No, I would agree—but I can think of one exception, if a misleading circular, for instance, was sent out, or something of that kind. Broadly speaking, however, I would say no.

4453. There could be circumstances but, as you say, they would have to be something rather special?—Yes.

Mr. Divine: Is it not something historical? You had originally to get the sanction of the Court to alter your memorandum, then that was done away with and the shareholders were given the right to alter it. You were put back in the position in which we were before the Act. You had to satisfy the Court, and the Court refused an alteration or allowed it, before. Then the shareholder could do the same, and it did not necessarily apply to a minority. I think the Court would look at it as if it had been an application by the company before the 1948 Act, and sometimes they would turn the company down, but not very often.

4454. It is hard to say, if one widens section 5 in the way I have suggested, why the Court should ever feel it was trammelled by a past attitude to this problem, and why they should not take the view that the majority knows best.—I think, in practice, they probably would.

4455. *Chairman:* The preference shareholders would be concerned to see that a good, conservative business was going on, whereas the ordinary shareholders might like to have a flutter?—Yes.

4456. Then you would agree, would you not, that the preference shareholders would have a distinct interest to oppose that?—Yes.

4457. *Mr. Richardson:* It might be a suitable case for taking separate class votes?—*Mr. Sykes:* On the other hand, would it not be right that the shareholders have taken their shares on the footing of what is in the memorandum and articles and, at any rate after the new Act, on the footing of what is in the new Act. Why should they complain? I agree that as regards the preference shareholders, before 1962—that might be so, but need we, and would it be right to, look backward to that extent?

4458. *Mr. Scott:* Would it not be possible to include as one of the special rights of preference shareholders, such as they have nowadays—for example a separate right to vote on a proposal to reduce capital, or to alter the rights of the preference shareholders—a separate class vote on any change of the articles or the memorandum of the company.—That, with respect, I would say appeals to

me very much. I should have thought there was much to be said for requiring, in the light of what Lord Jenkins has indicated, in those circumstances the separate vote of every class if you are proposing to alter the objects clause in your memorandum. The rights are various; you could not legislate for any particular rights, but you might have a deferred share, which might have a particular objection to an alteration in the memorandum. I should therefore have thought that there might be much to be said for having a class veto for each class.

Mr. Divine: I would be rather against complicating things in that way. I do not, myself, attach very much attention to the importance of altering the articles and memorandum. It is done very often, and I think no harm can come by leaving the company free to alter by special resolution. I would not clutter it up with questions of class veto.

4459. I suppose in some cases it could be quite important.—Of course, we have had a lot of rubber companies turning into property companies overnight!

4460. *Sir George Erskine:* Do you suggest, Mr. Sykes, that in such a case a meeting of each class would be required by statute?—*Mr. Sykes:* That is what occurred to me, in the light of what Mr. Scott has said.

4461. *Mr. Scott:* Could we turn now to subsidiary companies? If a company carrying on, say, a furniture manufacturing business today, buys another company carrying on the same type of business but which has a more imaginative memorandum of association, authorising various other activities—for example, building—do you think the directors of the parent company should be prevented, so far as the shareholders are concerned, from allowing that newly acquired subsidiary to carry on this additional business, beyond anything that is authorised by the parent company's memorandum?—No, I certainly do not. If it acquires some subsidiary lawfully under its own objects, I cannot see why, and I gather this is the suggestion, it should not allow the subsidiary to carry on any business within the subsidiary's objects.

4462. Would you suggest it should be allowed to procure the formation of a company itself, having wider powers?—If it is within its powers to promote companies and sell its undertaking to them, and so on, I would say yes.

4463. Of course, that is an indirect way of a company widening the objects beyond those in its own memorandum, by forming itself, as it were, into a group and allowing other constituent members to have wider powers.—I agree.

4464. *Mr. Brown*: On that view, is it worth bothering to have restrictions in the memorandum?—I agree there is a good deal to be said for that, of course, but I think one should bear in mind what is so often overlooked today, in my view, which is that each company is a separate one. But I agree, of course, that is an easy way of getting round the restriction. I should, however, not have thought it would have been practicable, anyway, to make the sort of restriction suggested by *Mr. Scott's* original question.

Mr. Divine: No, I do not think so.

4465. *Mr. Scott*: I am interested in that answer and, in fact, if I may say so, I share that view. It does in fact, however, open a fairly wide door, does it not, to the evasion of restrictions in the memorandum or articles?—*Mr. Sykes*: Yes, it does.

4466. Allied to the question of *ultra vires*, and a change in the company's activities, many witnesses have suggested that there should be no fundamental change in the company's activities, even if the new proposed activity, either by foresight or good luck, is in fact included in the memorandum of association, without the previous sanction of the shareholders. Of course, it is easy to recognise the more extreme type of change in activities, but changes may occur gradually over a period of years. For instance, in the case of a company manufacturing, say, steam locomotives, that company may take in a new invention. The demand for steam locomotives falls away, and the new invention proves to be important and valuable and it gradually assumes the greater part of the company's business. Looking back on it, you then can say that the company had fundamentally changed

its business in the last five years. But do you in fact think there should be any compulsory requirement that a fundamental change—or, indeed, any change—in the company's activities should be approved by the shareholders?—I do not. In the first place, I do not think it would be practicable. I should be sorry for anyone trying to draft a section which tried to do it. Secondly, it would seem to be quite wrong because as long as the powers of the company or of the management of the company are delegated to the board, in my view they should be allowed to continue to exercise those powers unfettered, unless by an appropriate resolution. It would have to be a special resolution forbidding them to do it, and I can envisage the sort of difficulty which *Mr. Scott* has put forward of a gradual change in circumstances. I might put forward another case which occurred to me last night. Suppose one has a company manufacturing something on a particular type of machine, and then, owing to some quite revolutionary discovery in, let us say, electronics, it becomes possible to use those machines for doing something entirely different. I do not see why, in that sort of case, which might be a fundamental change in the activities of the company, the shareholders should be consulted. Surely, too, there is another point, which has just occurred to me—one knows in many of these things, or one is told at any rate and one accepts it, and I am sure *Mr. Scott* has heard the same thing—that it may be a matter of great and utmost secrecy. Suppose a company wants to go and buy something, some secret process or something, and some other person is thought to be after it. Are the directors not to be able to acquire that secret process because they first of all have to go to the shareholders—then *Mr. X* comes in and says, "Oh yes, I'm going to get that; I'll offer another £1,000."

4467. And, of course, supplementary to that, if the directors seek the consent of the shareholders they must necessarily tell them the full and complete story, otherwise the vote is useless anyway.—Yes, and I have known many cases where the proposing vendor simply would not negotiate unless it was secret—that is another facet of it—until it was finished and complete.

4468. So, on that aspect, your recommendation is that there should be no change in the law so as to impose an obligation on the directors to get consent?

—Yes, that is so. Perhaps I should add that, of course, not all the questions that have been or will be put to us have been discussed by our committee, and Mr. Divine and I must to some extent be expressing our personal views when, for instance, we are asked a question like that—which I do not think was discussed by the Bar Council Committee.

Mr. Divine: That is quite correct.

4469. I did think it was connected with *ultra vires*; that is why I mentioned it.—

Mr. Sykes: Yes, of course. We are very happy to answer any questions we can, but I thought I ought to make that point clear.

4470. *Mr. Bingen:* Can you see anything inconsistent between the new Companies Act providing that the company should have all powers to get over all these problems of *ultra vires*, yet at the same time providing that there should be no fundamental change in the main activities for the time being actually carried on by a company without that being referred to the shareholders and approved in general terms?—I would have thought it was, in a sense, inconsistent. One, of course, is dealing with the general powers of the company and the other with the powers of management of the board.

4471. I was starting from the assumption that memoranda are now so wide that in point of fact most companies can do anything. On the other hand, there is clearly a demand by some people for more shareholder control, where the company is really changing its existing business. I am wondering whether you could not reconcile these two points of view by giving companies all the powers of a natural person as a matter of practice and yet require in the new Act that directors must not make fundamental changes without the shareholders' consent.—Yes, but I think my answer to that really is that it lies in what I have said to Mr. Scott. I do not believe myself the shareholders ought to have that right to interfere in that way. Does that answer your question?

4472. I wondered if you saw anything inconsistent between having those two sorts of variables, or two approaches.—No, I would not have thought there was anything inconsistent, because as I said, I think they are two quite different things. One is the powers of management, and one what might be called the general objects of a company.

Mr. Divine: I agree.

4473. *Sir George Erskine:* As regards what we call express notice, if as a prudent person I was going to enter into a contract with a company and before I did so I asked for its memorandum and articles of association, does that in fact give me express notice? If it does, am I better not to ask for it?—*Mr. Sykes:* Well, I think really that is dealt with in paragraph 2 of our memorandum on section 5. It says that a person shall not be deemed to have had express notice that an act or thing was not within the powers of the company merely by reason of the fact that he was aware of some provision of the memorandum of association, unless it expressly prohibited the doing by the company of such act or thing. But you were asking whether you would be better not to ask for it; I would have said yes. It may be that that discloses some possible defect in the recommendation, but that would be my frank answer which I should give if you were with me at a conference, at any rate.

4474. *Chairman:* The outcome, really, of this discussion on *ultra vires* is that in your view the rule should not be abolished altogether, but that there should be protection for a third party dealing with the company in good faith, provided he has no express notice of the *ultra vires* quality of the act, and he is not to be fixed with notice by anything short of an express prohibition in the memorandum.—Yes, my Lord. I would add one short comment, if I may, that occurred to me in the light of something Mr. Bingen said. If, of course, companies were given all the powers of a natural person, perhaps I might remind the Committee that that would go even further than a chartered company because, as the Committee will be well aware, as in the case of *Jenkins v. The Pharmaceutical Society of Great Britain*, there are circumstances in

which members of chartered companies, notwithstanding the fact that they have all the powers of a natural person, can interfere. That was a case, you may remember, where the Court did restrain a chartered company from doing a particular thing because there was a risk, if it were done, the Attorney General might apply by *scire facias* to revoke the charter. So I thought I should just make that comment, in view of the fact that obviously the question of giving a company all the powers of a natural person is under consideration, and it would then, I would submit, put them in a rather more favourable position even than a chartered company.

4475. The reference to the company having all the powers of a natural person is a rather picturesque way of describing the position; it must really mean that the company shall have power to enter into any contract—any obligation which a natural person trading on his own account would be able to incur—that sort of thing?—Yes, I would agree hut, as I say, it occurs to me that that would still give the company wider powers perhaps than a chartered company. That might be irrelevant, hut I think I should make that observation, in passing.

4476. I think it is very relevant. If there are no more questions on *ultra vires*, we can pass to the next point in the memorandum, which concerns a very different matter, that of sections 119, 120 and 121 of the Act in regard to dominion registers. You certainly show, I think, that these sections could do with tidying up, hut they obviously bring in rather difficult questions, such as the fiscal effect of any alteration, and questions also of domicile—which I am always sorry to see introduced into any statutory provision. It seems to be the case that there was a similar provision, in 1883 I think, in some special Act about colonial registers. It was taken up in 1908, and in 1929 it assumed something more like its present form, and now we have the 1948 version. I was looking at these sections in Buckley a short time ago, and I noticed that there was a complete dearth of footnotes referring to decided cases. Does that suggest that there has been in fact no trouble over these sections?—I have had grave trouble with it myself, but

that may be purely criticism of myself in that I cannot understand the provisions whenever I am asked to advise on these sections. It takes me days and days and then I am never certain that I have arrived at the right answer. I did come across what seemed to me to be a quite ludicrous position which arises under an Act called, I think, the Federation of Malaya Independence Act. The effect of that, if I construed it rightly—and I hope your Lordship will not think that I was construing it rightly—is that when section 119 refers to His Majesty's Dominions, it does also refer to parts, for instance, of Malaya which quite definitely are not part of His Majesty's Dominions. The section as it now is, unless I have mistakenly construed the Federation of Malaya Independence Act, is wholly misleading to a person who reads it, in the sense that it does apply to one place which is not part of Her Majesty's Dominions.

4477. *Professor Gower*: What is the point of limiting it to the Dominions anyway?—Would it be something to do with fiscal questions?

4478. It might have originally, but it seems a little far-fetched today?—Yes, except that it might be a question of whether one would allow a register to be kept in Timbuctoo, where there was no stamp duty at all, which might encourage a lot of people—this of course is tied up with another recommendation—to go and live in Timbuctoo, or at any rate put their shares in the name of a nominee resident in Timbuctoo. Of course, does it not also depend on the local laws? Here we are sailing in what to me are uncharted waters to a great extent, but I think also this section derives some benefit from the local laws.

4479. *Mr. Mackinnon*: I think section 120, subsection 2, deals with a competent court of jurisdiction, and one could see there might be the question of extending this to an area where the court might be totally unacquainted with the company laws as we know them today.—Oh yes, I see. I am much obliged, Mr. Mackinnon.

4480. *Chairman*: Your recommendation, I think, is that you would substitute "any part or parts of Her Majesty's Dominions" for "any part". That is one suggestion. It would get over the

question whether you can set up a dominion register for Australia by having it in one of the States of the Commonwealth—that kind of difficulty?—Yes.

4481. Then the other point is, as you say, that there is no point in confining the use of the dominion register to people resident in the part of Her Majesty's Dominions where the register is set up, and every member of the company, wherever resident, ought to have a free choice as to where they will be registered.—Yes.

4482. Is that not travelling a long way from the original intention of the enactment?—Yes, it may be; I quite agree. It occurred to me last night also, re-reading this memorandum, whether the references to beneficial interests in our recommendation do not really to some extent cut across the general provision, the general sentiment, of the Companies Act, against recognising anything other than the registered holder.

4483. I do not know that anything very constructive has emerged from this discussion. I think all we can say is that it will be looked into with a view to clarifying some of the obscurities. It may be that other government departments might well have an interest—the Inland Revenue for example. We shall have to proceed with caution on that matter.—Yes, my Lord.

4484. *Sir George Erskine:* Arising out of Professor Gower's question, there is a system in America whereby the shares in a foreign company are not themselves issued but they are represented by one holding on the register and the Americans can deal in these shares without a transfer taking place on the register in London.—That, of course, is true of the United States. But it does mean, does it not, that the nationals of that country have no, as it were, protection from the English register? If there is any trouble, they have to fight it out over there.

4485. *Chairman:* Then we pass on to section 75, which concerns the necessity of having a witness to a transfer of shares, and the incapacity of one spouse to witness another's signature. You say these obstacles to free and convenient transfer should be put an end to?—Yes.

4486. I think that is in fact being dealt with, or has been dealt with, by a special committee on the transfer of securities, and I think you will find that your points will be met as a result of their deliberations.—Thank you, my Lord.

4487. The next one arises under section 129 and the Seventh Schedule, the exempt private company. Your committee has suggested some useful amendments to the terms of the schedule which we have duly noted, but what I think this Committee would like to hear is whether the Bar Council has any views as to the desirability of continuing the exempt private company as a distinct species of company with distinct privileges as to accounts, and so forth.—As regards that, I do not believe it was discussed, and certainly it was not decided. I think it was felt that it was one of those matters which one might call a policy question, whereas the Bar Council was rather more concerned to see, as it were, where the shoe pinches in the present legislation. No doubt if the Committee thought fit the Bar Council Committee could be re-convened to deal with that, or any other, question if you wish. I would, if you would like it, my Lord, give my personal views on that here and now, but if it was felt that it should be referred back to the committee it could be, of course, with pleasure.

4488. I think it would probably be helpful to the Committee if you did give us your personal views so far as you are in a position to do so.—Certainly, my Lord. They may be regarded as heretical, and I must stress they are purely personal views. I am and always have been entirely opposed to the exempt private company. I can see no reason at all why a person who gets the benefit of limited liability should not have to disclose such information as any other company does. After all, it is a privilege to have limited liability, and I personally have always felt that it is definitely wrong that the public who deal or wish to deal, whether on a business basis or in any other way, with such a company should not have available such information as they can get from the published accounts. I am well aware, of course, of the arguments that are put forward on the other side, but that seems to me the overriding consideration, coupled with which, of course, the thing

as it stands at the present, at any rate, is most unsatisfactory, as I think no one can dispute. There is, for instance, the illustration we have given—I have had it in practice more than once—of an exempt private company in which one small shareholder falls out with the board or wants to get rid of his shares. He says—and I have seen letters to this effect—"All right, you buy my shares at £x" (which the other parties at any rate regard as a grossly inflated price) "or, if you do not, tomorrow I am going to execute a transfer of trust in one share in favour of X"—and there the exemption goes. I do not know what Mr. Divine's views are, but that is my personal view, put shortly.

Mr. Divine: I have no views at all about it. I am quite indifferent.

4489. Then I think the next point concerns the statutory meeting which, ever since I remember, people have said was no good, but which always seems to stick. Why is that?—*Mr. Sykes:* Well, I was reading section 130 last night, and I cannot really believe that all those various things that have to be put in the statutory report really tell anyone anything very important. Anyway, there is nothing that the members can do about it if they do not like anything that is in the statutory report, as far as I can see. They can discuss it under subsection 7, and no doubt they might have a very jolly discussion about the abstract of the receipts of the company and the payments, but it would not take them any further, in my submission. It is anyway, as I would stress, ridiculous to have a section which can be and almost invariably is, avoided in practice, and puts people to a little extra trouble to avoid it.

4490. But if it was of any value it would be easy enough to prevent the method of evasion. If there was any value in the section it could be provided that where a company is formed as a private company in the first instance, but with the intention of being converted into a public company, and if it is so converted within a certain time, then it shall be under the obligation of section 130.—Subject to a minor submission that I would make—not with the intention but if in fact within a particular time it is so converted; because intention is not always an easy thing to

prove. But, be that as it may, I would say that really the statutory report does not take anything any further, if I may put it colloquially, if you look at the various things that have to be stated in it.

Mr. Divine: I agree. I do not remember ever seeing a statutory meeting held.

Mr. Sykes: I do not believe, if I may say so—this may show how often it crops up—that until last night I had ever read section 130 through. I do not remember doing so.

Mr. Divine: I do not believe that I have even yet.

4491. There is an idea that, as regards these debatable restrictions on directors' powers, such as on a change in the fundamental nature of activities of a company, it might conceivably be possible to impose any such restrictions by articles in Table A; and it might be possible to say that, whether Table A was adopted or not, the articles of every company should in the first instance include these. Then you might give shareholders, after things had settled down, so to speak, an opportunity, if the directors thought these articles bad, to consider them and remove them by special resolution. For some purpose of that sort conceivably there might be a use for a statutory meeting. Do you think there is any possibility in that? It might be less extreme than putting these provisions in the Act itself, which would make them unalterable.—*Mr. Sykes:* Yes.

4492. But perhaps that is not a fair question?—I have not, I must say, directed my mind to it. I only put myself on record as unalterably, at the moment, opposed to a statutory meeting.

4493. In anything it concerns at present, section 130 is, so to speak, just dead-wood?—Yes.

4494. I see. Then you have points on section 139 and section 141. The first concerns representation of corporations at company meetings, and there you are simply seeking to protect the company by ensuring that the person who represents it is really properly authorised to do so. I do not think there is really any controversy arising on that.—No.

4495. *Mr. Scott:* I see that you want to have 48 hours previous notification in

the case of an authorisation by a company, similar to what is required in the case of an ordinary proxy. That would mean that if a company did not appoint somebody and a meeting was about to take place, say, first thing tomorrow, it could not be represented, as it can today—the difference being, I suppose, that normally that is the way a company is actually present at a meeting; it has a representative there who is the company.—Yes.

4496. It is not perhaps an advantage but it does no harm to anybody that a company should have the right to attend another company's meeting right up to the opening of the doors, and not have to commit itself 48 hours before by having lodged a notice?—I do see the force of that and, speaking for myself, I am very much inclined to, if I may say so, accept it, subject however to the qualification that I should have thought it would be only reasonable that the company which is holding the meeting should have some opportunity of checking up on the credentials of the representative.

4497. And they should accept his vote subject to the scrutiny of his credentials at the meeting—but you would not necessarily say he should be barred from attendance because he had not lodged his credentials 48 hours before?—Not 48 hours before; I am rather resiling from what is said here in the light of what you say.

Mr. Divine: I do not agree; 48 hours is not unreasonable. If a company or corporation, as a member of another company, is not interested enough to appoint representatives and inform the first company more than 48 hours before the meeting, I do not see why it should not be debarred from attending.

4498. The practical result, in my experience, is that it frequently does happen that way, and somebody comes along and asks how they attend the meeting when it is too late for them to have lodged a proxy. If you are going to debar them from voting on that occasion, they will have to say, "Very well, if we have a large vote and are not allowed to use it on this occasion, we shall have to use it to convene another meeting and pass another resolution."

Professor Gower: In a case of proxy, one does say A, whom failing B, whom failing C, so that you have someone in reserve if someone falls sick, for instance. In this sort of resolution, however, you just resolve that Mr. So-and-so should represent the company, and if he fell sick 24 hours before the meeting the company would not be represented.—*Mr. Divine:* But there is no reason why it should not be represented if the resolution appointed A, failing whom B and so on. But our suggestion is that the company is not bound to recognise a representative. There is nothing to prevent the company, if it thinks fit, waiving the requirement.

4499. *Mr. Brown:* My own experience is that there is a board resolution authorising all the people who may represent the company at any meeting, and then they merely send a letter to the other company to that effect.

Mr. Scott: I am aware that it does not always work out like that in practice. Is the case not rather different from that where somebody appoints a proxy. The company can only turn up through an individual, and is it not reasonable that he should be entitled to do so, subject to the point of satisfying the chairman or whoever it is, that he is in fact so authorised?—*Mr. Sykes:* I do not quite agree with Mr. Divine on this. I do not think the analogy of a proxy is quite a correct analogy here. As you suggest, here the company itself is turning up in person, really.

4500. *Chairman:* Unless there is further to be said on that topic, we can turn now to section 159, and the first point is the question of appointing a firm of auditors by firm name. The suggestion is that the appointment should take effect as an appointment of all the members of the firm for the time being?—Yes.

4501. The second point there is the question of the retirement of the auditor, and it is suggested that he should only be able to retire with the sanction of the company in general meeting. That opens up a rather ghastly prospect of the ageing auditor, getting older and older and not being able to throw down his burden unless the company says he can. Is that not rather contrary to principle? I would respectfully agree, but this occurred to me

last night—I would have thought that the matter could be dealt with by some modification. Take the case of an auditor, even if not ageing, who is ill. Can he resign? There might be some provision that with the consent of the Board of Trade he could or should, but I think we all felt on the committee that the auditor being in a very special relationship, in a sense, to the members rather than to the company, he should not just be able to get out of his responsibilities by signing a document.

Chairman: I would like to ask Mr. Lawson to say if anything occurs to him on these two points.

4502. *Mr. Lawson:* The first point, I think, is that you are suggesting, are you not, that one should revert to the position by which the auditor is reappointed each year?—*Mr. Divine:* Yes.

4503. I think you limit it to the firm, but I do not know if there is any particular reason to limit it to firms as against individuals, but in any case that amendment would help with your first point, would it not, about the composition of the firm?—*Mr. Sykes:* Yes, I think it would.

4504. I mean, it is only a risk in one year, if you know what I mean. It might be that one should require that the auditors should advise the company of any changes in the composition of the firm; the fact is, of course, that that is always done.—Yes, quite.

4505. That, I think, would help with your first point?—Yes, I think it would. There is another small point which again occurred to me last night, and that had not occurred to me before. It is merely a drafting question, but I will raise it. With regard to the appointment of a firm by its firm name, of course firms may change their names from time to time. That, I think, is just a drafting matter, but it would need some thought in the drafting.

4506. Your second point, I think, is really more difficult. You see, what happens in practice is that if a firm of auditors for some reason or other is no longer regarded as particularly suitable by the board—and it may not necessarily be any reflection on the firm, but it is thought there should be a change—if

the board go to some other firm with a view to making a change in favour of that firm, there is very little that the existing auditor can do to avoid, in fact, being kicked out.—No.

4507. From the point of view of his professional reputation it is very much better for him to choose a suitable moment to retire, rather than be removed at a general meeting. The sort of thing that happens is that the auditor has been appointed for one year, and he says, "I will complete these accounts, but when I have completed them I will retire and create a casual vacancy", or something of that kind. That is what happens in practice, and I wonder whether there is really any objection to that?—He could, of course, in the case you have mentioned, under section 159, subsection 2 (c) give to the company notice in writing of his unwillingness to be reappointed. That, of course, could be at the annual general meeting.

4508. There are frequently arguments, from the point of view of the auditor as well as from the point of view of the company, whether it is better to create a casual vacancy, and your proposal would, I think, rather prevent that happening.—Yes, it would, I agree—only, as I say, I feel, and I think all the members of the committee felt, that an auditor should not be just free to resign. I would take that view myself, but I would suggest that if it was thought right that an auditor should be allowed expressly to resign, there should be some check on it. I do not say that in any offensive sense of the word, but there should be something, possibly the consent of the Board of Trade, if not the approval of the company in general meeting.

4509. The difficulty is where the auditor finds that the directors have been doing something of which he disapproves, and the directors want to get rid of him. Mr. Divine knows about this, because he helped us with such a case, I think. We issued from the Institute a very long document dealing with that type of difficult situation, and my recollection is that we did advise that in that type of case auditors should not resign until they had completed their report to the shareholders. They should not just run away

from a difficult situation. It is a question whether one should not try and import that sort of thought into the Act.—Yes.

Professor Gower: That advice was on the basis that an auditor is legally entitled to resign, which we lawyers rather doubt.

Mr. Lawson: It is perhaps desirable that the legal position should be as we have advised, and I suggest there will be complications if you do not allow an auditor to resign.

4510. *Chairman:* What do you do if he does? You could get a mandatory injunction that he goes on with his duties; you could put him in prison for the rest of his life!—Your Lordship means if he just stops acting, as it were? Well, that, of course, would be a misfeasance, would it not? He might conceivably be liable to heavy damages. He is an officer of the company for that purpose.

4511. *Mr. Bingen:* Surely if an auditor finds himself in an impossible position such as Mr. Lawson suggests, he should have the right to resign? He should have the right to resign, and circularise the shareholders, at the risk of a libel action, setting out the reason why he had to resign. Is not that the practical position?

Mr. Lawson: I think in practice the auditor should complete a report in a situation of that kind. The auditor should tell the shareholders that they should not compel him to go on working with a company in which he was unhappy and, having done his job for one year, he wishes to resign.—I am not very clear about this, because that is a thing he can do anyway, can he not, under section 159, subsection 2(c)? He can give the company notice in writing of his unwillingness to be reappointed, and if he is going to make his report for that year, would it not be right that he should go to the annual general meeting—he would be entitled to receive notice of it and attend—and say what he wants to, and say that now he has given notice in writing of his unwillingness to be reappointed, he will tell them why?

4512. I think, possibly, in that case, yes. But there are many other cases, are there not?

Mr. Bingen: Where he may not be able to get sufficient information to complete the accounts. You might get that sort of situation.—I agree.

4513. *Mr. Lumsden:* May I ask why the Bar Council are opposed to the automatic reappointment procedure?—

Mr. Divine: We are not opposed; it arose out of this question of appointments in a firm name, that that should be put on a proper basis, so that you can appoint by a firm name, and what the effect of it is. Then it was thought that if you allow the partners for the time being to be the auditors, then perhaps there ought not to be the automatic reappointment. My personal view is that there should be no difference, that you appoint a firm, as is done in practice, and they are automatically reappointed year by year, as the present practice is. Why should the law not acknowledge the fact and say that the partners for the time being in the firm, however it is composed, from time to time are the auditors? That is my personal view, but the committee did not like the idea of automatic reappointment year by year of a partnership firm, the personnel of which changes over the years. That was their view; I do not share it, personally.

4514. *Professor Gower:* I did have one case in practice where there were two partners, A and B, in a firm of accountants. A and B retired and sold the business to C, of whom the company knew nothing. C claimed that since the auditors had been appointed in the firm name, he was entitled to be reappointed under this provision. We took the view that this was not right and should not be right. I gather that the Bar Council agree with us on that. That is where there does appear to be an objection, to me.—*Mr. Sykes:* I would entirely agree, if I may say so, with Professor Gower. It is indeed in my view quite plain that of the vast majority of persons who call themselves and are called auditors of any company today—the enormous majority just are not the auditors in law, for that very reason. It is the same principle,

whether you sell the business to another person under that name, or whether the the partners have retired, and all gone away.

4515. *Chairman*: I do not think we need take up time on section 184, where you have suggested a drafting amendment to clarify the situation. A rather more important one concerns sections 191, 192 and 193, as regards compensation for loss of office. Your memorandum points out that the references in those sections are to the office of director, and they do not refer to an executive office held with the appointment of director, such as a managing directorship, or something of that kind. You express the view that these sections ought to be made to include such executive offices. That is your suggestion, but it occurs to me that the two things are perhaps rather different. The executive office is usually held, is it not, under some form of service agreement, which will give the director a legal right to receive what is due to him, and if his contract is terminated he will be entitled to compensation representing the residual value of the appointment which is then put an end to. Would it be right to lump that together with the mere office of director, which probably gives no security of tenure at all? Are the two not really rather different? I can see that an *ex gratia* payment to an ex-director ought to be made at the will of the shareholders, but does the same consideration apply to what is due to the man under his contract of service?—It seems to me that what your Lordship is saying, if I may say so with respect, is really covered by section 194, subsection 3, because your Lordship will see from that, that *bona fide* payments by way of damages for breach of contract or by way of pension in respect of past services, which includes superannuation allowance, superannuation gratuity or similar payment, are expressly excluded. So, my Lord, all we had in mind was that if what is being handed over to him is raised over and above what would be *bona fide* damages then to that extent the company in general meeting should express a view about it.

4516. *Professor Gower*: That is the view which is always taken?—Yes.

4517. *Chairman*: But your recommendations did not seem to accord with that view.—I am sorry, my Lord.

4518. *Professor Gower*: Your point was that it was badly drafted: that it did not make it as clear as it ought to have done?—Yes. Our suggestion is not that section 194 (3) should be altered, so that if the alterations we suggest should be made in sections 191, 192 and 193 are made it still would not apply to *bona fide* payments for breach of contract or superannuation payments.

4519. *Chairman*: But subject to that it should apply to all those emoluments?—Yes, to all compensation for loss of office. That is to say, anything over and above what he can genuinely, reasonably and properly get for damages, superannuation or the like, the shareholders ought to know of and approve.

4520. Yes. I think I follow that. You also deal in this part of your report with the destination of sums which a director holds in trust.—Yes.

4521. It seems to me that it is an improvement upon the existing section. Next there is section 209 and you propose a re-draft of the existing section. Perhaps I might begin by asking you this: Mr. Registrar Berkeley gave evidence before us some time ago and he expressed the view that the section 206 procedure was ousting the section 209 procedure and he suggested the abolition of section 209, his theory being that the whole thing can be done by a scheme of arrangement and that it is easier to do it that way because you have only got to get a 75 per cent. majority of the people present and voting at any meeting, whereas under section 209 you have to have the holders of nine-tenths of the shares.—I personally would certainly dissent from Mr. Registrar Berkeley's views. One point occurs to me immediately. There are a great number of comparatively small take-over bids. It would, in my submission, be quite absurd if in every case one should have to go to the Court and incur what is, after all, a great deal of expense and a certain amount of delay (though, perhaps, no more delay than there is under section 209 as it stands at present but one would hope this absurd four-months' period will be done away with). But I would respectfully suggest

that the two sections can run in parallel perfectly well. The section 206 procedure is very useful indeed, in effect, for making a take-over bid. I would have thought a suggestion might be made that section 206 should not be allowed to be applied as a take-over section and I would be prepared to deal with that and say that is quite a wrong view. However, it has not apparently been suggested. For my part I would say sections 209 and 206 can run perfectly happily together and that it would be a great pity to abandon section 209, which is useful. I am not at all sure (but I have not thought about it until this moment) that every take-over bid could necessarily be worked into a scheme under section 206.

Mr. Divine: It could not. Section 209 is very extensively used. But in some cases where two companies are agreeable to a merger by one company taking over the other we found it could be done more quickly, more cheaply and more conveniently by having a scheme under section 206. After we had discovered that, we had quite a few under that section but it is quite mistaken to suggest that that procedure, which is only appropriate in a particular type of case, has in any way ousted section 209. It is used constantly and it is very useful. I agree that there is nothing incompatible between the two sections. They can perfectly well run on together and you use whichever of them is convenient.

4522. Speaking for myself, I would have regarded the opening words of section 206 as hardly appropriate to a simple case of a purchase of shares covered by section 209. It is not an arrangement between the companies and their members or any class of them nor, *prima facie*, is it an arrangement between the companies and their creditors. One might ingeniously work it round into that position but it is not the natural meaning of the words.—*Mr. Sykes:* It is worked around, in order to have a scheme which is that very thing, in this sort of way. In the case of a parent company which holds none of the preference shares of a subsidiary, the preference shares of the parent company being substituted for those in the subsidiary; that is an arrangement between the subsidiary and its members because there is usually a reduction of capital by which

the preference shares in the subsidiary are reduced to nil and the subsidiary company procures the parent company to allot its own preference shares. That is how it comes to be a scheme between the subsidiary and its preference shareholders.

Mr. Divine: Might I add one general comment? We do not need to use section 206 in a case like that. You have a reduction of capital and that is all you ask the Court to sanction. It has the effect, in a sense, of a take-over of the preference capital but it is all domestic within the group of companies, and there is no need to have written offers under section 206.

4523. Yes. I see it has been suggested that the two sets of provisions are inconsistent in as much as in the section 209 case you have got to get nine-tenths of the shareholders accepting it whilst in the other case only a 75 per cent. acceptance by those present and voting is required. It is said that is illogical and inconsistent.

—*Mr. Sykes:* I submit, first of all, that that is not quite accurate and secondly that it is not illogical. The reason why I say it is not quite accurate is because you need under section 206 not only three-quarters of those present and voting but also a majority in number which is, perhaps, not entirely irrelevant. Section 206 in earlier forms has certainly existed since the 1908 Act and I would have thought it perfectly well could go on. I can see nothing anomalous in having a different majority in one section (which may be used for take-over purposes but is also used for a vast majority of other purposes)—that being 206—and section 209 which requires a different majority. If it is said that under section 209 in order compulsorily to acquire the balance you have got to get 90 per cent. and that you do not need anything like that majority under section 206, my answer is that you need three-quarters plus a majority in number. I ignore the proviso in section 209 where some of the shares are already held by the offeror. It is true that it is a lower majority under section 206 but the minority have also got the protection of the Court, a circular approved by the Court before it goes out and a hearing before the Court which any person concerned can attend and, if he is well advised,

he runs little risk of not getting his costs if he does attend.

4524. He always gets them.—I have never known a case where he did not get them. That is quite right. It is right that persons should be encouraged to go to the Courts if they feel they have a grievance, but that is put forward as showing that there are all sorts of protections if the point is made that it is 75 per cent. against 90 per cent. Because of those protections and because anyone can go to Court and say "I do not like this; will you not allow it?" I would say there is no inconsistency and that they should be allowed to exist side by side as they are now. I would say that the Bar Council Committee are all agreed that section 209 really needs a completely fresh start. There is no section I have found which has caused more difficulty and anxiety in construing although, curiously enough, there have not been many cases about it.

Mr. Divine: I agree.

4525. Regarding the majority question in section 209 the transferee would say "What I am putting forward is so reasonable that every shareholder with any sense will accept it". However, he has got to demonstrate that and he has to get a very high majority because he is seeking to expropriate dissentient shareholders, and the onus is thus put upon him to show that what he is proposing is reasonable.—Yes.

4526. And as to the various blemishes in the section it does not seem to me to have been much improved since the 1929 section.—No.

4527. The words in brackets referring to shares "other than shares already held at the date of the offer by, or by a nominee for, the transferee company or its subsidiary" recur several times in the section and it is very difficult, is it not, to see what the meaning is and I should have thought they ought to be left out.—Yes, my Lord, I agree.

Mr. Sykes: I would not have thought Mr. Divine and I could do more than say that Mr. Divine has admirably drafted another suggested section. In principle, however, section 209 is all right but it

needs the most careful and drastic consideration in its drafting.

Mr. Divine: Yes.

Mr. Sykes: Might I add a purely personal point? I read the other day in *The Times*, I think, what amounted to a suggestion that a section 209 (2) notice should, in effect, be given if the prospective purchaser had got 50 per cent. I think your Lordship will agree that I have correctly stated the gist of that suggestion.

4528. I think that suggestion came from Mr. Clore or his legal adviser.—Yes. I have not given much thought to it, my Lord, but I thought it sounded rather a good idea. It struck me that once a purchaser has got 50 per cent. there might be a lot to be said for enabling the minority to get out then and there.

4529. *Chairman:* By compelling the purchaser to buy them out?

Mr. Bingen: That is what he suggested. He did not suggest it should be the other way round.—I mentioned a section 209 (2) notice which gives the minority the option. The holder of under 50 per cent. in a company is not in a frightfully enviable position if 50 per cent. or more is held by one man, and if someone is aiming to get control there is a great deal to be said for a person being able to say "This man has now got 50 per cent. For heaven's sake let me get out while the going's good at the same price".

4530. *Mr. Scott:* Does that only apply to a case where a take-over bid is made for all the shares and not to a case where there is a gradual purchase and one day a person or a company happens to increase its holding from, say, 47 to 51 per cent? —My view is based on the fact that the offeree should be given the express power of compulsorily requiring the offeror under a section 209 offer (which is quite different from buying up to and over 50 per cent. on the market, I would submit) to acquire his shares.

4531. *Chairman:* This has got to be in pursuance of a take-over bid for the lot? —Yes.

4532. And if it succeeds up to 50 per cent. then the remaining 50 per cent. can sell their shares compulsorily to the bidder?—That, as I understood it, was the suggestion.

4533. I think that is right.—And it rather impressed me for that reason.

4534. What you have just told us does make me think that possibly there is more in the suggestion than I had at first thought.—As I told your Lordship, when I read it in *The Times* I was very impressed by it. I do not know whether Mr. Divine has any views about it?

Mr. Divine: No. I have not thought about it.

4535. Then you pointed out the reference to the acquisition of any shares in a company, the scheme contemplating "the transfer of shares or any class of shares in a company". That must mean all the shares in a company and not part only.

—*Mr. Sykes:* I am not absolutely sure about this. It is a point I have often been asked about and I endeavour to give empirical answers when they arise! But it is a frightfully difficult section to construe.

Mr. Divine: Yes, very difficult.

4536. That reference to "the transfer of shares" might apply to a parcel of shares, however small, which could not be right.—*Mr. Sykes:* I would not have thought so but I would not like to commit myself categorically regarding the construction offhand. I know I have been asked the question on more than one occasion (and I have, I think, given your Lordship's answer) but the section is not happily phrased. If your Lordship is asking me whether it should apply so that you can go to Mr. Richardson and Mr. Lawson and acquire their shares as they are two small shareholders my answer would be "Certainly not".

4537. You do not think it ought to apply?—No.

4538. But whether on the true construction of this section it now does apply you say is a different matter?—Yes.

4539. I see. Then you point out that the section ought to deal with beneficial ownership and nothing short of that?—Yes.

4540. I am not quite sure how that works. Would you say the section ought to apply in a case where you get three companies, A, B and C, which have an

arrangement between themselves involving the acquisition of the shares of another company, D, and it is agreed that company A shall act for the purpose of acquiring shares under section 209 and that they shall afterwards be divided up in some way? Would you say that would be within this section or ought to be within a section of this sort?—I personally should have thought it ought to be one purchaser and one alone. Mr. Divine may take a different view. I do not know whether I have very strong views about it but I would not have thought, perhaps, that it was quite right for a statute to allow one consortium to gang up (I use the word in no offensive sense) against a particular company and to make an assault on that one company.

4541. *Mr. Scott:* They could form a company for the purpose and do it indirectly.—Yes.

4542. Does anyone achieve anything by making them do it indirectly?—If they had to do it indirectly the subsidiary would become the beneficial owner and it would probably involve a good deal more expenditure.

4543. *Chairman:* Most of the discussions on this question, so far as this Committee is concerned, have been directed rather to disclosure of the true beneficial interests of the people concerned in the bid than to limiting the people who can operate the section.—Yes.

4544. So if the bidder is acting for a whole chain of nominees that is all right so long as he comes out into the open and says "These are the true bidders".—Yes, but what occurs to me is this: I should have thought the object of this section would be to enable the shares in a particular company to be got under one hat; under the sort of thing we are now discussing they might be got under three hats and I am not sure that really that is quite right. I do not know whether there is any logic in that remark but there is a feeling that the statute might well say—and it does say so at the moment, certainly—that one company can acquire the shares of another. But why should it go on and extend that to say, in effect, that three companies can?

4545. Three companies jointly?—Yes.

4546. I agree you could not have three companies bidding each to buy one-third or one-third of 90 per cent. That would not be right.—No.

4547. But I am not sure when you come to this question of beneficial ownership whether the bidder is always acquiring the beneficial ownership. Nothing is left vested in the shareholders of the transferor company and what the transferee does with the beneficial interest when he has got it might possibly be regarded, it seems to me, as nothing very material.—I think it is very often correct to say the bidder himself never acquires the beneficial interest. He very often, in fact, is doing it for someone else. Not very often, perhaps, but sometimes he does so. Would you agree, Mr. Divine?

Mr. Divine: Yes.

Mr. Sykes: He takes the beneficial interest away from the shareholder but very often he does not—both Mr. Divine and I know—in fact, get it for himself.

4548. Mr. Lumsden: How is one going to trace the beneficial interest of the bidder? Any company bidding for the shares of another is acquiring the beneficial interest for itself but, you may say, the beneficial interest in that bidding company belongs to its shareholders. There may be 50,000 shareholders but equally there may be only two people who are shareholders. Would you say those two people are the beneficial owners as opposed to the company which is bidding?—No. I was brought up on *Salomon v. Salomon*, which says the company is the beneficial owner of the shares because it has a separate entity from its shareholders.

4549. Does it not follow that the bidding company is therefore in all cases acquiring the beneficial ownership as beneficial owner?—No, because in the sort of case I was suggesting it is so very often arranged with some other company that it will get it for them. That is the sort of case I had in mind. It is not disclosed to anyone at the time except to the legal advisers.

Mr. Divine: I have had a case where the bidding company was acting for a syndicate of American companies. And if you allow any number of companies to bid why not allow individuals to bid?

Why should not the section say that if a person makes an offer for the shares of another company and 90 per cent. of the shareholders accept he can acquire the balance compulsorily unless, as Mr. Sykes and I think, the original intention was to deal with the case of one company acquiring the shares of another.

4550. Mr. Bingen: That approach does not go to the root of section 209, compulsory acquisition, where you have got to have 90 per cent. acceptance but to the sort of things you ought to disclose when making a take-over bid?—Yes.

Mr. Sykes: May I add another point which has occurred to me as to whether one company or more could join in under section 209. I have always thought section 209 is somewhat parallel with section 55 of the Finance Act, 1927, which was intended to give relief from capital duty and *ad valorem* transfer duty upon amalgamations and reconstructions. I would have thought the real point of section 209 is parallel with that and that it is there to facilitate amalgamations and reconstructions; and is it doing so if three or four or more companies can join in as offerors?

4551. Mr. Mackinnon: You suggest the section ought to start with the words "Whether for the purpose of reconstruction or amalgamation . . ."—I do not think I would do that myself because I very much doubt whether they are apt words. But I would agree with your suggestion in principle—that they might be linked to the same kind of thing.

4552. Professor Gower: If you read the Greene Report it seems that they intended section 209 (1) to operate in that sort of amalgamation—hence the limitation to acquisitions by companies. But section 209 (2) is different. There is no reason why a minority should not have the opportunity of getting out even though it is an individual who is bidding and not a company. It is an unlikely eventuality but I would have thought the same principle would apply, whereas section 209 (1) should perhaps be restricted to a case where one company is taking over another.

4553. Chairman: This particular group of sections of the Act has the sub-title "Arrangements and Reconstructions".—Yes, it has.

4554. This is intended to be machinery to give effect to arrangements or reconstructions and is designed to prevent a small minority from being unreasonable. In the Greene Report it was referred to as oppression of the majority by the minority. —Yes, I appreciate that. I had not looked at the sub-heading.

4555. Do you say that in the case under section 209 where more than one-tenth is already held by the transferee it should be necessary to get a three-quarters majority as well as the proper proportion of the shares?—I would say it is intended to give additional protection where the purchaser or offeror is already in the company but why it should, as a matter of logic, I do not know.

Mr. Divine: I have never understood why.

4556. I think that about exhausts the matter for the moment. It is quite clear that the section needs a very careful and thorough redrafting.—*Mr. Sykes:* Yes.

4557. *Mr. Richardson:* If a suggestion on the lines of the suggestion made by Mr. Clore were adopted, that in the case of a 51 per cent. or greater holding the minority should have the chance of getting out on the terms of the take-over offer, do you think a person selling his shares to the transferee company on that basis should be counted in the 90 per cent., if 90 per cent. were required in that way? —Yes, I think they should, Mr. Richardson, although it had not occurred to me until this moment. That is an off-the-cuff answer but I would have thought that because they have done it voluntarily that must be so.

Mr. Divine: If it follows subsection (2) as at present they can apply to be taken over on those terms or upon better terms. If they stick out for better terms and get them they have not approved of the original offer and they would not be counted in the 90 per cent.

Mr. Richardson: That is why I was careful to say if they accepted it on the same terms as the offer.

4558. *Professor Gower:* Assuming that section 209 (1) operated, that the dissenter appeals to the Court and the Court decides the terms are not fair and that

the shares should be taken over on slightly different terms, do you think the section should provide some means whereby the people who have sold out on the old terms should be able to take advantage of the new terms which the Court has said are fairer?—*Mr. Sykes:* In my opinion the Court cannot do that. I do not know what Mr. Divine's view is. The wording of subsections (1) and (2) of section 209 are surprisingly different. I have always taken the view that in section 209 (1) "unless the Court thinks fit to order otherwise" means that the Court can say "No you don't" or "Yes, you do". That is the view I have always taken.

Mr. Divine: I think it has been so held.

4559. *Mr. Richardson:* And it could be a reason for altering the concluding words of section 209 (2).—*Mr. Sykes:* Yes, I do not quite see why they should be different.

4560. *Professor Gower:* Which one is right?—Section 209 (1), I think. I really do not see why the burden should be put upon the Court. It is a burden which I imagine the Court would be very unwilling to accept, the burden of deciding what the terms should be. It would have to have a mass of material before it.

4561. The man obviously ought to be bought out. If someone has acquired 90 per cent. he ought to have redress and be able to get out, not necessarily on the terms which the other people have accepted as the Court may think they are unfair.—Yes, I do see the force of that.

4562. *Chairman:* The next one which I have noted is section 54. I do not think there is much we can do about that this morning.—No.

4563. I expect you both share the general view that it is a section which might well be clarified.—It might well be clarified and I would say if it is going to be of any force or effect it should also be strengthened.

4564. By increasing the penalty?—Yes.

4565. *Mr. Mackinnon:* Do you really feel the section ought to be retained? I do not know what your views about this are.—I personally think so but I think

Mr. Divine takes the opposite view. I think it is quite wrong that a person should be able to buy shares in a company and use its assets for paying for those shares. It seems to me to be wrong in principle and Mr. Divine and I know—and I am sure you know, too—that it is a thing which is very frequently done. Section 54 is very often completely ignored. Assuming as a matter of principle that it is decided it should be there it should have real teeth in it. I also agree it is not very easy to construe the words "in connection with" in subsection (1). I myself have arrived at a view which I regard as satisfactory, and no doubt Mr. Divine has, but no doubt it should be clarified.

4566. *Sir George Erskine*: Would there not have to be some time limit to it?—You mean, Sir George, in the sense of imposing a permanent end to it?

4567. Yes.—I would certainly agree with that because there might well be a case where other methods of financing were in view and that they had fallen through. Then I would say that if it was not the method of financing which everyone had in mind at the time the purchase was made it should be all right. I would say, regarding the construction of the section as it stands, that it is all right and I think Mr. Divine agrees upon that.

Mr. Divine: Yes.

Mr. Sykes: But if it is very seriously in contemplation at the time of the purchase broadly speaking I say it is "in connection with" and I agree that there should be a time limit.

4568. *Mr. Scott*: If you are going to strengthen it, and you have suggested a £1,000 fine or six months' imprisonment, presumably that is a section which in that case should be clearly expressed in its terms so that people know what is required?—Yes.

4569. Do you think, if Company A buys Company B for cash and borrows money for the purpose and, getting Company B in its possession, makes Company B pay a dividend out of its profits to Company A which applies the money to repaying the overdraft, that the funds of Company B have been wrongfully applied for the purchase of its

shares?—No. My personal view is that they have not. The dividend has gone out and it has ceased to be the funds of Company B. They are then the absolute property of Company A.

4570. But you would not allow it to lend money in advance of paying a dividend?—No, that is a different thing.

4571. That would involve a £1,000 fine?—Yes.

4572. Suppose Company A makes an offer to acquire the shares of Company B and says to the shareholders "If you do not like our offer the hanking house will buy them from you for £x" and the company pays a commission to that hanking house for undertaking to buy such shares. Do you think that would be wrong? It frequently happens in practice, only they do it the other way round. However, the effect is just the same.—Is that so? I am not sure I quite follow that. Is not that paying a commission for the purchase of its own shares?

4573. It is framed so that they can disguise it as being a payment for another company's shares so as to make them available to the principal company, but it is only done that way in order to avoid contravening section 54 which therefore serves no useful purpose in that respect. Therefore, should it not be possible to pay a commission to someone who agrees to take the shares from someone else?—You have taken me by surprise but I doubt whether that could be done.

Mr. Divine: My view is that it is ridiculous to suggest that paying an issuing house a commission or fee for services overall, which include the buying of shares, is giving it financial assistance in connection with the purchase. It seems to me to be miles away from that.

4574. *Mr. Scott*: I shall not have to pay a £1,000 fine!

Mr. Richardson: It is the use of the word "indirectly" in section 54 (1) which frightens off the issuing house.

4575. *Chairman*: This is what the Law Society has said about it so far. It sets out the short effect of section 54 and with reference to a group says, in paragraph 109, that in many groups of companies

finance is quite properly centralised in a parent company which acts as bankers to the group and that when a company with liquid resources is taken over by the parent company it could be argued that the parent company thereby recouped itself of the purchase price of the shares and thereby received financial assistance in connection with the purchase.—*Mr. Sykes*: I am not sure what is meant by "taken over".

4576. I agree it is not very clear.—*Mr. Divine*: The new subsidiary surrenders all its cash to the holding company.

Mr. Sykes: I would have thought, if the principle of the section is to be retained, that that is quite wrong, if it is very seriously in contemplation when the purchase is made.

4577. If the transaction were put to us in this way, that a company can buy all the shares in another company by financing it in the first instance by means of a loan and then, being in a position to control the cash of the acquired company, can pay the cash to the bank in discharge of the overdraft, and the bank would at least know where the money came from, what would you say about that?—*Mr. Divine*: I would regard that as quite wrong.

Mr. Sykes: I agree. To my mind if that were contemplated at the time of the purchase and if that was the only thing they had in mind that would be a clear breach of the section.

4578. *Sir George Erskine*: It might not only be cash; it might be done by selling the assets of the acquired company, and lending the proceeds.—Yes.

4579. *Mr. Scott*: What is the object at which it is aimed? It is difficult to know what the underlying thought behind the section is.

Chairman: The general idea is that it is aimed at prevention of evasion of the rule that you cannot reduce your capital.

4580. *Mr. Scott*: It is for the protection of creditors?

Chairman: Yes.

Sir George Erskine: And minority shareholders, too.

4581. *Mr. Bingen*: Was it not designed to prevent a company buying its own shares in the ordinary way for its directors? The transaction in mind may have nothing to do with a take-over.

Chairman: It was to ensure that you could not do indirectly something which was not permitted under the Act. That is, perhaps, *ex abundanti cautela* although it is always better to be on the safe side.

4582. *Mr. Lawson*: Should there not be a difference between cases where there is a purchase of the whole of the shares and cases where there is a minority left? It is difficult to know what should be done in the type of case quoted in the Law Society's evidence.—I think there is an inherent weakness in what you say. You are tending to overlook the creditors of the subsidiary. You have said, in effect, does it matter if it is a wholly owned subsidiary. But subsidiaries can and do have creditors of their own.

4583. *Mr. Lawson*: But there are a good many which are not wholly owned subsidiaries.

Sir George Erskine: There are also preference shareholders to be considered.

Mr. Lawson: They are minority shareholders. There might be a difference between a case where you buy 100 per cent. of the share capital and a case where there are substantial minorities left, which include preference shareholders if you like.

4584. *Professor Gower*: It has been suggested that where there is a wholly owned subsidiary the parent company should be liable for its debts. If we were to provide for that there could be no possible objection, could there?—No, none at all.

4585. *Mr. Richardson*: Does Mr. Divine see no reason for the retention of the section in its present form?—*Mr. Divine*: No. I think Mr. Sykes misrepresented my views. I agree with Mr. Sykes about the desirability of its retention.

4586. *Chairman*: The next point is on section 195. Your memorandum states: "subsection (1) should be extended so as to cover shares or debentures in which the director has a beneficial interest, even

though the shares or debentures may themselves be held in the names of the trustees of a settlement or of nominees". That would cast the net very wide and include all kinds of interests of which the director himself quite conceivably in some cases might not be aware.—*Mr. Sykes:* Yes.

4587. My only comment on it was that perhaps that would be going too far. It would be oppressive to the conscientious director but less oppressive to the less conscientious director.—If we read on the next sentence says "We appreciate that difficulties may arise in view of the possible remoteness of the beneficial interests in some cases"; and we put forward as a suggestion something rather less oppressive. I think we felt it would be quite impossible to expect directors to disclose contingent reversionary interests under the will of their great aunt.

4588. Yes, that would be a difficulty. What about options to take shares?—Of course, they are very important from the point of view of disclosure and I imagine they are quite often used. I should have thought the existence of an option to purchase or to sell was a material thing to disclose.

Mr. Divine: An option is covered by our suggestion.

Mr. Sykes: It is; I agree.

4589. You take what is the general view, that there is no reason why that register should not be open during the same period as the register of members.—No.

4590. I do not think there is anything else we need trouble about on section 195.—Could I just add this: you observe recommendation (iv) says "It should be for consideration whether the audited accounts should be required to contain also, in effect, a summary of the changes in the register during the period covered by the accounts". I would like to see in the accounts a list of the directors' shareholdings as at the date of the last accounts and as at the date of the present ones so that some comparison between the two could be made. It would not be possible, of course, to show all the intervening changes.

4591. Then we come to voteless shares. There is a remarkable difference of

opinion on this subject but you take what is regarded as the orthodox view that the shareholder gets such rights of voting as the constitution of the company gives him.—The only comment I have to make is that if it had been a personal memorandum I should possibly have expressed my view in more forcible language!

4592. Then it has been suggested to us that the holders of shares carrying no votes should nevertheless be entitled to attend meetings although they could not vote and probably could not speak.—I would not see any objection to that.

Mr. Divine: No.

4593. You would not see any great objection?—*Mr. Sykes:* No. I can see practical difficulties when meetings have polls and votes on a show of hands and that kind of thing. But after all these shareholders do get the accounts. They can think about them and can write to the directors if they want to and say "What about these accounts? Why is so-and-so appearing?" and so on.

4594. Then there was a suggestion that they might be given a limited right of voting on matters of particular importance, for instance a winding-up?—Apart from any other consideration it would be impossible to draft anything which could possibly make sense and could possibly be construed.

Mr. Divine: I agree.

4595. Then you do not think very much of that point.—No.

4596. Under protection of minorities I have got your suggestion about the executor of a deceased shareholder in a private company, which is that if the directors refuse to register the personal representative he can demand, notwithstanding anything in the articles of association of the company, that he be given reasons for that refusal.—*Mr. Sykes:* Yes.

4597. Supposing the directors gave reasons and the reasons were wholly inadequate or irrelevant what could the personal representatives do then?—Then, I would have thought, they probably would have the right to apply to the Court anyway to rectify the register. They should have a right but it

may be a question of drafting whether they should be given an express right. But if the reasons are inadequate or irrelevant they should have the right, certainly, to go to the Court.

Mr. Divine: They would have the right.

4598. It would be an invasion upon the rights of the other shareholders simply to say that the personal representative of a deceased shareholder should be entitled as of right to go on the register.—Yes.

4599. That would be too much, would it?—*Mr. Sykes:* I would say so but they need some protection in this case, we are all agreed. We have seen on many occasions—and this applies largely to private companies where possibly the principal shareholder dies—the others rub their hands and say “Good! So-and-so is out of the way. We will keep his personal representatives off the register”. That sort of thing is always arising. Very often, of course, they increase their own salaries but they do not go quite to the point where one can say “This is oppressive”.

4600. *Mr. Bingen:* Would you say that is a section 210 case?—Yes, if they pushed their salaries up just enough you could catch them.

4601. And if they gave inadequate reasons for not allowing personal representatives to go on the register that might also be section 210?—It is not at present.

4602. But I am asking whether it would be a good idea that it should come under that section.—It would certainly make them think about it.

4603. *Chairman:* Then we come to disclosure of the ownership of beneficial interest. Everyone seems to think it would be a good thing if it could be done but every scheme devised involves a great deal of work and difficulty. But the sort of half-way house suggestion is that recourse might be had to an extended form of the provisions relating to inspection under section 172. Might it be made possible for the directors, if they had reason to believe someone was acquiring shares through a nominee, to apply for an inspection?—I am sorry if I have overlooked something but is there not some power already in their hands under

section 172 to do so? Where it appears to the Board of Trade that there is good reason so to do they may appoint one or more inspectors to report on the membership of the company. Mr. Lindon made a report upon the Savoy Hotel under that section.

4604. But the proposal is that the Board of Trade might be required to act at the instance of the board of directors so that it can be done more expeditiously than under the present procedure.—But it would be done by the Board of Trade?

4605. It would be done by the Board of Trade.—Yes. It might be done by working into section 172 some of the provisions of 164 and 165 and it may even be made easier by appointing inspectors to investigate the affairs. I personally would agree that it should be made easier to have an investigation of the beneficial ownership.

Mr. Divine: Yes, I would agree with that.

4606. Beyond that there has been a suggestion made that where someone acquires the beneficial interest in a certain percentage of the capital of a company he should be obliged to disclose his position to the directors. Does that type of provision appeal to you?—It is such a practical matter that I do not know whether I have a particular view about it.

4607. You have to remember this legislation will extend to all companies great and small, and some of the big ones have thousands and thousands of shareholders. Then it becomes a practical difficulty. That is what everyone felt.—I should have thought there were important practical difficulties in the way.

4608. Do you think, as a matter of general principle, it would be right if it could be managed?—No, I do not think it would, my Lord. I see no particular reason why a director should be able to find that kind of thing out except in the general case of an inspection by the Board of Trade.

Chairman: I am much obliged. Then, I think Mr. Mackinnon is interested in the subject of pre-acquisition profits and he would like to put a question or two to you about it.

4609. *Mr. Mackinnon*: I think it all starts from Sir Milner Holland's observations at the beginning of your memorandum, observations from the sub-committee addressed to the Council of the Bar, when he says "We have not dealt with the vexed questions of share premium accounts and distribution of pre-acquisition profits, which obviously require clarification". The first question I want to ask you is this: we understand that there are conflicting opinions as to the effect of section 56 dealing with the share premium account, particularly in the case of shares issued for a consideration other than cash and I was wondering whether you had any comments to make upon it. Is that the case?—There is a very bitter difference of opinion between the two schools of thought. The questions of share premium account and pre-acquisition profits are rather linked. If you start with the share premium account, one view is that if you acquire property of any sort for fully paid shares you must estimate as best you can the true value of the property you have acquired and must then bring it into your books at that figure, and that the difference between that figure and the nominal amount of the share capital you have issued must be treated as share premium. The other view, which I take, is that if you acquire property for fully paid shares you can bring that property into your books at any book figure which would be a proper book figure to take, irrespective of the section, and that if as a result of bringing it in at that figure there is thrown up a reserve on the left-hand side of your balance sheet because your book figure is greater than the nominal amount of the shares you have issued, that is your share premium account. I regard the section as entirely parallel with the provisions of section 58 dealing with the capital redemption reserve fund on a redemption of preference shares. That section says you shall transfer to a capital redemption reserve fund a sum equal to the nominal amount of the shares redeemed. It was sometimes thought, early in the history of that section, that you had to make double the requisite amount of profits in order to be able to redeem your preference shares. It was something which arose purely as a matter of accountancy. If you have taken £1,000 of your cash and used it to redeem £1,000

nominal preference shares then you have taken £1,000 off each side of your balance sheet but you have still got the profits you apply which are still standing to the credit of your profit and loss account. All the section is saying is that you must put a label upon it. In precisely the same way section 56 says that if you have brought a new asset into your balance sheet and have issued shares in order to do so then, if a reserve item appears on the left-hand side of the balance sheet, as a result of that you must, purely as a matter of accountancy, give it the label of share premium account. If you have acquired property for fully paid shares the cost to you of that property is what has to appear on the left-hand side of your balance sheet. That is the nominal amount, *prima facie*, of the shares you have issued.

4610. It comes to this: one view says it is obligatory to value assets acquired at their true value and place any surplus in the share premium account and leaves no discretion to the directors, whilst the view you canvass is that complete discretion should be given to the directors. You said they could take any book figures which they thought proper.—No, any book figure which would be a proper one to take.

4611. I am not quite sure what you mean by that phrase. Is it the figure in the books of the company which you are acquiring as a subsidiary?—Not necessarily. If you are acquiring a business as opposed to shares it may well be you have got to take the estimated value of the assets because you have got to put the freeholds, stock-in-trade, cash, etc., down on your balance sheets and almost inevitably you will get a share premium account in that case. But if you are buying all the shares in another company you need not put any particular value on those. You can put upon them the book value, the nominal value of the shares issued. I draw a distinction between buying shares and buying a business.

4612. Obviously the matter needs clarification. In which sense would you recommend that the section be clarified?—Undoubtedly it should be clarified according to the view I take of the law as it is at present because the present situation on the other view leads to the most

absurd difficulties. If you take the case of the reconstruction of a company the shareholders in a holding company get exactly the same interest as they had in the old company except that it is a holding company and holds all the shares of the old company. If you turn the case round the company you hold shares in becomes the subsidiary of the holding company in which you now hold shares and the assets and liabilities underlying it are entirely the same. Your interest and the other shareholders' interests are entirely the same yet, according to one doctrine, the capital and revenue reserves of the business which are in the balance sheet of what is now the subsidiary must, although they may be paid out in dividends to the holding company, be treated by the holding company as capital not capable of distribution.

4613. Could we leave the acquisition of a subsidiary on one side where I think, from your explanation, there is a difference in principle, because, as I understand it, if you buy assets out-and-out the directors would have to value the assets and almost inevitably would have to set up a share premium account in that case.—Yes.

4614. Can we leave that out because there is no divergence of opinion, for instance, between you and Mr. Sykes on that point?—No.

4615. Therefore we can leave the question of clarifying the difficult case of the acquisition of a subsidiary.—Yes.

4616. What I was wondering about was this: what would you say to the suggestion that you should have the same rule applicable to all cases and that when you wished to use pre-acquisition profits you could declare the dividend to the new holding company which has acquired them and allow the distribution of those dividends, in effect, by allowing the share premium account to be written off at the will of the company rather than having to go to the Court.—That seems to me to be creating a remedy for a disease which you have deliberately created yourself. Why impose in the first instance the obligation to have a share premium account and freeze the pre-acquisition profits in order then to create a remedy?

4617. It may be rather a difficult thing to draw a section which is going to

distinguish between the two cases and it may be better to have the section set up on the footing of valuing the acquired assets in all cases, setting up the share premium account and, in order to get over the difficulty in the case of the merger, allowing the unfreezing of the share premium account in this way?—I cannot see any justification for doing so.

4618. Could you clarify it in the sense that in normal cases there is a proper valuation to be made by the directors of the assets coming in and in the second case, that of the acquisition of a subsidiary company, they should be left with a free hand?—Yes.

4619. Turning to pre-acquisition profits a suggestion has been made that it would be a good idea if one could ante-date the acquisition of the subsidiary company so as to open up its pre-acquisition profits on a wider scale. What would you think about that? What is your view on pre-acquisition profits, anyhow?—In my view the law at present does not prevent the distribution of pre-acquisition profits. If I am right that is an end of the matter. It is simply a matter for clarification. If I am wrong I would strongly advocate the law being altered so that there is no freezing of pre-acquisition profits. The whole notion, it seems to me, is based on a fallacious analogy with the purchase of an undertaking. If a company purchases an undertaking it buys all the assets of that undertaking and it is quite irrelevant to the company how much of those assets represent profits earned by the previous owner of the business. It is entirely irrelevant. You cannot say "Part of this represents profits of the business" and that therefore it is reasonable for the company to say "We have distributed some of those profits in the form of dividends". That is an absurd notion but by a false analogy it is thought that if a company buys a subsidiary it ought not to treat the profits, money in that subsidiary which is capable of distribution, as something it can treat as revenue if and when it is received.

4620. So your recommendation would be to leave section 56 as it stands except for the merger case where one company acquires another. You say an exception should be made in that case, in order to

avoid having to set up a share premium account, and that you should tie it up with the pre-acquisition profits position and leave them unfrozen.—I would not make any exceptions. I would clarify the share premium account section so as to make it clear that what the section is doing is a similar thing to section 58: putting a particular label, with certain results, on something that arises as a matter of accountancy.

4621. So perhaps all we are discussing is the vehicle which would give expression to it?—Yes.

4622. How, if it is done, would you like to see it put into force?—I was trying to think how you could deal with it simply. One could add a subsection to section 56 saying that a company which issues shares, credited as paid-up, wholly or in part for a consideration other than cash shall not be deemed to have issued at a premium by reason of the fact that the value of such a consideration may be greater than the amount so credited as paid up on such shares. That would do it from my point of view.

4623. But then you say you are not obliged to set up a share premium account.—No, not by reason of the fact that the value is greater but if the book figure throws up a greater value there is a share premium account under the section.

4624. And that is where we have to get an answer to the question, what is the book figure? In the case of an incorporated company are you accepting that that is the position or is that a matter for distinction?—No, the directors have got to put a proper figure upon it.

4625. But in deciding the book figure is there not a distinction?—There is a very great distinction, I agree.

4626. That is what I am getting at. I am not arguing one way or the other but merely seeking to find out what you are getting at.—If you say you have got to put a figure down I see great difficulty in placing that responsibility upon the directors but with the capital redemption reserve fund it is a thing which arises as a matter of arithmetic. With your share premium account, however, you are saying that you must when you acquire new assets value them in a particular way.

4627. Can I put one last question to you? You accept in the case of 500,000 £1 shares issued for £750,000 (each share being worth 30s.) that you should put £250,000 to the share premium account. I think the question many of us would ask ourselves is why, if you issued 500,000 £1 shares to get £750,000 worth of assets, which you could go round the corner and sell the next day, you should not also have a share premium account of £250,000. That is one view of this matter. You seem to think there is a distinction between those two cases which should be rectified and I do not quite follow why there should be that distinction.—You have mentioned £750,000 worth of assets. That sum of £750,000 is only an estimate or guess. If it is not cash it is anyone's guess as to what the real value is. You cannot say "We will say it is so much" because you are begging the question. The cost is the nominal value plus the share premium account if you are bound to have one. So you are going round in a circle.

4628. But very often one has to make estimates: a company's £1 shares may be standing on the market at 50s. If it issues those shares for the acquisition of the assets you are not saying the cost to the company is simply £1, are you?—As a matter of law, yes. The cost to the company is *prima facie* the nominal value of the shares and that is what is shown in the accounts. That is the addition to the liabilities.

4629. With respect, the addition to the liabilities is the true value of the shares, i.e., the nominal value plus the share premium account.—If you have a share premium account.

4630. As the law stands at the moment you have to have one. There is a decision; do you think it is wrong?—You are referring to *Ropner Holdings*?

4631. Yes.—There the company had elected to bring in the book value of the shares of the two companies it had acquired. That was the basis upon which they made their valuation—the book value of the assets of the two companies—to find out what was a fair figure; and it followed, as the night follows the day, that a share premium account arose. An action was brought to try to establish

that a company did not need to have a share premium account, but they need not have brought in the shares at that figure, according to my view.

4632. *Professor Gower*: The only real practical importance of this is where you have a merger of some sort, as a result of which free reserves become frozen, if the law is not as you think it should be. This follows from the fact that under our law the only way you can have a merger is by one company buying up another or the shares of another company. The Americans have a system whereby two companies can marry and the result of that marriage is that neither swallows up the other. Under that sort of system this would not arise; the free reserves would still remain free reserves. Would this not be a logical way of tackling this problem?—I would not like to say. I am not familiar with American law and I do not know how it works.

4633. But we are getting this problem because of the nonsensical results of the *Salomon v. Salomon* principle to which Mr. Sykes made reference whereby we insist upon preserving the distinct entity of the two companies and say "If you want a merger this can only be done by one company buying another or the shares of another, so creating a new corporate entity which will acquire the revenue of both". The Americans, however, have this system whereby two companies merge without forming any new company, without either of the two old companies disappearing. This seems to me to avoid this absurdity of what was formerly free reserves becoming frozen because of the merger. This "freezing" seems to me to be rather stupid.—Yes.

4634. *Mr. Mackinnon*: Does Mr. Sykes share your view upon how the shares should be dealt with?—*Mr. Sykes*: For the record I should say I disagree with almost everything Mr. Divine has said, especially when he said there has been bitter disagreement. On the contrary, it has been quite friendly!

Mr. Divine: Yes.

Mr. Sykes: My own personal view is that section 56 should be kept and should be clarified, though with great respect to Mr. Divine I do not think it needs any clarification. Quite obviously, he takes quite a different view which I respect, but

to my mind the share premium account should be kept. I see no real difficulty in the directors *bona fide* putting what they consider is a reasonable valuation upon an acquisition by saying "What is the value to the company of what we have acquired?" and the difference between the nominal amount of the share capital issued and that figure should be the share premium. The company has expended its share capital in that way and there is no reason why it should be allowed to distribute it by way of dividend. I realise to the full the criticisms which have been made about these mergers; I quite agree that they have produced rather absurd results. I am very much attracted by what Professor Gower has had to say. The only thing is that I have no idea what form this marriage takes, but I do recognise what I think is an absurdity when you get, say, one insurance company taking over another or a holding company being formed to acquire shares in two insurance companies with the result that the whole of the pre-acquisition profits are frozen. I should have thought there was a good deal to be said for what you, Mr. Mackinnon, have suggested, that there should be some latitude as regards part of the share premium account, such part of it as represents pre-acquisition profits—because the two problems are really the same—being distributed without reference to the Court. But it seems to me that as the law stands at the moment—and broadly speaking it is correct—that what you have acquired with your share capital represents capital in your hands and you cannot distribute it by and large. I am quite prepared to concede there should be an exception, however, in these pre-acquisition profits cases.

4635. *Sir George Erskine*: Mr. Divine said the assets acquired should be brought in at a figure the directors thought proper and instanced the purchase of shares in exchange for shares where the shares acquired were valued by the acquiring company at the nominal value of the shares issued, and he thought that that should remain so. What would he think would be the position if the purchasing company had, in addition to offering its £1 shares, made an alternative cash offer for the other shares at, say, £5 a share which meant that the consideration was

worth £5. If a very small number of shareholders accepted that offer it would appear to mean that the share purchase for cash would come in at £5. Would the others come in at £1?—*Mr. Divine*: I will be corrected if I am wrong but as a matter of accountancy the whole block of shares would be entered in the books at cost. I do not think you put a separate book value on each share.

4636. But in your calculations you would have calculated the matter differently.—As far as the company is concerned in a sense it has got the shares which it acquired for shares cheaper than the ones it acquired for cash; because its own shares have a value above par in the market it is able to buy, at a cost to it of par, something which, in fact, is worth more.

4637. You do not think there is anything illogical about it?—It seems to me to be a very desirable state of affairs. It makes for very much more flexibility. I have never been able to understand why if I have acquired 49 per cent. of the shares of a company I can freely deal with any dividends I receive, whereas if I acquire 51 per cent. immediately I must freeze in my own hands the dividends I receive. It seems to me to be entirely illogical. I do not consider any harm is done, if I am wrong on the law, by clarifying it now in my way because it does not mean there is going to be any dissipation of money which should be treated as capital. The general law will take care of it. If I acquire all the shares in another company—and according to my doctrine it is at cost—the nominal amount of the shares I have issued is the cost to me. If I get large dividends paid to me out of the profits earned before I acquired the shares that, of course, depletes the actual value of the shares in the company. The money has gone out from that company in the form of dividends and has come to me. If my book figure is quite low then it probably does not matter. The shares will still be worth more than the book value. Therefore, my share capital—which is what concerns the creditors—is still more than covered by the assets. If, on the other hand, the dividend I receive is so enormous in comparison with the assets of the new subsidiary as a whole that the result is to deplete the true value

of my subsidiary to an extent below the cost in my books then, as a matter of ordinary commercial prudence and, if the amount involved is at all substantial as a matter of law, it is the duty of the directors to take the whole or part of that dividend and either apply it to writing down the book value of the shares in the subsidiary or apply it to a provision for depreciation. That, I think, is the law. It is a wrongful distribution of capital if you buy—paying for it out of capital—an asset which is going to produce a large income over two years and then become worthless. I think one of the Lord Justices in one of the leading cases said that. Obviously you cannot spend the company's moneys buying up for three years, say, an extremely valuable patent and distributing the revenue from that patent during those years. That would be *ultra vires*. The purchase of a subsidiary with large undistributed profits is a very similar case but if you take out those profits and deplete the value so that it is less than your book figure then you have got to put it right in your accounts in that way and, *prima facie*, you have to freeze the dividends received. I would not go further than that. It seems to me highly undesirable that people should be so fettered and you can leave it to the general law to see that, in fact, capital is not frittered away in the form of dividends.

4638. *Mr. Lawson*: Regarding Mr. Mackinnon's point concerning the use of the share premium account to deal with the pre-acquisition profits position, do you not think there should be some limit on that? You can have this case, for instance: you buy the entire share capital of a subsidiary company which has £10,000 of capital and £90,000 of undistributed profits and then use your share premium account to write down your investment to £10,000. Therefore, you have brought £90,000 in as dividends. You then have a profit and have, in fact, distributed capital to your shareholders.—Yes. That is doing indirectly what I would prefer to see allowed to be done directly.

4639. Have you any views as to whether a share premium account might be used to write off a debit balance in a profit and loss account, where there are no other reserves available to do that, without

going to the Court?—No. If you accept the principle of the share premium account it seems to me that is contrary to the basic principle.

4640. You think one should go to the Court?—Yes.

Chairman: I think we have exhausted most of the major questions. We have

(The witnesses withdrew)

(Adjourned until 2 p.m.)

MR. H. DOUGLASS, MR. G. WOODCOCK, MR. L. MURRAY and MR. N. FERGUSON
called and examined

4641. *Chairman*: Good afternoon, gentlemen. We are very much obliged to you for coming along to help us. Now, for the purposes of our record, Mr. Douglass, you are a Member of the General Council of the T.U.C., I think?—*Mr. Douglass*: Yes, Sir.

4642. Mr. Woodcock, you are the General Secretary?—*Mr. Woodcock*: Yes.

4643. Mr. Murray is the Secretary of the Research & Economic Department and Mr. Ferguson is in the Research & Economic Department?—*Mr. Murray*: Yes.

4644. I understand that Mr. Cousins would have been here but he is unfortunately indisposed. I hope it is nothing serious.—*Mr. Woodcock*: He is a victim of the 'flu.

4645. Well, Gentlemen, I take it that you are here to protect the interests of the members of your constituent Unions in relation to any amendments in the Company Law which may emerge from the present inquiry: does that more or less accurately state your position?—Well, subject to some qualification and some expansion. We have never at the T.U.C. taken the view that we are so narrow in our outlook that we are concerned only with people who are members of Trade Unions. We think of ourselves as representative of work-people as a whole, whether in Unions or not. Then the T.U.C. particularly—since we are concerned with matters which affect all

noted the many other suggestions you have made. They are mostly those which you call suggestions of a minor character directed towards points of detail. I do not think we need take up time discussing those. All I have to do now on behalf of the Committee is to thank both of you very much for coming here and being so helpful.

(The witnesses withdrew)

(Adjourned until 2 p.m.)

work-people irrespective of the particular industry or craft or grade to which they belong—is always very conscious that those people have dependents—wives and children, so that I would not like you to think that we are here simply to represent the interests of our members.

4646. I put it too narrowly, then?—We do not think that the interests of work-people are limited to what they get in their wage packets each week or to the conditions in which they work. We are a very substantial proportion of the total population of the country, and we boast that we can and do, with some limitations, represent what we consider to be the public interest.

4647. Yes. And I suppose it might be right to say—this is another generalisation, which of course may be dangerous—that, apart from the nationalised concerns and the Government, it is probable that limited liability companies constitute the bulk of the employers in this country today?—In terms of the people they employ, yes.

4648. So that any questions affecting the employment of persons by limited companies might be of special interest to you?—Yes—and those employed by people other than limited companies.

4649. Yes, but limited companies are under certain statutory obligations as to disclosure and so forth, and it would be your concern, I take it, to see that these provisions as to disclosure were available to your constituents?—Yes.

4650. And you express the view, in your memorandum, that companies should be compelled by law to disclose in their accounts a much wider range of information than is at present required; and you take that view, I understand, because it is your opinion that the further disclosure which you think should be made is called for not only in the interests of actual or prospective shareholders and creditors, but also in the interests of the people employed by any given company?—Yes, and we would go further: in the interests of the public at large.

4651. Yes, no doubt. At present the employees of any given company have available concerning it the information which is obtainable by any member of the public by inspecting the files at Bush House, and they also have such further information as the company, through its management, may think fit to disclose; and in your view the first of these sources, that is the published information, leaves room for improvement?—Certainly the information which companies are required to file at Bush House should be more extensive.

4652. Then as to the other source of information—that is from the management—you say that many managements co-operate by providing reasonably full information. Would you be prepared to go so far as to say that most managements do, or would you only say that many do?—No, it is still much the exception rather than the rule that managements go beyond their statutory obligations. There are, of course, some firms, which we consider are progressive in this field, which do make serious and sustained efforts to provide the information which they have to the public, and perhaps more particularly to their employees. However, even in this field, we have to distinguish between those who are really trying to give information to their work-people or to the public and those who are sometimes just putting up a bluff, in that although they publish information which, on the face of it, seems additional, it is much less really. The companies which give information additional to what they are required to supply by the Companies Acts are in the minority; the majority of them are still very reluctant to give any information

except that which they are compelled to give.

4653. I appreciate your line of approach that, inasmuch as the employee has access to the published documents, it is in his interest that the publication should be as complete as possible; I can understand that. I think that in your memorandum you call the employees' advantage in that respect "a useful by-product" of the statutory obligation to publish?—Well, it could be considered so at the moment, in that we have to take it now as a useful by-product. Our view is that the Acts at the present time are designed to compel companies to publish information purely in the interests of their shareholders. So far as we can see, there has been no intention, in framing these Acts in the past, to compel employers or manufacturers (call them what you will) to provide the information which is necessary to enable the work-people to form a view or reach a decision about the particular firm or about the industry as a whole. It just happens to be a by-product; we think it ought not to be a by-product.

4654. That is what I call your second branch of information, really. Now, is it your view that any legislation made as a result of this inquiry should go as far as to enact by statute that information on certain specific topics should be given to the work-people as distinct from the public at large?—No, I doubt if we could really sustain that argument. We would argue that it is a desirable thing for companies to assume responsibility for giving information to their work-people, with whom they are in special relationship. But I doubt if we would go so far as to say that you could impose a statutory obligation upon companies to give information to their work-people. I do not think work-people in that sense could be sufficiently distinguished from the public at large to enable us to put forward a view of that sort. We are not asking for information to be given merely to the work-people, but for published information which the work-people or the public can use.

4655. So far as the work-people are left to rely on the published information, it is in the interests of their Unions on

their behalf to see that the published information is as complete as possible, is it not?—Yes.

4656. Questions as to what a company ought to publish are questions of company law. But when you get down to the proposition that work-people should have a special claim to information on particular topics from the employers, then it seems to me that it might be said that that travelled beyond the scope of this inquiry, because that would appertain to the relationship between master and servant and would go beyond the consideration of company law?—I would find it very difficult to comment on the many implications raised by that proposition. I cannot see the possibility of justifying to this Committee, which is dealing with company law, a need for the publication of information exclusively for the use of the work-people or their Trade Union representatives. I am not prepared to say that the work-people have not got the right to special information; but I cannot put that to you and expect you to deal with it under the Companies Acts. But beyond that, I am a little puzzled about what you are seeking to get me to give you my views about.

4657. I was only trying to make clear the scope of your memorandum. You see, it is directed I think in the main to the proposition that work-people ought to have proper information, coupled with examples which you give showing what further information you think should be available in the way of accounts and so on?—Yes, but not exclusively for work-people.

4658. You disclaim any suggestion that this Committee ought to recommend that work-people should have some special information over and above what is given to the public at large, and in particular what goes to the creditors and the shareholders?—We do not see how we could ask you to do that, but we are thinking of information which you could properly require companies to publish which would be available to everybody.

4659. Including the work-people?—Including the work-people, yes.

4660. I just wanted to find out how you stand in that way. Then we will go on,

in a moment, with the various matters bearing on information with which you deal in your memorandum, but first of all there is one thing which I think I ought to mention to you: do you remember the question of shares of no par value?—Yes.

4661. That was opposed by the trade union member of the Gedge Committee. I only wanted to ask whether you had anything that you wanted to add to what the trade union representatives said on that occasion?—I think I would ask Mr. Murray to say how we would like to qualify it; I do not think we have anything to add. The views we expressed on shares of no par value at that time were very much influenced by the circumstances at that time. I do not know if you remember the period, but this was a difficult period of wage restraint, in which the T.U.C. General Council, rightly or wrongly, expressed views which, on the face of them, were unpopular with trade unionists. We were very anxious at that time that we should get as much support and justification for this rather unpopular view, and it seemed to us that, whatever might be the other merits or demerits of shares of no par value, they tended to obscure to the ordinary individual the profits position of the company. You might say that this is nonsense, but if they know the par value, over a period of time they do get an understanding of the percentage rate of dividend which is not very wide of the mark. But when you give them a figure at large, they are ignorant, and when they are ignorant they are apt to be very suspicious. That was our justification for expressing to the Gedge Committee our opposition on this, but whether we want to maintain that view now, I do not know. I do not think we would want to extend it or even reaffirm it, but Mr. Murray might give you an indication of what our modern view is on this matter.

Mr. Murray: I do not know that I can add very much to what Mr. Woodcock has said. He has explained the circumstances which surrounded the decision at the time. It was related to what some of us regarded as a spate of devices for increasing dividends but not making it very obvious to the public at large and to work-people that such increases were

being made. But if you put it to us as a specific question as to whether no par value shares should be permitted, and on what conditions, and if you have had the benefit of views expressed elsewhere as to why that should be done, then that would be a matter for the General Council to think about.

4662. The majority recommendation of the Gedge Committee was in favour of no par value shares?—Yes.

4663. And the general line taken by witnesses to this Committee so far is that, seeing that no par value shares were recommended by a competent committee, and I think were the subject of an intimation by the Government that they intended to put no par value shares into law, it really was not for them to express themselves any further one way or the other. Some people have expressed themselves in favour of implementing the majority recommendation, and nobody has seriously sought to challenge the view of the Gedge Committee. So, as you were the protagonists on the other side before the Gedge Committee, it seemed right that you should be given an opportunity of saying how you stand about it now. You are content, are you, to let it rest on the Gedge Committee?—*Mr. Woodcock*: We have not included it in our evidence, so I think we will have to leave it. If you thought that you would like from us an expression of our modern view, we would certainly go back and produce it, but we have not thought it necessary to include a statement about shares of no par value in our evidence.

4664. We did ask you about it?—You did, indeed, yes.

4665. So that it comes to this, that you are content to let the matter rest as it is, are you?—We are content that you should take both what we said to the Gedge Committee and what we have said today into account if you want to.

4666. We do not want this measure, which did engender a certain amount of heat at that time, to go by default without an opportunity for the chief protagonists to reconsider their view; but I think that point is now covered?—Yes.

4667. Next we can return to the question of information, and there is one case

in particular which stands out in that connection, and that is the exempt private company. You make it very clear in your memorandum, if I may say so, that you consider that that sort of private company should not continue, and you are no doubt well aware of the contrary arguments. I think the main contrary argument turns on the question of small companies which have to disclose their accounts being put at a disadvantage *vis-à-vis* their competitors, as they have to give information of which their competitors might be able to make use. You are not particularly impressed by that argument, I take it?—We have never been impressed by it. It has been used over the years to limit the scope of Censuses of Production and Distribution, and we think that the argument could not be sustained in relation to companies that seek for themselves the right of secrecy, and seek it for specific reasons.

4668. Besides the question of competition in the business carried on by the company, it has been suggested to us that it would be a hardship for the little man, carrying on his business in a butcher's shop in a village, to be required to publish his affairs so that nothing would be kept secret; that in those circumstances people would say "I am surprised that they have a new motor-car, because I was at Bush House yesterday and the balance sheet looked very bad". That was the objection?—Well, that sort of objection does not worry me. There may be very good reasons why the public should ask those questions. But in any case we ourselves are always reasonable people; we would never want to stretch a principle to the point at which it turns back on itself. I do not think those arguments against publication of the information are valid, but if you as a Committee thought that there was some limit beyond which it would be futile to require publication, I suppose you would take the responsibility for saying that.

4669. Of course this general consideration as to keeping one's private affairs to oneself might have considerable force if the exempt company were confined to, say, the small grocers shop run by a husband and wife in a village, but, as I understand it, exempt private companies

cover a very much wider field than that? —Yes, and you may say that you can draw a line below which you would not bother. But it would take a lot to impress us with the view that even where you get a man and wife with a small shop in a village, they should not be required to disclose certain information. We take a public interest view of this. There is an awful lot of public disquiet about the extent to which the sort of people you are describing manage to dip in the till, and it may be very much in the public interest that their affairs should be disclosed.

4670. And, in the long run, it may be in their interests, too?—Yes.

4671. And if they have not got to file accounts, their accounts may get into rather a mess?—They often do, yes.

4672. I take it from what you have said on the question of disclosing accounts that you would be in favour of altering the law so that the accounts of these companies would have to be audited by auditors duly qualified in accordance with standards laid down by the Companies Act?—Yes—whatever those standards may be.

4673. There is no reason for them to be given a privilege to the effect that they can employ anyone who calls himself an accountant, who does not come up to the standards laid down by the Act. You would treat them in this respect in the same way as any other company?—In principle, that would be our view, but if this Committee, after going into the matter very much more in detail, thought that there was justification for some modification or relaxation without impinging too hardly on the principle, then I do not think that we would react violently against that. We would never, as I say, force the principle to the point where it turned back on itself.

4674. You say that, subject to any exceptions that one finds on going into the case in greater detail, *prima facie* the arrangements as to accounting for these exempt private companies ought to be the same as for any other company?—*Prima facie*, yes. You may very well, in your more detailed examination of the question, think that you could modify it

—but, I would suggest, not for the reason that these people are entitled to some privacy, but because it would not be practicable, or it would be a waste of time, or difficult or awkward to impose these things on them; but not on principle.

4675. If it was found, on going into the situation, that there were not enough fully qualified accountants to go round, that would be a reasonable ground for relaxation of the requirement?—Yes, it would.

4676. And finally on exempt private companies, they have an exemption from the general rule that loans must not be made to directors; they have that privilege, alone of all companies. Have you considered whether you think that that should be retained?—*Mr. Ferguson*: I do not think we have any considered views on that issue. We have considered purely the question of the exemption from the statutory obligation to file accounts. The question of loans to directors has not been examined by us.

4677. I see. So that that is not a matter on which you wish to express any view, one way or the other. The next matter bearing on information concerns the special exemption which is enjoyed at the moment by banks, insurance companies and discount houses and, by regulation of the Board of Trade, shipping companies, in regard to what is to be shown in their accounts. As you probably know far better than I do, they at present enjoy certain exemptions, the upshot of which is that they are able to build up a secret or hidden reserve or an inner reserve, which is not discernible by any outsider looking at the published accounts. Do I gather that you are against the continuance of this exemption?—*Mr. Woodcock*: Yes, indeed. I am not very familiar with the arguments which have been used to justify the special privileges for shipping companies, though. I have had to look at the position of the banks in the course of various activities. I think they might have had plausible reasons at one time for claiming special privileges, but I think those times have long since gone. I do not think that the banks are in the insecure position that they were in at one time. Why should they not be

required to conform to the conditions regarding disclosure of information as all other companies have to do?

4678. They have the special characteristic, along with insurance companies, that they have to consult the interests not only of their shareholders but of their depositors and, in the case of insurance companies, their policy-holders, and the interests of the latter are paramount?—Yes, but even that argument assumes that the depositor is much happier when he is ignorant than when he knows what is going on. I do not accept that argument, although it was put to me when I was a member of the Radcliffe Committee. I would have thought that you could just as easily and plausibly argue that failure to reveal the position might be a cause of lack of confidence in the bank or the insurance company. I think they are powerful and more stable organisations now, and while their argument once was a plausible one—that it would be much better to allow them to shield some of their activities from the public—I do not think that that argument can be sustained now. I do not think the public is any more benefited by being kept in ignorance, and if these companies were to get into a difficult position I think the depositors ought to know about it as well as the public.

4679. There is nothing wrong in keeping a secret reserve—something in hand behind the scenes?—No, but there may be something wrong in leaving the impression that that may be the position when in fact it is not. I suppose the reason why they refuse to disclose this information is on the assumption that if they were in a difficult position, nevertheless the fact that they had never published anything would lead the public to think that things were all right anyhow. Now, where does the advantage lie—in maintaining the bluff or not? I am all against it.

4680. On the subject of secret reserves, I do not want in any way to offend you, but may I quote this passage from a publication called the Co-operative Independent Commission Report, 1958, which is in these terms: "We, therefore, recommend societies not merely to continue, but to intensify the practice of creating

hidden reserves by generous depreciation allowances."—I am afraid the Co-ops. must speak for themselves.

4681. If a company takes a very conservative view as to the value of its property, and makes the depreciation more rapid than normally would be the case, by that process it might build up hidden reserves in the excess value of its property over and above what was shown in the accounts?—We do not think that companies ought to do that.

4682. Do you think that it would be wrong to do that?—Well, *wrong* is a very wide term; I think it is for you to define *wrong* in a legal sense, though of course the Government will have the ultimate decision.

4683. Is it wrong in the sense that we are looking at the obligations of companies?—Yes. We want the fullest possible disclosure, at any time, of their position.

4684. You appreciate that on the other side of the question the banks say that from time to time they suffer from large losses through depreciation of securities and that sort of thing. They say that greater confidence would be maintained if they provided secret reserves which can, so to speak, iron out these inequalities in results?—Yes, but we are not impressed by that argument. It might have had some plausibility when the banks were much weaker than they are now, but I doubt if at present this internal juggling that they do means very much one way or the other. There is the counter-argument that if a bank is sound there is no reason why it should not disclose all the information; and if it is getting into a bad position and it is allowed to hide that position, there might be some damage to the public that it is allowed to go on for so long.

4685. As a rule, the thing works the other way: you have your published reserves on the fact of the accounts and something over and above that?—I think the banks trade on the public belief that since they have this right to conceal part of their reserves they probably have large secret reserves: it adds to their strength.

4686. Would you say that the present exemptions were damaging to the interests of the employees of the banks?—Oh, yes, I have no doubt at all about that.

4687. Would it really be the case that they can be put at a disadvantage in negotiating wage demands?—All bank employees are under such enormous disadvantages in all respects that this must be to them a very marginal matter. As you know, the banks refuse to recognise the National Union of Bank Employees. They have not even got to first base. The bank officers might be willing as a union to accept this information in confidence but they are nowhere near achieving recognition, much less disclosure.

Mr. Murray: In fact, when we consulted them on it, the National Union of Bank Employees did say that they would like to see this disclosure.

Mr. Douglass: Putting it in the form of a simple question—should a bank be able to publish misleading accounts?

4688. If you like to put it that way, and define the word *misleading*, I would not object to it, but as you state it I would not accept your statement in that bald way. —Well, I put it in that way because many bank employees feel that that is what it means.

4689. But would there be any actual advantage if the banks adopted a new style of making up their accounts?—There is always a disadvantage if a bank professes not to have the amount of money that it really has.

4690. We did actually ask various concerns as to their view about the effect of these privileges on the fixing of wages and so on, and perhaps I might just read them to you. The General Council of British Shipping said that the Seamen's Union had just made the finest settlement in Great Britain since the war and that they did not question whether the shipping companies had the ability to pay.—I would certainly question the steel employers' ability to pay.

Mr. Woodcock: I would prefer the National Union of Seamen to speak for themselves; what you quote is merely somebody's view of what they think. In

fact the National Union of Seamen have told us that they do very much deprecate these exemptions. There was a good deal of practical dissatisfaction with the result of the agreement that was made—in fact there was a strike about the settlement.

4691. Then you would say it was not the finest settlement since the war?—*Mr. Douglass:* I would say quite definitely it was not.

4692. Did the question of ability to pay come into the negotiations?—*Mr. Woodcock:* The question of ability to pay always comes into it. Obviously a union is not limited in that respect; if the employer says he is unable to pay that is not the last word, but I have never known any claim which has not been met with the argument "We cannot pay it". Not that we want to come to the position where negotiations are carried on between two high-powered firms of accountants.

4693. Then the last of my quotations is from the Committee of London Clearing Banks, who said that salary demands were not usually considered in relation to ability to pay and who doubted if salary demands were ever rejected on grounds of profitability.—Well, I think that is pitching it a little bit high. I think they might be entitled to make a statement of that sort if they are thinking only of the banks themselves and their internal staff associations, but the position in banks is a peculiar one. Even today the banks manage to get away with the idea that unionism does not matter very much, so that the whole picture is distorted; but if you are speaking of industry generally, then I do assure you that ability to pay is an argument which is always used by the employers, and the unions have to deal with it either by ignoring it or by going into the argument. The whole object of trade unionism is not to get people out on strike, but to get a settlement, and the more intimate and friendly are your relations with the employers, the more it becomes the common desire to settle, and then the more advantageous it is for each side to be completely honest about what is going on. There is nothing which interferes more with this general settlement of disputes than lack of full disclosure. Any attempt to obscure the position creates opposition, and it might

have been very different if they had known very much more. I cannot challenge the banks if from their own experience they say that these staff associations have not raised the question of profitability, but I know that generally it is raised by the unions or the employers in negotiations. Mr. Douglass will be able to confirm that, I think.

Mr. Douglass: I have even negotiated reductions in wages for a period, though there has been a *quid pro quo* that as soon as they get on to their feet again this reduction will be restored.

4694. That is eminently reasonable, I think.—Well, I think it proves the point that Mr. Woodcock is making.

4695. Then, I am by no means an expert in these matters, but I was under the impression that most wage claims were negotiated throughout an industry on a country-wide basis, are they not?—I think that is true in the case of most industries, and the national wage claim generally relates to a minimum that is to be paid throughout the industry. In my own industry, as in many others, there are also local claims which go forward and have as their basis more work and increased output, and always you have in the background the ability of the firms to pay because of increasing profits. Wherever we get a very prosperous firm, then inevitably we get high wages. Throughout the whole of my industry no two firms pay exactly the same wages to all their employees, because their actual occupations differ according to the varying types of machinery which are introduced from time to time, and there is always a greater willingness on the part of firms that are doing well to meet the claims of the men than on the part of firms that are not doing so well. If you have a firm with more obsolete machinery, there is a sort of futility about putting wage claims in to that firm, providing the established national minimum is paid.

4696. I see: your basis is the national minimum, and then you say that individual cases would be suitably dealt with according to their merits?—Yes, and according to the merits of the firm.

Mr. Woodcock: Even when you are negotiating generally for a national minimum, the question of profitability comes

into it. It is true that the conception of profitability is a wider one in that case. Really the argument in national negotiations is often: "What do you take as a standard?", and that raises the question of the profitability of the individual firms that go to make up the national picture. If your information about the firms is limited, then your line may be very different from what it would be if you had full information. So often in national negotiations you are dealing with the profitability of the industry as a whole, which depends on knowledge of the profitability of particular firms in the industry. And then there is in most of our industries room for negotiation for additional wages with individual employers. Many of the members of this Committee will know the extent to which that has gone on for years. At the present moment, there is much more of that going on, and it may well be that, even if there was no strong case for this disclosure in the past, the modern tendency towards additional payments over and above the national minimum in particular firms is going on so extensively that that would be a reason for more disclosure now than was the case, say, in 1938, when we were often lucky to get the rates of the national agreement; we are not satisfied with that today.

Mr. Douglass: You had last year a number of national wage claims argued, and the ultimate results did vary with the profitability of the particular industry concerned; but already we have talked to our members about profitability, and I can tell you now that it would be little use for you to talk to my members about increasing productivity unless they benefited from the profitability resulting from that productivity in the form of a wage increase.

4697. *Mr. Bingen:* This discussion has arisen from the question of exemptions accorded to the banks, insurance companies and discount houses?—*Mr. Woodcock:* No; it arose from the banks' assertion that nobody ever asked for a wage increase on the basis of profitability.

4698. I think the Chairman originally raised the issue of the exemption given to banks, insurance companies, discount houses and shipping companies; that is

in a rather narrow field. I want to ask you whether the unions as such were concerned with this problem of lack of information in any industries except insurance and banking, where they would like to be concerned but at the moment they have failed to infiltrate?—The unions have not failed to infiltrate; they have infiltrated to a limited extent. Insurance as a whole is rather better than banks and there are some orthodox unions well established in insurance companies. The Prudential people are very well organised; in the Co-operative Insurance Society they are very well organised. We are not entirely excluded anywhere; even in the banks there is some degree of organisation.

4699. But do you take a very serious view of this question of disclosure of more information, or do you regard it as rather marginal in your approach to profitability?—We take it seriously.

4700. *Chairman:* What the Committee of London Clearing Bankers said was that salary demands were not usually considered in relation to ability to pay and they doubted whether salary demands were ever rejected on grounds of profitability—on the ground that the bank could not afford to pay them.—If they were talking about the banks they were entitled to their point of view, but if they were talking about industry generally then that is not true.

4701. *Mrs. Naylor:* The context was purely banks.—Then we are entitled to look on this as a situation where the banks do not know what their work-people expect of them. I doubt if the position would be improved by asking the banks about their knowledge of what their work-people want, because they take extraordinary steps to see that their own employees are not allowed to form a general collective view.

Mr. Douglass: Can you tell us what the difference is between a bank clerk and a clerk employed by some industrial firm?

4702. *Chairman:* You are asking me a question?—Well, you are asking us a question on the assumption that there is a difference. I think it is impossible for us to answer the question until we know what the difference is.

Mr. Woodcock: I have a great respect for bankers as bankers, but as employers they are not very bright.

4703. I was only trying to put their view, that wages and salaries were probably fixed on more general considerations than the profitability of the individual concern, and you say that the national minimum is fixed on a general basis—on cost of living and so on?—No, I do not say that. I say that even in the national negotiations profitability comes in. I am not going to be made to say that the unions go into these negotiations with certain fixed principles. I have never known an occasion when profitability was ruled out. If you have in your mind the level of profitability of industry as a whole, then the conception depends on a knowledge of the position of individual firms. In the old days, if you took coal mining, your conception of what they could pay was based on your knowledge of how individual firms were doing, so that the circumstances of particular companies do come into it, and it is not true to say that, because negotiations are "horse-trading", these things are irrelevant; they are very relevant.

4704. As regards the three types of concerns with which we are concerned now—i.e., banks, insurance companies and shipping companies—it is your opinion, is it, that the present exemptions as regards disclosure in their accounts would or might handicap their employees in their negotiations in relation to wages?—Yes indeed, and would handicap the public in estimating the position and the standing of the banks, insurance companies and shipping companies as well.

4705. You say that so far as the public is concerned there ought to be full disclosure, and that the absence of full disclosure might prejudice the public, and might more directly prejudice employees in negotiating wage increases?—Yes, that would be our view on that.

4706. *Mr. Scott:* The insurance companies may be in a different category because they do file their own accounts with the Board of Trade under special requirements applicable to insurance companies. Do the accounts they file at the Board of Trade give such information as

would be of assistance in assessing their position?—*Mr. Ferguson*: While they obviously give some information, they put it in in rather a specialised manner, and we could not regard that as a substitute for the information that we would like to see in the accounts.

4707. *Chairman*: Next, you say that one of the largest shipping companies has published its accounts since 1954 without recourse to the exemptions granted by the Board of Trade. I think that must be a reference to the P. & O. Company?—*Yes*.

4708. We did have some evidence from Mr. Aston, a director of the P. & O. Company, in which he said that they did, for certain reasons, decide to forgo the exemptions I think in their group accounts, but as regards certain lines operating in certain places where the position regarding foreign competition was difficult they did avail themselves of these exemptions, so that is how that stands. His view was that the exemption was something to be used in the particular cases in which it seemed necessary to the company owing to the conditions they had encountered?—*Mr. Woodcock*: In the interests of the company, as defined by P. & O.?

4709. From your point of view that would probably be less open to criticism than the existence throughout the undertaking of these privileges, regardless of the question whether in particular branches of the concern it was necessary or not?—*Well*, less open to criticism, but still subject to criticism. They do go some way, but not far enough.

4710. *Chairman*: Finally, on this question if it should turn out by some extraordinary chance—I do not know whether it could or not—that the banks were right and the shipping companies were right, and it was detrimental to their interests to publish everything, would not their employees be some of the first to suffer?—It is a question of what you mean by suffering. I cannot with the best will in the world imagine that banks, insurance companies and shipping companies are the best judges of what is considered to be suffering, in the broadest sense of the word. They may very well think that if they could just be allowed to be judges by themselves, everything would come out

all right. We all think that but I do not think we are entitled to presume that other people would take the same view.

4711. Then in your observations about accounts, you would like to see a periodical valuation of fixed assets to be required by law and the values thus estimated to appear as a note in the balance sheet. I think you suggest a going concern basis as probably the best method of valuation, subject I think to a note being put on the accounts as to the method which was adopted.—*Mr. Ferguson*: Yes.

4712. This raises fine questions of accounts in which I confess I am not as well-versed as I ought to be. But it is said that a going concern basis is only one of several methods of valuing the assets of a concern and it is a matter of extraordinary difficulty and uncertainty as to how the valuation should be defined.—We agree that the going concern basis is difficult to define exactly. Nevertheless I think this basis is generally accepted as a concept among accountants and in many cases when a company is sold this is the basis of the valuation of its fixed assets. We think it is a practical way of tackling this problem. But to go on further, roughly what we had in mind is that companies should value their fixed assets at periodic intervals on something like these principles, an estimate of the replacement cost of productive capital assets less depreciation, and possibly taking into account future life, together with the consideration of any value of the assets as a whole; in other words, an additional value in relation to replacement costs. I think we would obviously accept this can only be an approximation, and it is for that reason that we suggest that it should be included as a note rather than in the accounts themselves. But I think that our main concern here has been that we regard the historical approach to the valuation of fixed assets as tending to be misleading. For instance, when a company is sold the work-people find that very suddenly the assets change value very drastically. What we should like to see is some more information, so that if there is an occasion when the company may be sold or changes hands any subsequent revaluation of these fixed assets does not come as a complete shock.

4713. *Mr. Lawson*: Is there not some danger that such a figure of valuation appearing in the balance sheet might be misleading? Shareholders would be apt to substitute that value for the figure actually in the balance sheet and think they had something there which would probably realise that value if the company were sold, whereas of course you cannot sell the assets apart from the business itself. I wonder if you really want to go as far as to say the valuation should be given, and whether it would not be sufficient to meet your point if some provision were made for additional information being given of one kind or another according to the circumstances in the particular case. Do you see what I mean? —Yes. A lot would depend on the additional information you have in mind.

4714. I think it is very difficult to define. One company might say, "Our buildings were built 20 years ago and therefore the cost of replacing them would be perhaps three times as much as their value in the balance sheet". Another company might make the same statement, but add, "Nevertheless, building costs in this particular type of building are so reduced that we would not regard them as being worth three times whatever was their original cost but they perhaps have a value above the balance sheet figures". Another company might say, "The shareholders will be interested to know the buildings are insured for so much". It might be different information in different companies.—*Mr. Woodcock*: If you accept the point we are making but you think it is impossible or inadvisable to meet it in the way we have proposed, we certainly would be willing to look at it and probably to agree some other method of achieving the same objective. We see these difficulties and you see them, but we must not let difficulties put us off, which is easy to do. We press the point that some information of this kind ought to be there. Something of this kind ought to be done and we would certainly look at anything that was proposed as a substitute. In other words, we are not sticking on this as a rigid proposal but we put it forward as our own suggestion as to the way in which it could be done. Obviously the details would be subject to

more detailed investigation and more expert knowledge.

Mr. Douglass: Some effort has already been made to deal with this by the column in the balance sheet named "tangible assets". It must be more clearly set out.

Mr. Murray: I would have thought Mr. Lawson's comments implied an amazing degree of ignorance on the part of shareholders, and I would have thought a practical way of getting over it would be by companies doing a little education, by pointing out very clearly that in fact this should not be taken as an indication of what the assets could be sold for. Equally on our side, when we have to deal with our own members in the course of negotiations, we would make it clear that this was the purpose. I would have thought one could get over this with not too much difficulty in that sort of way.

4715. *Chairman*: Then you also suggest that the trading account items ought to be disclosed and broken down in various ways in order to give a true picture, I think; you want the disclosure of turnover?—What we want is something before the figure of profit from which we have to start now. We want an idea of how this was built up. We want an idea of whether there were any particular or special circumstances operating during the year which has made this exceptional or whether it is part of a general trend. At the moment we have no means of breaking down the disclosed profit figure. We think it would be helpful to us and, indeed, to employers if we could have that information for our negotiations.

4716. Some of the companies say that this would involve a very large amount of work and really the result in many cases would not be worth while.—This information that we are asking for in paragraph 10 of our memorandum I should have thought was already available within the companies. We do not ourselves think it would require a great deal of work; we are very surprised to hear it. These are the raw materials from which they construct their net profit figure. If one looks at the items we mention—cost of goods sold, turnover, cost of raw materials, wages—surely every company has these figures.

4717. *Professor Gower*: I think the argument was if they had to break it down into separate activities, it might cause extra work.—That is a slightly different point. Again, if a company has a range of activities, I would have thought, speaking perhaps from ignorance, that it would want to know what sort of return it was getting from the various activities in which it was engaged so as to compare their profitability and decide whether it wanted to go on with a particular activity or do something different. We are subject to what they say on this, but it seems to us odd that they should not have this information readily available.

4718. *Mr. Lawson*: The difficulty sometimes is that they have the figures of particular departments but when there are a great many transactions between one department and another department and so on, the management do not even for their own purposes obtain global figures for the whole undertaking. On the other hand, it might be extremely dangerous to publish figures for each individual department.—*Mr. Douglass*: I remember a time when we could get the figures for individual departments within the company in which we worked and it did a lot of good in those days, it did not do harm. I would say so far as productivity itself is concerned, where the breakdown of the costs of that company were known to the men involved it helped tremendously in making the firm more profitable and getting higher productivity. I have seen it happen, so I speak from experience on that.

4719. *Chairman*: Of course, the principle of disclosure is one thing, and how is going to be carried out in each individual case may be more difficult.—

Mr. Murray: We concede it may be difficult; we would not argue about that. The point Mr. Lawson makes seems to us to be one aspect of the general inhibition which companies in this country have about disclosure at all. They are attached to secrecy as compared with America where a great deal of this information is available and, so far as one can see, disclosure has not had unduly adverse effects upon the American economic or industrial activity.

4720. *Chairman*: The point is that you make suggestions for the improvement of the accounts and of course the Committee will in the end, I suppose, have to consider and recommend what the best form of accounts to be required may be.—If you tell us our suggestions are quite impracticable of course we will have to accept that.

4721. Then the next point, I think, concerns disclosure of particulars of subsidiary companies and I can deal with that quite shortly. Most people seem to be agreed in principle that it would be a good thing that subsidiary companies should be disclosed, with certain qualifications. They say there are circumstances in which it might be detrimental to the interests of a company to disclose the existence of or the particulars concerning a particular subsidiary. They say also there may be some subsidiaries which are quite insignificant amongst the many various subsidiaries of a large concern and there the requirements should be dispensed with as well. What is your view about that? Do you think it should be made a rule without exception that all particulars of all subsidiaries should be published?—We do not know what the circumstances are to which you refer. We do not know therefore what the exceptions should be. It seems to us on the face of it there should be disclosure of these connections, and if there are special circumstances which could be put to us and which we could consider, we might agree there should be exceptions. I do not know.

4722. As far as I can remember then, there is the case of a subsidiary operating abroad in a country where there are difficult political considerations and so on, and there it is suggested it might be better for the connection of the subsidiary with a particular company in this country not to be disclosed. That is one type of reason. The others you may or may not think less meritorious. There is the case of a concern making a given commodity and it wants to start operations in a different price range.—*Mr. Woodcock*: What you mean is they are afraid that if they were selling a commodity which they had advertised expensively and for which they had charged a high price, and then

they put a cheaper product on the market, people would be suspicious?

4723. Suppose you have a very fashionable West End hotel, and they want to make a bit more profit, and they think it is a good thing to buy a fleet of coffee stalls. They might think that it would be damaging to the prestige of their West End establishment if it were known that a good deal of the money was in fact made out of tea and wads.—They may think that, but you have to look at what other people think of it. I think it is of the greatest public interest. Maybe I am exceptional, maybe we all are, but this is information that at least we would find interesting and, I think, useful. We have often enough in the past, and I think we will more in the future, come across difficulties in negotiations because of not knowing what we ought to know. If we could prod a company into doing certain things, it might be to our advantage. When you come to prod a company, if you can show a precedent it is much better than theorising. You say, "This is done by X company and they find it not impossible or difficult to do. Why can you not try the same thing?" I think we always find it very difficult to believe that there is a real public justification for this kind of secrecy. You can always see personal, private reasons for it, but I would have thought it was one of the big issues before this Committee: what are the respective rights of the public and the companies? Should every attempt by a company to refuse to disclose be required to be shown to be in the public interest? I suppose this is a matter of opinion. Our opinion is quite firm on that point, that subject to anything we might say in a particular case where a particular reason is given, in general we do not see the justification for this kind of obscurity about what a company is doing.

4724. Even if secrecy was demonstrably for the benefit of the members of the company, you would say that the public interest was paramount?—Yes. I do not think that it is an absolute test, that it is demonstrably for the benefit of the shareholders of the company. It is a relevant consideration but not necessarily the last word. I do not know how far this question goes, but you may have some

of these issues coming up if this Press business goes through and it may be very important. I think the public should know the profitability and the ownership of particular products, in this case particular journals or magazines. One may want to know exactly what their connection is. It is very important that one should.

4725. There are one or two other examples of the subsidiary company and the parent company's reluctance to be identified with it. But what you have said now, of course, makes it unnecessary for me to refer to them because you say that these private considerations ought to yield to the general principle; they are all relevant particulars of companies' affairs and should be accessible to everyone?—Yes.

4726. I think we could pass from that and the next point I have noted is take-over bids. As to that, I gather you have seen the regulations issued by the Board of Trade and that in general they meet your views?—Yes.

4727. You made some additional suggestions about a copy of the offer being filed with the Registrar of Companies. I think that is a new provision but in general I think you do approve of these new regulations?—Yes.

4728. As to the effects of the take-over on employees, you say that the bidder ought to be put under a statutory obligation when carrying out one of these transactions to state what the intention is as regards the future of the employees. You naturally attach great importance to the future of the employees and I must say I fully sympathise. But the question is how to devise any legal method of protecting their interests.—*Mr. Ferguson*: We do not ourselves know of any legal method whereby one could protect the employees' interests, and in general one could in most cases leave it to the normal consultation process between employees and employers and to the negotiating machinery to take care of any cases of redundancy and matters of that nature.

4729. One of the troubles is that very often the object underlying one of these

take-over bids is to rationalise the undertaking so that they concentrate work in one factory instead of two to save costs, and this may make some of the work-people redundant. That is the risk.—Yes, that would happen with many take-overs. Employees should be given the greatest possible information not only to enable them to make arrangements if that should happen, but generally so that they know what is going on and have full information about their employment.

4730. Yes. But it is impossible to devise any scheme of pensioning people off and so forth—unless of course they are members of a fund.—*Mr. Woodcock*: Yes, I do not think we went quite so far as that when we talked about disclosure of intentions. But we must make the point that if the public knew more about the intention of a take-over, it would help us with a lot of troubles arising out of it. Sometimes you get the information, sometimes you do not. Where you get the information you can prepare for it. But I think we will have to leave it to you as to how far that could be made an obligation.

4731. If it is included amongst the terms of the take-over, then at least it might strengthen your hands in any negotiations for the benefit of the employees?—It may from their point of view ease the take-over insofar as the unions might otherwise be obstructive; in some cases the employees might be obstructive if they did not know what was intended.

4732. Then the next point I had noted is disclosure of ownership and control, and you are in favour of disclosure by anyone who has more than 10 per cent. of the capital. Your suggestion is: "We therefore suggest that any person or institution holding or acquiring through a nominee or nominees a total of more than, say, 10 per cent. of the issued share capital or debentures of any company should file with the company a statutory declaration of the name, address, nationality and description of the true beneficial owner." That suggestion is on the same general lines as suggestions which have been made by other witnesses. There is a considerable body of opinion to the effect that this disclosure is desirable, but there is also a fairly strong body of

opinion that in fact to implement any provision of that sort would create enormous difficulties.—*Mr. Ferguson*: We are not competent to say whether the administrative details are going to be insuperable or not. But we have noticed that the American practice for their equivalent of public companies does insist upon some similar regulation and as far as we know it has worked reasonably effectively.

4733. In America?—Yes.

4734. Have you got specific instances where the knowledge of beneficial interest has been turned to good account or prevented some undesirable development?—We have no details of that.

4735. How far would it really benefit the employees?—I think on this subject we would take our stand on principle.

4736. Public interest rather than employees' interest?—*Mr. Murray*: I think it might go a little beyond that; there might be a special interest. One of our unions on one occasion brought to our attention the difficulty they found in securing recognition of the union in a particular firm for negotiating purposes. They had reason to believe that a large quantity of shares was held by a particular individual on whom they hoped—and I think it is perfectly legal for unions to operate in this way—to bring some pressure to bear to talk to the management and to persuade them to act in a more reasonable and civilised way. They found it quite impossible to obtain definite information as to whether this was the case and I do not know what happened thereafter, whether in fact they approached this individual or not. But there may well be occasions like this where the interests of our members could be advanced by knowing with whom they were dealing. Also, the managements themselves might be more disposed to adopt what we regard as good practices if they knew that within the body of their shareholders there were some people who might make a nuisance of themselves if they did not do so. So there can be at least marginal trade union interest in this as distinct from the more general public interest to which you referred.

Mr. Douglass: When meeting with companies you have regard to the influence that is behind the scenes. In some you make the approach on a general principle that the wage claim will be recognised as morally justified; with another company you know full well you are going to have to fight every inch of the way and the case is made out on the assumption that ultimately it is going to arbitration; so your approach to the company must always take account of the powers behind the scenes.

4737. Yes, I see how you put it. Then as to unit trusts, you are naturally anxious that investors in unit trusts should understand what they are getting, which is an investment in relation to which they must accept some degree of risk. You say that there ought to be a representative association of unit trusts and an approved code of conduct. Well, as we understand it, the present position is that there is a body called the Association of Unit Trust Managers whose membership covers, I am told, 90 per cent. of the total funds invested in unit trusts in this country, and the way they would like to handle the problem is to produce in consultation with the Board of Trade a model trust deed setting out the rights of the unit holders, the constitution of the trust and the way in which it is to be operated, the duties of the manager and the duties of the trustee. Would an arrangement on those lines be acceptable from your point of view?—*Mr. Murray:* This sounds a reasonable approach. I seem to recollect there has been some controversy as to the constitution of this body. I believe one large firm refused to participate, but one cannot comment on that. We would have thought as a general type of approach and given, as you say, consultation with the Board of Trade, this might well go a considerable way towards solving the problem to which we draw attention.

Mr. Woodcock: Is this a new development? It is the first I have heard of it. Not long ago there seemed no prospect whatever of their forming a representative body.

4738. They have formed this association now which does appear to cover the bulk of the business. Of course, all unit

trusts have to be authorised under the Act. None of you have anything further to say on the subject of unit trusts? Then I had a note about donations for charitable purposes. Charitable in this context would include, I think, benevolent. First of all, I suppose you have nothing to say against charitable and benevolent contributions within reason.—Only that there should be disclosure of what payments are made or are proposed to be made.

4739. Would you have them disclosed, however small they were? They might be quite trifling amounts.—That is true. Nobody is concerned, as you say, with trifling amounts, but in these days some of the donations are not trifling at all; there are some quite substantial payments for charitable and benevolent purposes which I think should be disclosed.

4740. *Mr. Brown:* Do you mean in total or individually?—I think individually. It is not only the amount, it is the purpose.

4741. *Mr. Lawson:* There might be some difficulty sometimes as to whether the object of a donation is something that is charitable or something which at any rate has some benefit to the company concerned. Normally, companies give only to charities which are in some way connected with them or with which there is some association. The question might be rather difficult.—Yes. But why is it not possible to meet the requirement that all payments should be disclosed, and let the public decide whether it is for the benefit of the company directly or for a charitable purpose?

4742. *Mr. Richardson:* It is difficult sometimes to draw the line between what is advertising and what you would regard as a donation.—That is true.

4743. *Mr. Brown:* There is another practical point of not cluttering up the accounts too much with information. A large company might make hundreds of donations.—We concede that. Obviously it would be possible to draw the line, and you would not bother about certain small amounts. But there is a growing practice on the part of companies of making payments to all kinds of people for all kinds of purposes, and there seems

prima facie a very strong case for saying that they should be disclosed. There may be difficulties about disclosure, there may even be dangers about disclosure. There may be difficulties about defining how big the amount should be before it has to be disclosed. I say plump for disclosure rather than be overcome by the difficulties. I personally applaud gifts of some kind, but I think the shareholders themselves and in this case the public are entitled to know when considerable sums are donated. I believe in some cases literally thousands of pounds have been given to colleges and institutions. I would have no objection to that, but why fail to disclose it? I agree if you are thinking of legislation and what should be disclosed and what should not, when you get to the borderline you may have difficulty in finding a definition.

4744. *Mr. Lawson*: It may affect various funds in connection with employees, benefit funds of one kind or another, which technically may be charitable. It is a difficult definition, is it not?—I do not know what the definition is. If the widest range were given, then you would expect them to follow it. I do not see any danger in any case in disclosing what they give to employees. I do not think any employee would worry about that; if the money was given to them, that would satisfy them.

Mr. Douglas: Surely that information is given now?

Mr. Woodcock: In some cases, it is.

Mr. Douglass: If there is no objection to it being given now, there could be no objection to it being a statutory obligation. I make that point because I think in almost every case that sort of information is available. If it is already available, what is the objection to making it an obligation?

4745. What I am a little afraid of is that one might put something in the Act which would make it necessary for the companies to clutter up their accounts with a whole list of items, some of which might be the kind which I think you are really aiming at and an awful lot of others which would not be the items in which you are interested but which would have

to come within the definition. That is the sort of problem.—*Mr. Woodcock*: Yes, we can see the problem and you will have ultimately to settle it. I would be rather disappointed if the difficulties were such as to prevent your doing anything at all about it.

4746. *Chairman*: There is, as I see it, one point against this disclosure, that the amounts are probably relatively trifling compared with what is paid out every day under their general powers of management by the directors. Is it not rather meticulous to say that of all payments these particular donations should be disclosed?—Well, I would draw the line in amount. *Mr. Lawson* was raising the question of definition. I would be agreeable to the obligation being to disclose some but not others, but if you make a recommendation of that kind, there would be a no man's land which would be difficult to operate; that was your point. But we do this in every month of the year. Every month when the General Purposes Committee of the T.U.C. meets we have requests for assistance to one form of activity or another, mostly charities. We of course report to the General Council all the items, even if it were a mere £5, but in the Annual Report obviously we do not clutter it up with a whole list of £5 or £10. But there will be a great deal in the next Annual Report about the loan of £50,000 to the Belgian trade unions.

4747. *Mr. Bingen*: You are a trade union organisation and therefore you are making these contributions out of the contributions of your members, whereas a trading organisation is distributing monies which are accruing in the course of trade and directors must be assumed to be very careful as to the way in which they disburse funds belonging to the shareholders. It is rather a different position. A large public company, not the one with which I am associated, published their total contributions a few years ago. I do not know whether you took exception to it or whether you had any comments to make on it. No comment has been made, nobody seems to be any happier whether it is there or not.—It is a question of the use to which they are put. Surely the argument can be used—this does not lead to a conclusion on any specific gift—that

these companies, through their workers, have at their disposal very large sums of money and they can distribute these very large sums over a very wide field, and it is a matter of public interest, I would have thought, as to how exactly they used this very great power. I would personally, from what I know of the big companies that engage in this kind of activity, approve all their donations, but that is not the point. The public as a whole is entitled to know what it is that these people are doing and the extent to which they are doing it; just as the public, not only our own members, have a right to know what we do. We would not report to Congress and Congress would not be interested in ten guineas given to some organisation that set itself up to help women who have become incapacitated; but when we are spending large amounts, like the £50,000 to the Belgian unions, it is a matter of great public interest. I do not seek to say, "This is nothing to do with you". I recognise that our members and the public are interested and I would have thought the company directors who were distributing money would recognise their obligation not only to their shareholders but to the public.

4748. *Chairman*: Then you do not object to charitable and benevolent donations in reason but you say they should be disclosed in the accounts?—Yes, subject to an exception for very small gifts.

4749. Then the next one you are not so fond of, I believe, is the political donation. As to that, it occurs to me you may use that in more than one sense. A company may spend money on opposing or promoting legislation affecting its particular trade or business, may it not? That in a sense is political, but is that political in the sense you mean or do you confine it to direct subventions to the funds of this or that party?—We are very disturbed at the tendency for companies to spend money, under the general cloak of concern with the future of their company, on activities concerned with issues of great political interest at the time of elections. That is one thing. I must confess that we see very great difficulties in legislating to stop them from that kind of thing, unless you could legislate to stop them doing it in a certain period round about election

times. But when it comes to the more specific activities, then we are utterly opposed to companies having the right to spend on political objects as defined in the Trade Union Acts: that is the running of candidates, support of parties, publication of literature, and so on. General expenditure on an issue of nationalisation should, in our view, not be permitted during the period when the whole country is deeply engaged in the political issue.

4750. As far as I remember, the particular case of Tate & Lyle was not at election time, was it?—It was at election time.

4751. How close?—It was actually during the period of the election campaign. I think it would be reasonable that companies should not spend money on political campaigns during the period after nomination until after the election. I would have thought that good taste would have prevented them from doing that, but if they have not got the decency, then they should be prevented.

4752. Your suggestion about the limit of time would make it seem more a matter of election law than company law. Indeed, it could not be defined as company law anyhow, unless one is going to say that the prohibition should only affect companies and not individuals or partnerships. —You say, election law or company law: I do not know precisely what your terms of reference are, but I would have thought they would allow you, if you thought it important, to make a comment on it, even if you did not make a recommendation.

4753. Of course, it is a matter really of curtailing the company's power.—We would go this far with those who want to defend this practice, that we cannot really justify total prohibition upon a company. If a company seeking to defend itself against a political move goes through a proper form, that may be another matter. In any case, even if we sought a total prohibition, we realise the difficulty of definition, which might make you hold back from making any recommendation. But we think there is an issue here; as I say, I think it is largely a matter of taste. I personally would be quite content with no prohibition on the right to engage in publicity of issues that affect them, if I

could depend on companies' good taste, but I am not sure that would work. What I have said so far applies to advertisements by companies on matters affecting them. But we are very much opposed to expenditure on narrower political activities.

4754. That is the direct contribution? —A contribution to a political party or to an election campaign.

4755. If it was the case of a party going into the field with an announced intention to bring in Prohibition, maybe a brewery firm would have legitimate grounds for putting its arguments in favour of beer? —I think that is rather a different matter.

4756. Then the next item is preferential payments in winding up under section 319, and one should add to that the similar provisions which come in section 94 as regards receivers. You propose that preferential payments in respect of salaries or wages should be increased from £200 to £400 maximum for any one claimant. —Yes.

4757. That is a view the Committee notes. I suppose it depends on an estimate of the value of money and wage rates now as compared with what it was when the existing legislation was passed? —Mr. Ferguson: Yes.

4758. Whoever was getting £200 in four months in 1948 might very likely be getting very much more now, so it would be reasonable that his preferential rights should be increased to some extent. That is your point, really, is it not? —That is what we believe.

Mr. Murray: I would not draw a precise statistical connection between the two. We are not suggesting here that people are getting twice as much money as they were in 1948. Nevertheless we think the preferential payments might well go to £400; that is to say, we are not saying that £200 was the right figure or high enough in 1948. But your general point as to the rise in earnings is correct.

4759. Then you have a suggestion of a pre-preferential payment of one week's wages or salaries, limited to £25. I see that comes from the report of the Committee on Bankruptcy and Deeds of Arrangement Law Amendment. —Yes.

4760. And the recommendation to that effect which was made there you would like to see embodied in the Act? —Yes.

4761. On this subject, I do not know whether this point has occurred to you. There was the case of *Hutton v. West Cork Railway Company* in which it was held that a company could properly make gratuities to the work-people over and above their legal rights, because that tended to ensure a contented staff and therefore it was within the implied objects of the company. Then it was held once there was a winding up that was no longer so because it was no longer of any importance whether the employees were efficient or contented or not. The Public Trustee has submitted evidence in which he has suggested that where a company is solvent and is being wound up, it ought to be within the power of the liquidator, with the sanction of a resolution of the company, to make reasonable gratuities and donations to work-people who are losing their employment. That is a small point, perhaps, but I take it, it would have your support? —Yes, indeed.

Chairman: Those are all the questions I have to ask. I do not know whether any of my colleagues would like to ask anything.

4762. Mr. Bingen: I should like to ask one question. There has been quite a lot of general discussion about the position of shareholders *vis-à-vis* directors and managers of companies. There has been a suggestion from various quarters that shareholders are a mere body of sheep who take no interest in company affairs, allow themselves to be persuaded by the management and so on. Nowadays, a great number of people are interested in companies and invest in their shares; perhaps the T.U.C. has invested funds from time to time in the shares of individual companies. We have not discussed this afternoon one of the problems which has exercised us in previous meetings: how one can make shareholders more interested in the companies in which they have invested, and how one can prevent directors from perhaps taking decisions which are not in the interests of the shareholders. Have you any comments you would like to make on that broad, general

issue?—*Mr. Woodcock*: We have not discussed this, as far as I know, in the T.U.C. in a way that would enable us to be competent to answer the question you have put to us. We have known of this tendency for some time for shareholders to assume a declining importance in the affairs of companies. I would be very hard put to it, even if I disapproved of it, to think what you could do by law without impeding the flexibility implicit in modern industrial management.

Mr. Douglass: Could I put it this way, if we tell Mr. Bingen how to get shareholders to take an interest in their company's affairs, perhaps he would tell us how to get trade unionists to take an interest in their union's affairs. The answer, I think, is fairly simple. When a company's shares have been on the up and up for a long time, apathy happens automatically. If you get a company where the reverse takes place, then I think there would be an automatic interest on the part of the shareholders. At least, that is what happens with our trade union members. How you would remedy it in terms of legislation, I would not like to say.

4763. *Mr. Scott*: You would agree that there is a big difference between what might be commercially or indeed ethically desirable for companies to do in the way of disclosure and so forth and what could be imposed compulsorily by law on all companies? If anything is made compulsory, there must be a sanction to back it up if it is not complied with, sometimes even by oversight. So that in framing any recommendation, presumably it is rather important to bear in mind that although you can have a high standard, you cannot necessarily impose that by law on all companies. I am particularly impressed by what you said under paragraph 10 of your memorandum: "That the extent of disclosure which the Companies Act makes obligatory in the profit and loss account is inadequate is demonstrated by the increasing number of companies which voluntarily disclose information in excess of the minimum required by the Act." I think, if I may say so, that is a *non sequitur*. You always get people disclosing in excess of a minimum. Is there not something in that

observation?—*Mr. Woodcock*: There is a great deal in that observation. We have come across it in other directions. We come up against it, for example, in connection with the health service and welfare and industrial work. The law imposes only minimum obligations and we rely a great deal on the more progressive humanitarian firms to do something in excess of the law. But I think we have to admit that, as you say, there is bound to be at any time a difference between what is morally or ethically or commercially the kind of thing you ought to do and what in fact the law compels you to do. But we would go a little further and say there seems to be a tendency on the whole to wait a long time before accepting what is established practice as something which should be legalised. I think the question is, in company law is this gap too wide? Have we now reached the point at which one can lift up the level of legal obligations, especially in view of the fact that some companies have shown it can be done?

4764. Bear in mind that companies can differ so widely in their particular category: trading companies, merchanting companies, investment companies and so on, carrying on widely different interests. What is applicable to one is not to another. —I am merely saying your argument can be used to stop anything. Where do you draw the line? What is your standard? Do you decide what ought to be done, what you ought to compel all employers to do by reference to the least efficient, the least competent, the least progressive firm? Obviously you cannot determine it by the most progressive firm. Where do you draw the line? Which is, for this purpose, the representative firm? As I say, there will always be a gap but there is always this question as to where to draw the line. We are not asking for everybody to come up to the level of the most progressive. It is a question of what should be the standard; what evidence of competence do you take to justify making this obligation?

4765. *Mr. Brown*: I would like to continue the comments on shareholders investing in companies and particularly Mr. Douglass's remark that when things are not going so well, shareholders take

more interest and in fact, of course, that extends on occasions to interfering with the management when it becomes inefficient. With that in mind, I was surprised to hear no expression of dislike of voteless shares. Positions can arise when the control of the company is entirely with the management, and if that becomes inefficient, there is nobody to turn them out.—*Mr. Douglass*: My comment is if there is a controversy, the remedy lies with the shareholders, without our interfering in that.

Mr. Murray: If a man buys this type of share with his eyes open, he must take the consequences.

4766. I am thinking of the effect on employees as well.—*Mr. Woodcock*:

(The witnesses withdrew)

MR. R. E. WILLIAMS, MR. W. G. PULLEN, MR. R. V. LOW, MR. S. K. BROOKE
and MR. R. G. DYSON called and examined

4768. *Chairman*: Gentlemen, we are very much obliged to you for coming here this evening to state the view of the British Overseas Banks Association in regard to the question of the exemption which you are allowed under the Act from disclosing your inner reserves and certain provisions in your accounts. You, Mr. Williams, are the Chairman of the Association and General Manager of the Standard Bank of South Africa. Mr. Pullen is a member of the Committee of the Association and Chief General Manager of the Chartered Bank. Mr. Low is also a member of the Association and joint General Manager of the Bank of London and South America. Mr. Brooke is a member and Head Office Manager of the Australia and New Zealand Bank. And Mr. Dyson is a member and General Manager of Barclays Bank D.C.O. Is that correct?—*Mr. Williams*: That is correct, my Lord.

4769. Can you tell us something about your Association? How many constituent banks have you?—Thirty-two.

4770. Are they all over the world?—Yes, widely distributed all over the world. Approximately 50 per cent. are registered British companies and the other 50 per

Your question was based upon an assumption which I do not think we could accept generally: that the shareholders are more intelligent, more humane and more knowledgeable than the people they are up against.

4767. There could be extreme cases where nobody could interfere with the management.—Well, I do not know that nobody can interfere: there are more ways of interfering than one.

Chairman: Those are all the questions we want to trouble you with and I would just like to say on behalf of the Committee how very much obliged to you we are for coming and giving us so much of your time. I think we have had a very interesting discussion. Thank you very much.

cent. operate in the Commonwealth and have offices in London that qualify them for membership of the Association because they are registered in British territories. Those are the general qualifications.

4771. Some of them, I understand, are chartered companies?—Yes, our membership includes one or two chartered companies.

4772. Under the special provisions of the Fourteenth Schedule to the Act, have any directions been given which make their obligations different from one of the ordinary banks in this country?—*Mr. Pullen*: There is no difference in respect of the accounts.

4773. There is nothing which qualifies the ordinary accountancy provisions as applied to a bank?—Nothing at all.

4774. There is a certain amount of evidence we have heard about these exemptions and, in particular, from the Committee of London Clearing Bankers, and it seemed to us reasonable, in dealing with your evidence, to start by looking at the evidence in their memorandum, and then consider how far the conditions you

have to contend with, banking as you do overseas, could be regarded as adding to the reasons advanced by the Clearing Bankers. Do you follow?—*Mr. Williams*: Yes.

4775. This, I think, is the material passage from the London Clearing Bankers' memorandum which sums up their case: "(1) In the case of banks, the interests of the depositors outweigh those of shareholders. (2) Unquestioning confidence in the stability of the banking system is a national asset of the first importance. (3) While it is important enough that the banks should enjoy this unquestioning confidence at home, it is even more important that they should do so in the eyes of the outside world; and some overseas countries which are not so happily placed watch the evidence of stability very closely and react very quickly to any unusual symptoms. (4) But the earnings of the banks are subject to wide fluctuations from year to year since the results may be much affected by changes in the value of their investment holdings and by their experience in respect of bad debts. (5) In consequence, reserves, which in any other business would be considered large in relation to the capital employed and to the normal trading profit have to be built up in good times, in the knowledge that equally large drafts on those reserves may be required in other years. (6) Full disclosure in the accounts might embarrass the banks in their policy of making large provisions in good years, while the spectacle of heavy drafts on those reserves at other times might undermine that unquestioning confidence in the stability of the banks which is acknowledged to be a national asset of the first importance."

Those are the six points listed by the Committee of London Clearing Bankers, and one might add to that the reference in your own memorandum, in which you refer to the special difficulties in some foreign countries. I think you can help us best if you can tell us in your own words the additional reasons you say apply to your case as compared with the Clearing Banks.—We, of course, wholeheartedly support the arguments, representations and recommendations which have been made in respect of the banking

system as a whole by the other bankers who have spoken before this Committee. There are, as you say, specific matters which affect the British overseas banks in particular. One or two of the matters which have been mentioned by the clearing banks apply with even greater force to the British overseas banks. You have mentioned the question of confidence in the stability of the banking system. This is of vital importance in the young and emergent territories in which the British overseas banks largely operate. The question of investments has also been mentioned. I think there has been reference to the depreciation in British Government securities, which has to be cared for. The British overseas banks also hold British Government investments and, in addition, hold the securities of governments of territories in which they operate. In the young and emergent territories the value of these government investments is liable to even wider fluctuations, due to political and other disturbances. For the same reasons, there may be disruption of trade and business in many of these territories, and in this respect we are even more vulnerable than the British clearing banks. You have also alluded to the question of the overseas correspondents and connections of the British clearing banks. Such connections, I feel, are even more important to the British overseas banks. We deal almost entirely with overseas trade and I think, perhaps, a point should be made in regard to the bill on London, which is that worldwide instrument which deals with the settlement of international transactions. That is a bill on the banks in London, and particularly on the British overseas banks. Were the confidence of people overseas in any way weakened, the value of the bill on London, as I see it, would be largely lost. That must reflect on the economy of this country, inasmuch as the British overseas banks are really a source of considerable invisible exports for the United Kingdom.

Those are the considerations as I see them from the point of view of our position in this country, but as we carry on business in the overseas territories we are in a particularly difficult position. We operate in under-developed territories, in young and emergent countries in which

there is almost a complete lack of experience among the indigenous population in matters of finance. It might become very difficult to satisfy the authorities there, or such authorities as may come into power, of the need to maintain ample reserves. The growth of nationalism, too, coupled with this inexperience, might lead to pressure on the banks to remit any inner reserves to those territories. We should be under pressure to support all sorts of schemes of development which would not be normal banking propositions. It might be difficult to repatriate funds. There might even be restriction on movement of profits back to this country, which are part of the invisible exports of this country. In operating in these young and under-developed territories we frequently assist, to a not inappreciable extent, in supporting propositions which we feel to be in the interests of the economy of the country. Those propositions might not always be normal banking propositions. Nevertheless, we do that in the interests of the economy of the country in the knowledge that we have inner reserves. If the project which is supported is protracted, or if it goes wrong and we lose, we can weather the storm. If we were to disclose our reserves, it would behove the banks to confine their activities to purely orthodox banking propositions.

Most of the British overseas banks operate in several different countries and carry inner reserves covering the whole of their activities, so they can iron out difficulties in any one country from their total resources. If we found we had particular stresses and strains to cope with in a particular country, we should probably be able to carry the situation in the knowledge that we had these inner reserves, whereas if they were disclosed we should probably be under pressure to transmit those reserves overseas and, instead of carrying the stresses and strains, have to adopt urgent remedial action.

In these overseas territories where we operate, there are indigenous banks and international banks which are not subject to the requirement to disclose inner reserves, and British banks operating in those territories alongside those other banks would be at a distinct disadvantage

if they were now required to make such disclosure. I think it is most important that the stability of the banking system should be maintained in these overseas territories and I cannot see what would be gained by disclosing these reserves at all; in fact, very much the reverse. That, broadly, is our case, which we should like to put before you, with its particular bearing on our operations as distinct from the operations of the clearing banks in this country.

4776. Who are your customers—trading concerns, or private individuals?—They would be made up of both.

4777. It has been put to us that the old objection was that if you had no inner reserves and disclosed a loss which appeared on your balance sheet, there might be a run on the bank; and that that may have been so a hundred years ago but nowadays people are more sophisticated. How would that apply to your territories? How much do they know about it?—Very little.

Mr. Pullen: There was not so long ago a run on a bank at Singapore.

4778. *Mrs. Naylor:* How justified was the run on the bank in Singapore?—Perhaps liquidity was not as high as it should have been, but it only needs a rumour.

4779. *Mr. Brown:* There was no question of insolvency?—No, liquidity, perhaps.

Mr. Williams: You say that people in this country are sufficiently sophisticated and if there was a run on a particular bank they would not worry about it. That would not be true of the overseas territories. If there was a run on a particular bank as a result of disclosure in the balance sheet, other banks might become suspect and it would have a snowball effect and undermine the credit structure of the whole country. It might even apply in this country, although it would take longer for the snowball to build up—but it could happen.

4780. *Professor Gower:* The bank on which there was a run had presumably not disclosed its full reserves. It did not have to reveal its true financial position.

It might be argued that the best way to prevent rumours is to reveal the truth.

—*Mr. Pullen*: Legislation has been brought into force in India which prohibits full disclosure by banks. They have had two or three runs on banks and the governor of the Reserve Bank considers it essential for the strength of the banking system and the confidence of the public, that reserves are not disclosed. I happen to know that his fear is the paucity of certain reserves. But that is being catered for by legislation.

4781. *Mrs. Naylor*: Are there any territories in which there is compulsory disclosure?—*Mr. Williams*: No, none at all so far as I know.

4782. In how many countries do you operate?—The British overseas banks are world wide.

4783. *Sir George Erskine*: There is full disclosure in the United States?—*Mr. Pullen*: That is a misconception. Strictly speaking there is supposed to be full disclosure, but from some of my banking friends in the United States I understand they are able to build up reserves in contingencies by making provisions for bad and doubtful debts.

4784. *Mr. Bingen*: Are we now discussing solely the accounts of companies incorporated here which have a controlling interest in companies abroad? So far as you are operating through a company incorporated in Singapore we have got no jurisdiction.—We do not operate through a separate company there; it is a branch.

4785. *Sir George Erskine*: Are there any countries where you have got to make greater disclosure than is required at home?—Government inspection, but not disclosure.

Mr. Williams: Regulations vary from country to country, but by and large, so far as the Commonwealth is concerned, British practice is followed.

4786. There are government inspectors?—There are government inspectors in some parts, but not in the countries where the bank I represent operates.

Mr. Low: In Latin America there is a complicated system. For instance, in

Buenos Aires there are two government inspectors permanently on the branch premises. There is no public disclosure in the accounts we are required by law to publish in that country. There is no disclosure of what is placed to reserves for bad debts or losses thereon.

4787. *Mr. Brown*: So far as your members are not registered in this country, to what extent are they controlled by the British Companies Act?—*Mr. Williams*: They are not controlled by the British Companies Act in the same way as English companies. They are not in the same position as we here today are—we are representing the British overseas banks registered in this country.

4788. *Mr. Lawson*: You refer to the fact that it could have adverse consequences if it were known that a particular bank had run down its reserves. I was under the impression that so far as the purely British banks were concerned, although they do not disclose their true profits they do disclose the trend of their profits.—That is the practice.

4789. Does that apply to your banks as well?—Yes, it does.

4790. Do you attach the same importance to the profit and loss account as you do to the balance sheet? It would be possible to take the view that a bank might retain secret reserves in the balance sheet but should disclose the full profits for the year and the amount put into the secret reserve. Is each aspect of it equally harmful to you?—I think disclosure of fluctuations is equally important as the disclosure of the reserve itself. If there were a very heavy draft on the inner reserves and if it were reflected, questions would soon be asked as to the position of the bank.

4791. Supposing you showed only the amounts put into the inner reserve, you would not have to disclose when those inner reserves were used to meet large and exceptional losses.—In many of the territories in which we operate if large transfers were seen to be made to inner reserves, we should come under pressure to move the funds to the territory concerned, or to more than one of the territories, or to support to an even greater

extent the economy of those countries, and to a greater extent than would be wise from the point of view of the stability of the bank.

Mr. Pullen: The questioner has possibly not realised that a big fluctuation in British Government securities would mean a big transfer from inner reserves. In a year when the bank rate had gone up suddenly we had to transfer some millions of pounds from inner reserves or we would have had to show this as a loss on our holdings of government securities, which we should not like to be known in the eastern countries as it would not have been understood. They would think we were in a bad way.

4792. I was putting it to you that it might not be harmful if what you had to disclose was the annual amount you had put into the reserves.—It does not sound quite honest to me, quite frankly.

Mr. Williams: Would there not be a risk that the less well informed people would add the figures together and say "This institution must have an enormous fund by now. We have had no indication of any drawing from the reserves. What has happened to this fund?"

Mr. Lawson: You would probably have to put some limit on it.

4793. *Mr. Brown:* It is a fact that you have to disclose that there is a transfer, but not the amount?—No, there is no disclosure at all in the countries with which I am concerned, except to the income tax authorities, and then there is a return of the movement but not of the total amount of our inner reserves.

4794. I thought the profit and loss account indicated that there had been a transfer?—*Mr. Pullen:* I think the account states "to or from reserves".

4795. *Mrs. Naylor:* You are in an awkward position, because you want to look both richer than you are and poorer than you are?—Yes, it could be put that way.

Mr. Low: On the question of transfers to or from reserves, where it could be shown that profits made in one country, the remittance of which involved a drain

on that country's foreign exchange reserves, had been used to meet losses incurred in another country, or to cover the depreciation of working capital there due to currency devaluation, the political reaction in the former country could be extremely detrimental to the bank's own position in that particular country.

4796. *Mr. Lawson:* They must know that already, if they inspect your accounts locally?—Yes, but they do not know how much you make in another country.

4697. I can see that a particular country is extremely interested in seeing that the money that is made in that country is not transferred, but that, I imagine, they know already from the inspection.—Yes, in the majority of countries.

4798. *Mr. Bingen:* Take your branch in Buenos Aires where there are two inspectors. You have to publish certain figures and pay income tax. Would that not give a clue to the trading profit?—In that country, yes.

4799. If we had got them all together, we could consolidate your figures?—Yes.

4800. If we had got all the figures we should be able to work it out?—It would be extremely difficult to do; it would be almost impossible.

4801. *Mr. Brown:* I think you said the branch figures are not published?—The local balance sheets are published; the profit and loss is published.

4802. *Mr. Lawson:* The true profit is published?—No, after transfer.

4803. *Mr. Bingen:* The tax computation is shown?—*Mr. Pullen:* No.

4804. *Mr. Richardson:* That is known to the authorities privately?—Yes.

4805. *Mrs. Naylor:* The amount of tax paid is shown in the published accounts?—We do not have local accounts. We have to give one in India, but in practically every other country our figures are confidential to the central bank. They are not published locally. They are merely branches, not complete entities as companies.

4806. In the Argentine do you have to show tax figures, *Mr. Low?*—*Mr. Low:* Yes.

4807. *Mr. Lumsden*: It was mentioned that the United States banks achieved the same secrecy by creating contingency reserves for bad debts. Are the transfers to and from such reserves completely undisclosed?—*Mr. Pullen*: That is my impression. I know a lot of American bankers and they indicate they are allowed to put aside a percentage of their lendings as a contingency for bad debts.

4808. *Sir George Erskine*: I think that figure is disclosed—what is actually transferred to contingency account.—Yes, it is.

4809. *Mr. Brown*: Would you not consider that the American banks are not really comparable—that they do not trade overseas?—*Mr. Williams*: Broadly speaking, that is true. There are two American banks which operate in South Africa and they are not subject to the same regulations as we should be if under the British Companies Act we had to disclose reserves. The American banks are in a different category. The whole system in the United States is so different. I believe there are about 14,000 banks in America, spread throughout the length and breadth of the country, not banks with a country-wide network of branches. If there was any difficulty with regard to any particular bank in America—say, in the Middle West—any repercussions would tend to be confined to that area and would not have the country-wide repercussions there would be in this country or in some of the overseas territories where we operate.

Mr. Low: It is also true to say that there are few, if any, American banks operating solely overseas in the same way as the British overseas banks which we represent. Those American banks which do operate are the larger ones—the First National City, the Bank of America, and others—and the volume of their business represented by their overseas branches is relatively small compared with the size of the whole bank.

Mr. Williams: Our memorandum was quite brief because we did not wish to burden the Committee with repetition. We knew that the London Clearing Bankers were going to submit a comprehensive review. Would it be helpful to

the Committee if we were to put any of these points down in a supplementary memorandum?

4810. *Chairman*: If you feel you can do better justice to your case by sending us something, by all means do, and if, on consideration, you feel there is anything you can usefully add, perhaps you will send it in.—We should be pleased to do that.

4811. *Professor Gower*: I gather from your memorandum that one of your objections to losing the exemption is that this would lead to disclosure of information which would be used by the trade unions abroad in wage negotiations. The objection of the T.U.C. here to non-disclosure under the exemption is that it deprives them of information which they ought to have in connection with wage negotiations. The point made by the London Clearing Bankers was that this sort of information was not needed at all in wage negotiations. There seems to be an inconsistency here. The London Clearing Bankers say there is no point in disclosing the information because it would be useless in the negotiations, and you appear to say you want to retain the exemption because the information would be useful.—The point is that in some countries the trade unions are responsible and in other countries in which we operate they are less responsible; my own experience is that in the countries in which the bank which I represent operates the trade unions concerned have felt no disadvantage in not having the full figures as to the amount that has gone to reserves. This has not affected the negotiations in any way; they have been conducted by reference to quite different considerations from what the bank might have made by way of true profits.

4812. In other words, this argument about trade unions is irrelevant?—It could apply in some countries.

Mr. Pullen: We are in negotiation with three trade unions which are trying to get these reserves divulged so that they can get bonuses for their staffs and more fringe benefits, and in some countries they are already paying maternity benefits to the dependents of clerks, and so on. It is merely an attempt to try to get something

from us which a trade union in this country would never have considered. I am talking of the irresponsible as against the responsible unions.

4813. But looking at it from a trade union point of view, is it irresponsible?—I would think it irresponsible because I think the wage structure of the country is more important. We have actually had governments coming to us and telling us we must not pay servants of the bank at a rate which upsets the pay in government service. That again is a case where I know the government has taken action to stop the unions. I think trade unions abroad and trade unions here are quite different things.

4814. *Mr. Bingen*: We have been discussing this afternoon your suggestion that you should be exempted and placed in the same position as the clearing banks, and therefore we have to consider the balance of advantage on the one hand of the stability of the banking system and, on the other hand, the detriment alleged to the shareholders if there is not full disclosure. How far are the members of the British Overseas Banks Association public companies, in which I can buy a share, and how far are they subsidiaries of one or more of the British banks? Are some of the banks you represent private companies and others subsidiaries of public ones?—*Mr. Williams*: I am not sure that there are any private companies at all. I think they are all public companies; I would not like to say off-hand which might be in the category of subsidiaries.

4815. On the whole you are public companies, whose shares can be bought by the public?—Yes.

4816. So you are in the same position as the clearing banks, although you have your own particular problem?—Yes.

4817. *Mr. Althaus*: Underlying your case for withholding disclosure is the fear that you might have pressure put on you to transfer funds to the countries in which you operate or that alternatively you might be pressed to use a greater proportion of your reserves than you would wish in local investments. In some cases you

have inspectors on the premises and in other cases you have to make returns to someone, and presumably all these things are known to the governments concerned. Is the pressure you fear, governmental pressure, or public pressure?—It could be governmental pressure, or general national pressure from the national feeling which grows up in some of these territories.

4818. The government could build up general pressure. It is more general pressure that you fear?—Yes, that is so.

Mr. Low: Speaking for myself, it is mostly governmental pressure. I think the strongest point of these banks banking in foreign countries as opposed to the Commonwealth countries, is the demand that more capital shall be invested, greater than the needs that the banks themselves consider that their own business justifies.

4819. The publication of your inner reserves would give them more knowledge than they already have?—Yes, undoubtedly.

Mr. Low: It has, for instance, been suggested to us that a percentage of our free reserves, proportionate to the figure of our deposits in a country, should be invested in that country.

Mr. Pullen: That is a formula we have had put to us. These people take the value of the depositors' money in the branch and take the proportion of that to the balance sheet as a whole, and on the formula they use they would say that of these reserves, a proportion—a tenth perhaps—should come back to the country in the form of capital. We have had a certain amount of pressure there.

Mr. Low: It also brings out a point of national interest, that to have to invest larger capital in any one country creates a drain on this country's gold reserves—by having to keep an unnecessarily large capital in one country merely by having to respond to government pressure at the other end to do so.

4820. *Mr. Brown*: On the question of shareholders, I think that a year ago there was a take-over bid for a bank which

might have been a member of your Association. Did the shareholders sell their shares and not know if they were worth two or three times the price offered?—*Mr. Williams*: I am not sure that it would be correct to describe that as a take-over bid. It was a merger between the banks.

Mr. Pullen: The consideration offered was based on the inner reserves of both banks. That was how it was worked out.

4821. There is nothing for the shareholder to show that it was a satisfactory offer?—*Mr. Williams*: Any more than there would be in an ordinary industrial concern, as distinct from banks, where shareholders also depend on the advice of the board of directors, and would not

know to what extent stocks or work in progress, for example, were under-valued.

Mr. Pullen: We have a very different problem in this country. The banks' buildings are tangible assets in this country, but on one occasion we lost £1½ million of property through political pressure, and are under pressure for another £½ million now; six months ago that property might have been a considerable sum in our assets, and now it may be nothing. It is a very important point. You need hidden reserves to cover that sort of contingency.

Chairman: I think those are all the questions we have to ask you, and it just remains for me to thank you for coming here this afternoon.

(The witnesses withdrew)

APPENDIX XXXVI

Memorandum by the General Council of the Bar

The views, which are hereto annexed, have for ease of reference been arranged in three parts.

Part I contains matters which have been classified as *Major Points*. These have been treated systematically by reference to sections of the Companies Act, 1948, and to regulations in Table A.

Part II contains matters which have been classified as *Minor Points*. These have also been treated systematically by reference to sections of the Companies Act, 1948, and to regulations in Table A.

Part III deals with matters which cannot easily be discussed by reference to any particular section of the Companies Act, 1948, or to any particular regulation in Table A. These matters are grouped under the five heads (the bracketed numbers refer to the Annexes with which we were provided).

1. Directors' duties (6)
2. Shares with restricted or no voting rights (7)
3. The protection of minorities (8)
4. Company and business names (24)
5. The securing of proper disclosure of information in circulars seeking proxy votes (26 (c)).

We have not dealt with the vexed questions of share premium accounts and distribution of pre-acquisition profits, which obviously require clarification.

PART I

Major Points—Companies Act, 1948

Section 5

The Ultra Vires Rule

It was recommended by the Committee on Company Law Amendment which reported in 1945 (Cmd. 6659) that the *ultra vires* doctrine should be abolished. The report set out in paragraph 12 the following views of the Committee:—

"... a practice has grown up of drafting memoranda of association very widely and at great length so as to enable the company to engage in any form of activity in which it might conceivably at some latter date wish to engage and so as to confer on it all ancillary powers which it might conceivably require in connection with such activities. In consequence the doctrine of *ultra vires* is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company. For example, if a company which has not taken powers to carry on a taxi-cab service, nevertheless does so, third persons who have sold the taxi-cabs to the company or who have been employed to drive them, may have no legal right to recover payment from the company. We consider that, as now applied to companies, the *ultra vires* doctrine serves no positive purpose but is, on the other hand, a cause of unnecessary prolixity and vexation. We think that every company, whether incorporated before or after the passing of a new Companies Act, should, notwithstanding anything omitted from its memorandum of association, have as regards third parties the same powers as an individual. Existing provisions in memoranda as regards the powers of companies and any like provisions introduced into memoranda in future should operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors"

A recent illustration of the hardship which the *ultra vires* rule may inflict on third parties dealing with a company which had acted *ultra vires* is contained in the case of *Re Jon Beauforte (London) Limited*, 1953 Ch. 131. Moreover when the objects clause in the Memorandum of Association was made more readily alterable by the Companies Act, 1948, the rule became, if anything, even more of a trap for the unwary third person contracting with a company: such a person cannot be expected to keep a constant watch on the provisions in the objects clause from time to time in force in the case of every company with which he deals.

We suggest that the abolition of the *ultra vires* doctrine as regards third parties could best be effected by amending section 5, and that the following subsections be added thereto:—

- (1) Any act or thing done by a company which if the company had been empowered to do the same would have been lawfully and effectively done, shall, notwithstanding that the company had no power to do such act or thing, be effective in favour of any person relying on such act or thing who had not at the time when he so relied thereon express notice that such act or thing was not within the powers of the company, but any director or officer of the company who was responsible for the doing by the company of such act or thing shall be liable to the company for any loss or damage suffered by the company in consequence thereof.
- (2) A person shall not be deemed to have had express notice that an act or thing was not within the powers of a company merely by reason of the fact that he was aware of some provision of the Memorandum of Association of the company, unless such provision expressly prohibited the doing by the company of such act or thing.

Section 5 enables the holders of not less than a stated proportion of a company's share capital or of any class thereof, or (if there be no share capital) not less than a stated proportion of the members, or the holders of not less than a stated proportion of a company's debentures (if issued before the 1st December, 1947) to apply to the Court to quash an alteration of the objects of the company.

It is considered that this is a valuable safeguard to minorities which should be preserved. The time limit within which such an application has to be made is 21 days from the date on which the resolution affecting the alteration is passed; and it is accepted that such a time limit is desirable so that the company can know with certainty at an early date that an alteration has become binding and effective. But if the shares or debentures of a company are widely held, or in other special circumstances, it may be impracticable for those who object to the alteration to muster *within the time limit* a number of persons holding the stated proportion of shares or debentures or the stated proportion of members. The stated proportion in each case is 15 per cent., which in our view is too high. We suggest that "5 per cent." should be substituted for "15 per cent." wherever the latter expression occurs in section 5 (2).

Section 75

Instrument of transfer

The common form instrument of transfer is on its face a deed, though rarely operating as such, and provides for the signature of the parties to be witnessed.

The obtaining of witnesses is a nuisance, and it is believed that sometimes, where a party has omitted to have his signature witnessed, the omission is repaired by some person who in fact never witnessed the execution. Witnesses could well be dispensed with in this instance. Witnesses are not normally required to forms of renunciation and forms of application for registration on allotment letters, without any untoward consequences. Accordingly we suggest that a new section be added after section 75 in the following terms:—

"Unless the articles of a company expressly provide to the contrary an instrument of transfer of its shares need not be a deed or in the form of a deed, and

witnesses to the signatures of the parties shall not be required, and a provision in the articles that instruments of transfer shall be in common form shall not be construed as a provision to the contrary."

If this suggestion is not acceptable, we would propose in the alternative that it should be expressly provided that husbands and wives are competent to witness one another's signature (as to which see note (g), Halsbury, 3rd Ed., Vol. 11, page 348, title "Deeds and other Instruments").

Sections 119, 120 and 121

Dominion registers

(A) We suggest that at the present time the expression "Her Majesty's dominions" ought to be clarified as regards its ambit.

(B) It is not clear which is meant by a "part" of Her Majesty's dominions.

For example, can a company carrying on business throughout Australia keep one dominion register for members resident anywhere in Australia or alternatively keep a separate dominion register in each of the States of the Commonwealth, or in some only of the States of the Commonwealth for members resident in such respective States?

Subsection (5) of section 120 implies that a company can keep several dominion registers in the same "part" of Her Majesty's dominions, and accordingly it would appear that a company could have a separate dominion register in several or in each of the States of the Commonwealth of Australia on which members resident anywhere in Australia could be registered. Can two unconnected countries be treated as a single "part"? For example can a company keep in, say Johannesburg, a dominion register for members resident in the Union of South Africa or in Rhodesia? It is thought that it cannot, because subsection (2) of section 120 confers powers to rectify a dominion register in any competent court in that part of Her Majesty's dominions where the register is kept, and it would seem to be a necessary inference that a "part" within the meaning of section 119 must be a territory in respect of which there is a Court having jurisdiction throughout the territory.

(C) It is not clear which of the various possible meanings of the word "resident" is applicable.

In practice a company has no means of ensuring that entries on a dominion register shall be confined to "residents", whatever the word means in the context. A member wishing to be entered on the dominion register has only to furnish an accommodation address within the territory, and the company is none the wiser.

Apart from fiscal considerations, there would seem to be no point in restricting by reference to residence or otherwise the members who may be entered on a dominion register, and, so far as fiscal considerations are concerned, domicile rather than residence would appear to be the more appropriate qualification.

We suggest that the words "resident in that part" be omitted from subsection (1) of section 119 and two new subsections added in the following terms:—

"A company shall be at liberty to treat two or more parts of Her Majesty's dominions as constituting a single part for the purposes of this section.

"Where the domicile of any person having any beneficial interest in shares registered in a dominion register is not within that part of Her Majesty's dominions where the dominion register is kept but is within Great Britain those shares shall as respects that beneficial interest but not further or otherwise be deemed to be locally situate in the country of his domicile."

If the suggestion as to treating two or more parts as one is adopted, then in subsection (2) of section 120 for the words "in that part of Her Majesty's dominions" where they first occur there should be substituted the words "part of Her Majesty's dominions", and at the end of the subsection there should be substituted the word "district".

(D) We would point out that section 121 as it stands might be used as a means of evading stamp duty payable on transfers of shares of companies situate in the United Kingdom in cases where such companies maintain a dominion register in a dominion where the rate of stamp duty on share transfers is less than that prevailing in the United Kingdom.

Section 129 and the Seventh Schedule

Exempt and non-exempt private companies

(A) It is one of the basic conditions for qualification as an exempt private company that "no person other than the holder has any interest in any of the shares or debentures of the company", and under the combined effect of section 129 and the Sixth and Seventh Schedules a company claiming to be an exempt private company must each year send with the annual return a certificate signed by one of its directors and the secretary to the effect that to the best of their knowledge and belief this condition (among others) is satisfied and has been satisfied since the commencement of the Act (or the date directed by the Board of Trade in relation to the company).

In practice the company would frequently not know whether this condition had been broken in relation to any of the company's shares or debentures. Section 117 precludes the entry on the register of members of any notice of any trust and regulation 7 of Part I of Table A precludes the company from recognising any person as holding any share upon any trust and absolves the company from recognising any equitable interest. In reliance on articles in such a form the temptation is strong for the director and secretary signing the certificate mentioned above to adopt an ostrich-like attitude in relation to any equitable interest which may be subsisting in any of the company's shares or debentures.

We suggest that cases must frequently occur in which the basic condition mentioned in paragraph 1 (b) of the Seventh Schedule has been broken since the company first achieved its status as an exempt private company, but continues to enjoy that status after the breach. A company, having once enjoyed the privileges of an exempt private company is not anxious to discover facts which would deprive it of such privileges.

(B) Moreover a company, which has enjoyed the status of an exempt private company and is anxious to preserve it, will nevertheless lose that status if a single shareholder, for example, executes a declaration of trust in respect of one share or executes a transfer of one share either to a person as his nominee or by way of security; upon the execution of such a declaration of trust or if such a transfer is registered the transferor will in either event have an equitable interest in the share and the said basic condition will no longer be satisfied; if on the other hand, registration of the transfer is refused it would seem that the transferee may have such an equitable interest in the share as to cause the said basic condition not to be satisfied.

Since the holder of shares in an exempt private company is in a position to destroy the exemption at any time, the threat to do so can be used to bring pressure on the other shareholders to acquire all the shares of the holder at an exorbitant price. We suggest that this undesirable state of affairs could be avoided by inserting in the Act a new section in the following terms:—

"If the Articles of Association contain a provision prohibiting any transfer of shares, declaration of trust or other act which would cause the company to cease to be an exempt private company, any transfer of shares, declaration of trust or other act so prohibited, if purported to be made or done, shall be void and of no effect."

(C) Regulation 6 of Part II of Table A is of little value. There is no sanction behind the right thereby conferred on directors to require a member to make a statutory declaration. Moreover it is doubtful whether the right so conferred is used in practice, since it may only unearth facts which directors would prefer to remain buried.

(D) For the reasons pointed out in Buckley on the Companies Acts, 13th Ed., pages 956/7, the definition of "family settlement" in the Seventh Schedule is not entirely satisfactory.

Moreover the exception for shares or debentures held on the trusts of a will or family settlement is unduly restricted. Paragraph 3 (1) (b) of the schedule excepts (with certain reservations) shares or debentures held by trustees on the trusts of a will or family settlement disposing of the shares or debentures, and by virtue of paragraph 3 (2) shares or debentures held by trustees on trusts arising on an intestacy are, if the shares or debentures formed part of the intestate's estate at the time of his death, to be treated as if the trusts arose under a will disposing of the shares or debentures.

It is apprehended, particularly in view of paragraph 3 (2), that additional shares or debentures acquired by trustees after the date of the relevant family settlement or death (e.g. as a result of a capitalisation of profits) do not fall within the exception. Thus a capitalisation issue can have the effect of depriving a company of its exempt status, which is clearly ridiculous. A similar situation would arise as a result of a "rights issue".

We suggest that a new provision be added in paragraph 3 (2) in the following terms:—

"Where the holders of or persons entitled by transmission to any shares or debentures to which this paragraph applies acquire in right of those shares or debentures, whether as a result of a capitalisation of profits or reserves or an offer for subscription to members or debenture holders or otherwise, any further shares or debentures, then so long as those further shares or debentures continue in the possession of the persons as held or are entitled by transmission to the first mentioned shares or debentures the basic conditions shall be subject to an exception for such further shares or debentures."

Section 130

The statutory meeting

This section is quite useless. Its operation is almost always avoided by forming the company as a private company and immediately thereafter converting it into a public company.

Section 139

Representation of corporations at company meetings

The Act contains no provision entitling a company to require a person claiming to have been appointed the representative of a corporation to furnish any evidence in support of his claim, yet if such person refuses to furnish such evidence, the company will reject a vote tendered by him at its peril.

We suggest that provisos be added to subsection (1) in the following terms:—

"Provided that the company shall not be bound to recognise any person as such a representative at any meeting or adjourned meeting unless a copy of the resolution by which he was appointed, purporting to be certified as correct by an officer of the corporation making the appointment, has been delivered to the registered office of the company not later than 48 hours before the time appointed for the meeting or adjourned meeting as the case may be;

"Provided further that any resolution appointing such a representative shall be deemed to remain operative according to its tenor until notice in writing of the revocation of the appointment has been received at the registered office of the company."

Section 141

(A) Extraordinary resolutions

Since the abolition in 1929 of the requirement of a confirmatory meeting for a special resolution no useful purpose has been served by the retention of the extraordinary resolution as a separate type of resolution. The only substantial distinction now is that an extraordinary resolution requires seven days' less notice than a special resolution, and even this distinction disappears if the resolution is submitted to an annual general meeting.

We suggest that subsection (1) of section 141 be omitted, and that references to a special resolution be substituted throughout the Act for references to an extraordinary resolution.

If so a new section should be added in the following terms:—

"Any reference in any statute, instrument, order or document or in any oral contract, declaration or statement, to an extraordinary resolution of a company shall, in relation to a resolution passed or to be passed after the commencement of this Act, be deemed to be a reference to a special resolution of the company:

"Provided that where before the commencement of this Act a meeting has been convened for the purpose of passing an extraordinary resolution as defined in the Companies Act, 1948, and at that meeting that resolution has after the commencement of this Act been passed in the manner required by that Act for the passing of an extraordinary resolution and such resolution would have been effective for its purpose, such resolution shall be as effective as if it had been a special resolution."

(B) *Dispensing with necessity for holding meeting*

Where the shareholders are few, and are unanimous, the convening and holding of a meeting is a useless formality. We suggest that a new section be added to the Act in the following terms:—

"A resolution in writing signed by all the members of a company who would, if such resolution had been proposed at a general meeting, have been entitled to vote thereon, shall be as valid and effective as if it had been passed, and shall be deemed to have been passed, at a general meeting of the company duly convened and held, and if described in such writing as a special resolution shall be a special resolution.

"Such resolution may consist of one document signed by all the members entitled to vote as aforesaid or of several documents in the like form each signed by one or more of the members entitled to vote as aforesaid.

"Such resolution shall be deemed to have been passed on the date on which the same was signed by the last member to sign the same, and where any such document as is mentioned in the last preceding subsection states a date as being the date of the signature thereof by any member such document shall be *prima facie* evidence that it was signed by that member on that date."

If this suggestion is adopted, Table A, Part II, Reg. 5 should be deleted.

Section 159

(A) *Auditors: Appointment of firm by firm name*

More often than not a firm of accountants are appointed auditors by the firm name, and in practice the firm is treated year after year as being the auditors notwithstanding changes in the composition of the firm. In strictness, however, the appointment of a firm is merely the appointment of the particular individuals who constitute the firm at the time of the appointment. A partner who retires from the firm does not thereby cease to be one of the auditors, nor does a person who is admitted as a partner thereby become one of the auditors. The consequence may be that in course of time none of the members of the firm are *de jure* auditors, and there is no provision in the Act validating the acts of *de facto* auditors corresponding to the provisions of section 180 in relation to directors.

Any amendment to the section should, we think, be made retrospective in its effect, and we accordingly suggest that a subsection be added in the following terms:—

"The appointment of a firm by its firm name to be the auditors of a company shall be deemed to be an appointment of those persons who shall from time to time during the currency of the appointment be the partners in that firm as from time to time constituted and who are qualified to be auditors of that company.

"In the case of any such appointment as aforesaid made before the commencement of this Act this subsection shall be deemed to have had effect as respects such appointment from the date such appointment was made."

It is in our opinion undesirable that the provisions of the section as to the automatic reappointment of a retiring auditor should apply to a retiring firm of auditors, and we accordingly suggest that a second proviso be inserted at the end of subsection (2) as follows:—

"Provided also that where a firm has been appointed to be the auditors of a company such firm on retiring shall not be automatically reappointed by virtue of this subsection."

(B) Resignation of auditors

The Act contains no provision enabling an auditor to resign his office, and it is by no means clear whether even with the consent of the company, given either by the Board or by a general meeting, the auditor can resign.

It would seem desirable to provide expressly that an auditor may resign. It may, however, be considered that, since the auditor's duties are owed to the members rather than to the company, he should not be permitted to resign except with the consent of a general meeting.

It is suggested that subsections be added in the following terms:—

"An auditor may, with the consent of the company in general meeting, but not otherwise, resign his office.

"The directors shall, if requested by its auditor so to do, convene a general meeting of the company for the purpose of considering a resolution consenting to his resignation, and if the directors shall fail duly to convene such meeting within twenty-one days of such request the auditor may himself convene such meeting in the same manner as nearly as possible as that in which meetings are to be convened by the directors.

"Any reasonable expenses incurred by the auditor by reason of the failure of the directors duly to convene a meeting shall be repaid to the auditors by the company, and any sum so repaid shall be retained by the company out of any sums due or to become due from the company by way of fees or other remuneration in respect of their services to such of the directors as were in default."

We think also that it might be desirable to ensure by statutory provision that a retiring auditor should state in writing his reasons for retirement.

Section 184

Removal of directors

Subsection (4) provides that a vacancy created by the removal of a director under the section, if not filled at the meeting at which he is removed, may be filled as a casual vacancy.

The section does not expressly provide that the vacancy may be filled at the meeting, and in a particular case the articles may entrust the power of filling casual vacancies to the board to the exclusion of a general meeting. In such a case, where the members entitled to a bare majority of votes wish to remove all the directors, they may be in a difficulty as their action will leave the company with no directors, and the validity of any appointments made at the meeting would have to depend on the doctrine that if there is no existing board a general meeting may function in place of the board.

We suggest that subsection (4) should be altered to read:—

"A vacancy created by the removal of a director under this section may be filled at the meeting at which he is removed and, if not so filled, may be filled as a casual vacancy."

Sections 191, 192 and 193

Compensation for loss of office

(A) These sections refer to compensation for loss of office without indicating whether the office referred to is simply the office of a director, or includes some executive office

such as that of managing director. In contrast subsection (4) of section 196 expressly provides that compensation for loss of office, as regards disclosure in the accounts, includes sums for the loss of office as a director of the company or in connection with any of the other offices therein specified.

We suggest that a similar definition should be included for the purpose of sections 191, 192 and 193, and that the provisions of the sections be extended to past directors.

Section 191 provides that the amount of compensation must be disclosed to "members of the company" and the proposal approved by the company, whereas section 192 provides that the amount must be disclosed to "the members of the company" and the proposal approved by the company. It is presumably by reason merely of a drafting error that the definite article was omitted in the one case and included in the other.

(B) Sections 191 and 192 require approval of the proposal by the company. This is taken to mean the company in general meeting but we suggest this should be clarified.

(C) We think it should be made clear whether disclosure is to be made to all members of the company, or only to those entitled to vote at general meetings. We suggest that it should be to all members, so that those who are not entitled to vote may have an opportunity of invoking the assistance of the Court, e.g. by seeking an injunction.

Section 193

Requirements as to disclosure

Section 193, subsection (3), provides as follows:—

"If

- (a) the requirements of subsection (1) of this section [i.e. as to disclosure] are not complied with in relation to any such payment as is therein mentioned; or
- (b) the making of the proposed payment is not, before the transfer of any shares in pursuance of the offer, approved at a meeting summoned for the purpose of the holders of the shares to which the offer relates and of other holders of shares of the same class as any of the said shares; any sum received by the director on account of the payment shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer made . . . etc."

This subsection is unsatisfactory in several respects:—

(1) It does not distinguish the case where the payment is made by the company or a subsidiary of the company from the case where the payment is made by some other party, e.g. the purchaser.

(2) Where the payment is made by the company or a subsidiary of the company, the payment is at the expense indirectly of all the shareholders or all of some class of shareholders, and it would seem unjust that it should be held on trust exclusively for those who sold their shares in response to the offer.

(3) Where the payment is made by the purchaser, it is to be presumed that the consideration which he is prepared to pay is diminished *pro tanto*. This affects merely those who accept the offer, and there is no justification for giving any other members a voice on the question of its approval, especially since the purchaser himself may control sufficient of those other shares to carry the resolution.

(4) If, as is suggested above, only those who accept the offer are concerned, there seems no point in requiring separate approval by them, if they accepted the offer with knowledge of the proposed payment.

(5) The subsection gives no indication of the proportions in which the payment is to be held on trust for the shareholders. If there are two classes of shares, preference and ordinary, there would seem, in most cases, to be no justification for giving the preference shareholders any share in the payment.

It is suggested that the subsection be re-worded as follows:—

“If the requirements of subsection (1) of this section are not complied with in relation to any such payment then:—

- (a) If the payment was made by or at the expense of the company or a subsidiary of the company any sum received by the director on account of the payment shall be deemed to have been received by him in trust for the members of the company affected by the payment unless the making of the proposed payment has before the registration of the transfer of any shares in pursuance of the offer been approved by a meeting of such members summoned for the purpose.
- (b) For the purposes of paragraph (a) of this subsection the members affected by the payment shall be deemed to be those members of the company amongst whom the said sum would have become distributable in a winding up of the company if such winding-up had commenced at the date on which the said sum was received by the director and the said sum had been assets available for distribution amongst the contributories in the winding up after all the other assets of the company so available had been so distributed and the said sum shall be deemed to be held upon trust for them as aforesaid in the proportions in which the same would have been so distributable.
- (c) If the payment was made by or at the expense of some person other than the company or a subsidiary of the company any sum received by the director on account of the payment shall be deemed to have been received by him in trust for members affected by the payment unless the making of the proposed payment has before the registration of the transfer of any shares in pursuance of the offer been approved by a meeting of such members summoned for the purpose.
- (d) For the purpose of paragraph (c) of this subsection the members affected by the payment shall be deemed to be those members of the company who sold shares as a result of the offer made (not being shares the voting rights attached whereof are exercisable by or by the direction of the person or any of the persons by or on whose behalf the offer was made) and the said sum shall be deemed to be held upon trust for them as aforesaid in the proportions in which it would have been distributed amongst them as the holders of such shares if the same had become distributable in the winding up of the company commencing at the date on which the said sum was received by the director and the said sum had been assets available for distribution after all the other assets so available had been so distributed and all the holders of all the other shares had been excluded from any further participation in respect of such other shares in assets so available and the said sum shall be deemed to be held on trust for them as aforesaid in the proportions in which the same would have been so distributable.
- (e) Where any sum is held in trust as aforesaid the expenses incurred by the director in distributing that sum, including any costs charges and expenses incurred for the purpose of ascertaining for whom and in what proportions the same is so held in trust shall be borne by him and not retained out of that sum.”

If these alterations are made, subsection (4) should be altered by deleting the words from “the shareholders” to “members of the company” inclusive and by substituting for the words “that paragraph” the words “paragraph (a) or paragraph (c) of the last foregoing subsection”.

In any case subsection (4) is defective because there are sometimes cases where the shareholders referred to in paragraph (b) of subsection (3) in its present form are all the members of the company and yet (e.g. because some classes have no right to attend

and vote at meetings) there is no provision in the Article for such a meeting as is mentioned in that paragraph.

Section 209

Acquisition of dissentients' shares

The section contains a number of ambiguities and inconsistencies, as well as certain features which may be considered undesirable:—

(1) The expression "transfer of shares . . . to another company" is ambiguous. It may mean:—

- (a) the execution of an instrument of transfer by the transferor in favour of the transferee company, or
- (b) the completion of the instrument by its execution also by the transferee company, or
- (c) the delivery of the completed instrument for registration, or
- (d) the actual registration thereof.

Whichever of these meanings is the correct one, it is inconsistent with subsection (2), which contemplates that a transfer in pursuance of the scheme or contract may be not to the transferee company but to a nominee of the transferee company.

Subsection (1) should therefore refer to another company or its nominee, and, since the transferee company may wish all or any of the shares to be acquired by one of its subsidiaries, transfer to a subsidiary should be equated with transfer to the transferee company itself.

(2) The section refers to transfer of shares, which imports merely a transfer of legal ownership, and does not necessarily import that the transferee company becomes beneficial owner. Thus the transferee company may be acting purely as a nominee of an individual or group of individuals, or a syndicate of companies, which cases, it is presumed, the section was never intended to cover.

We consider that the section should only operate in favour of a transferee company who is acquiring the beneficial ownership in the shares to be transferred, and whose identity has been revealed to the person whose shares are being acquired. We accordingly suggest that for the reference to the transfer of shares there should be substituted a reference to the transfer of the beneficial ownership of shares.

(3) It is not clear whether in the construction of the words "another company" the singular includes the plural, so that a joint offer by two or more companies would be within the section. We suggest that the benefits of the section should be confined to the acquisition of the beneficial ownership of shares by a single company or its subsidiary.

(4) It is not always clear in practice what is the date of the "making of the offer" for the purposes of subsection (1). For example there is often a preliminary agreement with the directors under which they agree to sell their shares (subject to the usual conditions) and the general body of shareholders is then invited to sell on the same terms. Is the date of the making of the offer the date when the preliminary agreement was made, or the date when the invitation is sent out to the general body of shareholders? We suggest that the general publication of the offer should be the relevant date.

(5) It is not clear whether, where there are two or more classes of shares, acceptance by the holders of 90 per cent. in the aggregate fulfils the conditions of the section. It is obviously desirable that the acceptance should have to be by 90 per cent. of each class.

(6) The parenthesis "(other than shares already held etc.)" implies that shares already held by the transferee company or its subsidiary form part of the shares "whose transfer is involved". Clearly this cannot be so, except in a case where the transferee company or its subsidiary holds the shares as trustee for somebody else, in which case, however, those shares should not be excluded by the parenthesis.

(7) The word "held" merely imports legal ownership, and not necessarily beneficial ownership. The words "beneficially owned" should be substituted.

(8) It is pointless to make the transferee company wait for the expiration of four months from the date of the offer before giving a subsection (1) notice. It should be allowed to do so at any time within six months (or perhaps a shorter period) after the condition of 90 per cent. acceptance has been fulfilled.

(9) Offers frequently provide two or more alternative sets of terms between which the acceptor may elect. Unless, in such a case, the offer is carefully framed, the transferee company may find itself unable to operate the section if dissenting shareholders refuse to express an election. The transferee company should, we suggest, be enabled to stipulate, in giving the subsection (1) notice, which of the alternative sets of terms is to apply in the absence of an election by the dissentient within a specified period.

(10) The parenthesis in the proviso to subsection (1) is open to similar observations to those under paragraph 6 above.

(11) The significance of sub-paragraph (a) of the proviso is obscure. It seems to imply that in a case to which the proviso does not apply the transferee company may offer different terms to different holders of the shares which are the subject of the offer. But it seems doubtful if this can be so, because dissentients' shares are to be acquired on the terms under which the shares of the approving shareholders are acquired, which surely must be uniform for all.

If, on the other hand, the sub-paragraph merely means that you may not exclude any shareholder from the offer, this implies that you may do so in a case to which the proviso does not apply. But this can hardly be so, since it would enable the transferee company to exclude from its offer any large blocks of shares the holders of which were expected to decline the offer, so that actual dissentients shall be less than 10 per cent.

We suggest that sub-paragraph (a) be deleted.

This reveals another ambiguity in subsection (1). It should be made clear that an offer, in order to come within the section, must be an offer for all the shares, or all the shares of a class, other than those already beneficially owned by the transferee or a subsidiary.

(12) The observations in paragraph (7) above apply also to the word "held" in subsection (2).

(13) The words "are transferred" are ambiguous; see the observations in paragraph (1) above.

The relevant date for the purposes of subsection (2) should, we suggest, be the date of acquisition of a 90 per cent. beneficial interest by reason of acceptances of the offer and fulfilment of all conditions to which the offer is subject. Otherwise the transferee company can, by delaying the execution by the transferee of instruments of transfer or the presentation of the same for registration, postpone the date for giving the subsection (2) notice even beyond the six months' period referred to in subsection (1).

(14) It is not clear what would be the effect of the transferee company giving a subsection (2) notice after the due date. It should be made clear that the subsection is operative in such a case.

(15) In subsection (3) the reference to execution by the transferee company should be extended to include execution by a subsidiary of the transferee company or by a nominee of either.

(16) Where the consideration consists partly of shares in the transferee company and partly of cash, the cash being not more than 10 per cent. of the total consideration, subsections (3) and (4) may cause the transferee company to lose reliefs under section 55 of the Finance Act, 1927, because the shares issued to the transferee company on trust

for dissentients will not have been issued to shareholders of the transferor company, and this may reduce the proportion of shares issued to such shareholders below 90 per cent. It should, we suggest, be provided that the issue of shares to the transferor company under subsection (3) shall be deemed, for the purposes of section 55 of the Finance Act, 1927, to be an issue to the holder of the shares in the transferor company in respect of which the shares were issued.

(17) Where pursuant to subsection (4) shares in the transferee company have been issued to the transferor company to hold on trust for the dissentient, there is nothing to preclude the transferor company from exercising the voting rights attached to such shares. This is contrary to the policy underlying section 27, and it should, we suggest, be provided that the transferor company shall not exercise such votes except on the instructions of the beneficial owner.

(18) A member of the transferor company may, assuming that the offer permits of partial acceptance, decide to accept the offer in respect of one part of his holding and to reject it in respect of the remainder. In such a case, as the section is worded, the shares in respect of which he rejected the offer would be counted towards the requisite 90 per cent. The wording should be altered so as to avoid this result.

(19) Annexed is a draft of the section which we suggest should be substituted for the present section 209.

Draft Section to Replace Section 209

(1) Where a scheme, contract or offer involving the acquisition by one company, whether a company within the meaning of this Act or not (in this section referred to as "the transferee company") of the beneficial ownership of all the shares (other than shares already in the beneficial ownership of the transferee company) in the capital of another company, being a company within the meaning of this Act (in this section referred to as "the transferor company") has become binding on or been approved or accepted in respect of not less than nine-tenths in value of the shares affected not later than the date four months after the publication generally to the holders of the shares affected of the terms of such scheme, contract or offer, the transferee company may at any time before the expiration of the period of six months next following such publication give notice in the prescribed form to any dissenting shareholder that it desires to acquire his shares, and when such notice is given the transferee company shall, unless on an application made by the dissenting shareholder within one month from the date on which the notice was given, the Court thinks fit to order otherwise, be entitled and bound to acquire the beneficial ownership of those shares on the terms on which under the scheme, contract or offer, the beneficial ownership of the shares in respect of which the scheme, contract or offer has become binding or been approved or accepted is to be acquired by the transferee company.

Provided that where shares in the transferee company are at the date of such publication already in the beneficial ownership of the transferee company to a value greater than one-tenth of the aggregate value of those shares and the shares affected the foregoing provisions of this section shall not apply unless the assenting shareholders besides holding not less than nine-tenths in value of the shares affected are not less than three-fourths in number of the holders of those shares.

(2) For the purpose of this section shares in the transferor company in the beneficial ownership of a subsidiary of the transferee company shall be deemed to be in the beneficial ownership of the transferee company, the acquisition of the beneficial ownership of shares in the transferor company by a subsidiary of the transferee company shall be deemed to be the acquisition of such beneficial ownership by the transferee company, and shares shall not be treated as not being in the beneficial ownership of the transferee company merely by reason of the fact that those shares are or may become subject to a charge in favour of another person.

(3) Where, in consequence of any such scheme, contract or offer as aforesaid the beneficial interest in shares in the transferor company is acquired by the transferee

company and as a result of such acquisition the transferee company has become the beneficial owner of nine-tenths in value of all the shares in the transferor company then—

- (a) the transferee company shall within one month of the date of such acquisition give notice of that fact in the prescribed manner to all the holders of shares in the transferor company not in the beneficial ownership of the transferee company; and
- (b) any such holder may within three months from the giving of the notice to him require the transferee company to acquire his shares;

and where a shareholder gives notice under paragraph (b) of this subsection with respect to any shares, the transferee company shall be entitled and bound to acquire the beneficial ownership of those shares on the terms on which under the scheme, contract or offer the beneficial ownership of the shares of the assenting shareholders was acquired by it, or on such other terms as may be agreed or as the Court on the application either of the transferee company or of the shareholder thinks fit to order, and the provisions of subsections (4), (5) and (6) of this section shall be applicable *mutatis mutandis* as if references therein to a notice given under subsection (1) of this section were references to a notice given under paragraph (b) of this subsection.

(4) Where a notice has been given by the transferee company under subsection (1) of this section (and notwithstanding that the same may have been given after the date on which it ought to have been given) and the Court has not, on an application made by the dissenting shareholder, ordered to the contrary, the transferee company shall, on the expiration of one month from the date on which the notice was given, or, if an application to the Court by the dissenting shareholder is then pending, after that application has been disposed of, transmit to the transferor company a copy of the notice together with an instrument of transfer of the shares of the dissenting shareholder executed on behalf of the dissenting shareholder as transferor by any person appointed by the transferee company and by the transferee (being either the transferee company or a subsidiary of the transferee company or a nominee of the transferee company or of such a subsidiary) and pay to or vest in the transferor company the amount or other consideration representing the price payable by the transferee company for the shares the beneficial ownership of which by virtue of this section the transferee company is entitled to acquire, and the transferor company shall thereupon register as the holder of those shares the person who executed such instrument as the transferee; provided that an instrument of transfer shall not be so required for any share for which a share warrant is for the time being outstanding.

(5) The issue to the transferor company pursuant to the provisions of subsection (4) of this section of any shares in the transferee company shall be deemed for the purposes of section 55 of the Finance Act, 1927, to be the issue of those shares to the dissenting shareholder in respect of whom those shares were so issued.

(6) Any sums received by the transferor company under this section shall be paid into a separate bank account, and any such sums and any other consideration so received shall be held by that company on trust for the several persons entitled to the shares in respect of which the said sums or other consideration were respectively received.

(7) The transferor company or a nominee of the transferor company shall not be entitled to exercise any right of voting conferred by any shares in the transferee company issued to it or to its nominee as aforesaid except by and in accordance with instructions given by the dissentient shareholder in respect of whom those shares were so issued or his successor in title.

(8) In this section the expression "the shares affected" means the shares the acquisition of the beneficial ownership of which by the transferee company is involved in the scheme, contract or offer, the expression "assenting shareholder" means a holder of any of the shares affected in respect of which the scheme, contract or offer

has become binding or been approved or accepted, and the expression "dissenting shareholder" means a holder of any of the shares affected in respect of which the scheme, contract or offer has not become binding or been approved or accepted or who has failed or refused to transfer his shares in accordance with the scheme, contract or offer.

(9) Where the scheme, contract or offer becomes binding on or is approved or accepted by a person in respect of a part only of the shares held by him, he shall be treated as an assenting shareholder as regards that part of his holding and as a dissenting shareholder as regards the remainder of his holding.

(10) Where the scheme, contract or offer provides that an assenting shareholder may elect between two or more sets of terms for the acquisition by the transferee company of the beneficial ownership of the shares affected, the notice given by the transferee company under subsection (1) of this section shall be accompanied by or embody a notice in the prescribed form stating the alternative sets of terms between which assenting shareholders were entitled to elect and specifying which of these sets of terms shall be applicable to the dissenting shareholder if he does not before the expiration of fourteen days from the date of the giving of the notice notifying to the transferee company in writing his election as between such alternative sets of terms, and the terms upon which the transferee company shall under this section be entitled and bound to acquire the beneficial ownership of the shares of the dissenting shareholder shall be the set of terms which the dissenting shareholder shall so notify or, in default of such notification, the set of terms so specified as applicable.

(11) In the application of this section to a transferor company the share capital of which consists of two or more classes of shares, references to the shares in the capital of the transferor company shall be construed as references to the shares in its capital of a particular class.

(12) This section shall not apply to a scheme, contract or offer the terms of which were published generally to the holders of the shares affected before the commencement of this Act.

The section of the new Act corresponding to section 459 of the Companies Act, 1948, should include a subsection to the following effect:—

"Nothing in this Act shall affect the operation of section 209 of the Companies Act, 1948, as respects any such scheme or contract as is in that section referred to if the terms thereof were before the commencement of this Act published generally to the holders of the shares whose transfer was involved."

Section 210

Oppression

A petition under the section can be founded if the affairs of the company are conducted in a manner oppressive "to some part of the members". The quantum of such part is nowhere specified, and accordingly the cross-heading "Minorities" to the section is misleading (see in *re H. R. Harmer Ltd.*, 1959, 1 W.L.R. 62).

In view of the fact that oppression for the purposes of the section must be "burdensome, harsh and wrongful" (see per Viscount Simonds in *S.C.W.S. v. Meyer*, 1959, A.C. 324 at page 342) we see no justification for the continuance of any such limitation on the powers of the Court as is contained in section 210 (2) (b). The fact that something oppressive must have been done should be sufficient of itself to found the jurisdiction of the Court.

We think that personal representatives of a deceased shareholder should be allowed to petition for relief under this section.

Section 287

(A) If a member holds several blocks of shares on different trusts he may feel it his duty to dissent in respect of one or more of the trust holdings while not dissenting in

respect of the other or others. As subsection (3) is worded he cannot do so, since if he votes against the resolution in respect of any of the shares held by him he becomes a dissentient in respect of all the shares. Thus the section does not give effect to the principle introduced by the 1948 Act that a member need not use all his votes and may cast part of his votes one way and part in another.

We suggest that subsection (3) should be altered to read as follows:—

“If the voting rights conferred by any shares in the company were not cast in favour of the special resolution and the holder of those shares expresses his dissent from the special resolution in writing addressed to the liquidator and left at the registered office of the company within seven days after the passing of the resolution, he may require the liquidator either to abstain from carrying the resolution into effect or to purchase that part of his interest which those shares represent at a price to be determined by agreement or by arbitration in manner provided by this resolution.”.

(B) Subsection (4) may be unworkable if the members fail to pass a special resolution providing for the manner of raising the purchase money payable to dissentients. We suggest that the final words of the subsection should be altered to read:

“and, unless otherwise provided shall be deemed to be and shall be paid as part of the costs, charges and expenses of the winding up.”.

First Schedule

Table A

Clause 4. Variation of rights

Unless the holders of one-third of the issued shares of the class concerned are present in person or by proxy at a class meeting, there is not a quorum, and the provisions of clause 54 (which, in relation to general meetings of the company, provides that if a quorum is not present the meeting stands adjourned and at the adjourned meeting those members present, whatever their number, constitute a quorum) does not apply; see *Hemans v. Hotchkiss Ordnance Co.*, 1899, 1, Ch. 115.

We suggest that, in accordance with modern practice, there should be added before the words “and that any holder” the words “(but so that if at any adjourned meeting of such holders a quorum as above defined is not present those members who are present shall be a quorum)”.

The clause provides only for variation of rights, and not for abrogation. We suggest that, again in accordance with modern practice, there should be added after the word “varied” the words “or abrogated”.

Clause 32. Transmission of shares

The proviso to this clause entitles the directors to withhold dividends if persons entitled to shares by transmission will not either transfer the shares or be themselves registered as the holders. In practice this power is seldom, if ever, invoked, because “unclaimed dividends” are a nuisance to a company. Moreover the power is inappropriate to be conferred where there are restrictions on transfer which may disable persons entitled by transmission from freely transferring or requiring registration of themselves. We suggest that the proviso be omitted.

Clause 73. Validity of proxy votes

This clause provides (*inter alia*) that a proxy vote shall be valid notwithstanding the transfer of the share in respect of which the proxy is given if the company has not had notice of the transfer.

The clause is in common form, but it seems unsatisfactory. It assumes that transfer of a share *per se* operates to revoke an instrument of proxy given previously to the transfer, for which proposition there is no authority and for which there seems to be no warrant in principle. Until a transfer is registered the company must recognise

the registered holder as the only person entitled to the share, and therefore must recognise an instrument of proxy executed by that holder. The execution of an instrument of transfer by the registered holder cannot affect that situation. Nor, it is suggested, does the lodging of such transfer for registration affect the position until the transfer is registered. Otherwise this clause would appear to conflict with the right of a registered member to vote by proxy conferred by section 136 (1).

In practice an article in this form has been found embarrassing in a case where a general meeting is being held while a "take-over bid" is in process. Members may have sent in proxy forms and afterwards accepted the "take-over" offer and executed transfers. If these transfers are notified to the company before the meeting, it does not know whether or not, as a matter of law, it must treat the proxy forms as still valid or not. The article does not say they are invalid, but seems to assume, probably erroneously, that they are.

We suggest that there be deleted from the clause the words "or the transfer of the share in respect of which the proxy is given" and the words "or revocation" be substituted for the words "revocation or transfer".

Clauses 128 and 129. Capitalisation of Profits

The 1948 Table A for the first time introduced a provision for capitalisation of profits, but the form adopted by the draftsman for clause 128 was, even at that time, already antiquated. It describes the capitalised profits as "set free for distribution", which is the precise converse of a capitalisation transaction, the effect of which is to capitalise, and thus render incapable of distribution, a fund of profits which previously was capable of distribution.

Apart from this, capitalisation articles ought to be divested of the useless verbiage with which they are usually encumbered. For example what is the point of a resolution to effect a capitalisation starting with a statement that it is desirable to do so? If it was not considered desirable the resolution would not have been proposed.

Clause 129, again in common form, after conferring authority on the directors, in general terms, to provide for fractions of shares arising on a capitalisation, proceeds to give by way of example various methods, but does not specify the method which in practice is almost invariably adopted, i.e. to sell the shares represented by fractions and distribute the net proceeds of sale amongst the members entitled.

We suggest that for clauses 128 and 129 the following be substituted:—

"128. The company in general meeting may upon the recommendation of the directors resolve that any sum for the time being standing to the credit of any of the company's reserves (including any capital redemption reserve fund or share premium account) or to the credit of profit and loss account be capitalised and applied on behalf of the members who would have been entitled to receive the same if the same had been distributed by way of dividend and in the same proportions either in or towards paying up amounts for the time being unpaid on any shares held by them respectively or in paying up in full unissued shares or debentures of the company of a nominal amount equal to such profits, such shares or debentures to be allotted and distributed credited as fully paid up to and amongst such holders in the proportions aforesaid or partly in one way and partly in another. Provided that the only purpose for which sums standing to the credit of capital redemption reserve fund or share premium account shall be applied pursuant to this regulation shall be the payment up in full of unissued shares to be allotted and distributed as aforesaid.

"129. Whenever such a resolution as aforesaid shall have been passed the directors shall make all appropriations and applications of undivided profits resolved to be capitalised thereby and all allotments and issues of fully paid shares or debentures if any and generally shall do all acts and things required to give effect thereto with full power to the directors to make such provision as they shall think fit for the case of shares or debentures becoming distributable in fractions (and in particular without prejudice to the generality of the foregoing to sell the

shares or debentures represented by such fractions and distribute the net proceeds of such sale amongst the members otherwise entitled to such fractions in due proportions) and also to authorise any person to enter on behalf of all members concerned into an agreement with the company providing for the allotment to them respectively credited as fully paid up of any further shares or debentures to which they may become entitled on such capitalisation or as the case may require for the payment up by the application thereto of their respective proportions of the profits resolved to be capitalised of the amounts remaining unpaid on their existing shares and any agreement made under such authority shall be effective and binding on all such members."

PART 2

Minor Points—Companies Act, 1948

Section 5

Alteration of objects

(A) Subsection (5) provides that a special resolution altering a company's objects shall require the same notice to the holders of debentures entitled to object as to members of the company.

We suggest that there should be added the words:—

"and notwithstanding the proviso to subsection (2) of section 141 of this Act unless it is agreed by the holders of not less than 95 per cent. in nominal amount of such debentures that the notice shall be of less than twenty-one days such notice shall be of twenty-one days."

(B) Subsection 7 (b) provides that where a company passes a resolution altering its objects, and an application is made to the Court for the alteration to be cancelled, the company must deliver to the registrar a copy of the order made by the Court on the application within 15 days of the making of the order, unless an extension of time is granted. We do not believe it is in general practicable to obtain a copy of the order within 15 days, and we suggest this be altered to 21 days.

Section 16

Registration

The provision in subsection (1) that a company already registered as a limited company may re-register under the Act requires clarification. Does this mean that such a company may re-register as unlimited?

Section 23

Alteration of memorandum

Subsection (2) provides that the section is not to apply where the memorandum itself provides for or prohibits the alteration of all or any of the conditions referred to in subsection (1), and shall not authorise any variation or abrogation of the special rights of any class of members.

The effect of this subsection is often to necessitate a scheme of arrangement under section 206 of the Act, even in cases where all the members desire the alteration, and the procedure of section 206 is accordingly merely an expensive formality.

We suggest that after the words "shall not apply" there be inserted the words "unless all the members of the company (including persons entitled by transmission to any shares therein) shall have agreed to such alteration."

It seems inappropriate to describe as a "condition", e.g. class rights set out in a memorandum with a provision saying how they can be altered. We suggest that "provision" be substituted for "condition" wherever the latter appears in this section.

Section 27

This section does not apply to a case where a company which already holds shares in another company becomes a subsidiary of that other company after the commencement of the Act. This is clearly a *casus omissus* and we suggest that in subsection (3) after the words "its holding company" there be inserted the words "or a company which at any time becomes a subsidiary of a company of which it is already a member."

Sections 28 and 128

Private companies limited by guarantee and not having a share capital

(A) *Section 28:* A company limited by guarantee and not having a share capital is recognised as a private company if its Articles comply with the section, for which purpose they must be expressed to restrict the right to transfer its non-existent shares and prohibit any invitation to the public to subscribe for any of its non-existent shares.

We suggest that after the word "shares" in sub-paragraph (a) of subsection (1) there be inserted the words "if it has a share capital" and that sub-paragraph (c) be amended to read:—

"prohibits any invitation to the public to subscribe for any debentures or (if it has a share capital) any shares of the company."

(B) *Section 128:* This section does not provide for certificates in cases where a company limited by guarantee not having a share capital is a private company.

This section should be amended by:

(a) inserting after the words "section 124" the words "or by section 125",

(b) inserting after the words "Incorporation of the company" the words "in the case of a company having a share capital",

(c) inserting after the words "debentures of the company" the words "or, in the case of a company not having a share capital, issued any invitation to the public to subscribe for any debentures of the company" and immediately before the words "where the annual return" the words "in either case".

Section 52

Return as to allotments

Subsection (2) provides that where such a contract as is mentioned in subsection (1) is not reduced into writing the prescribed particulars of the contract shall be delivered for registration.

This assumes that where there is an allotment of shares as fully or partly paid up otherwise than in cash there is always a contract. This is not so, since the allotment may be in pursuance of a scheme of arrangement sanctioned under section 206, which is not contractual in character but has statutory force; see *Re Garners Motors Limited* 1937, Ch. 594.

Although in such cases it is common to provide in the scheme than an office copy of the order sanctioning it is to be deemed to be a contract, if the scheme contains no such provision there is apparently no obligation to file anything under the section except the return of allotments. This does not matter because an office copy of the scheme will necessarily have been filed (see subsection (3) of section 206) and therefore no useful purpose would be served by requiring anything further.

We suggest that a new subsection be inserted after subsection (2) in the following terms:—

"Where shares are allotted as fully or partly paid up otherwise than in cash in pursuance of the provisions of a scheme of arrangement taking effect under section 206 of this Act, such scheme shall be deemed for the purposes of this section to be such a contract as above mentioned, and the delivery to the registrar of companies for registration of the office copy of the order sanctioning the scheme by virtue of which delivery the order became effective shall be deemed to have

constituted compliance with the provisions of this section as to delivery of such contract."

Section 54

Provision of financial assistance by a company for purchase of its own shares

(A) Paragraphs (b) and (c) of the proviso to subsection (1) are intended to enable a company to give financial assistance in connection with schemes for the acquisition of shares by employees, but is limited by reference to employees of the company itself or of its holding company. Where a company operates wholly or in part through subsidiaries the paragraphs are largely stultified.

We suggest that paragraph (b) should be altered by inserting after the words "employees of the company" the words "or of any subsidiary of the company" and by adding at the end of the paragraph the words "or any such subsidiary", and that paragraph (c) should be altered by inserting after the words "the company" the words "or any subsidiary of the company".

(B) We think that this section is often ignored in practice in connection with take-over bids, and that severe penalties ought to be imposed for its breach, if it is to have any effect. We suggest that consideration should be given to a provision rendering every director of the company responsible for a breach of the provisions of the section liable to a fine of £1,000 or six months' imprisonment or both. It is not always appreciated that an infringement of the section in itself constitutes a misfeasance for the directors responsible are liable in damages to the company. We think it might be useful to include in the section words indicating this, e.g. "without prejudice to his liability in damages to the company by reason of the misfeasance."

Sections 56 and 58

Renounceable allotment letters

It has been thought by some, perhaps erroneously, that because the shares referred to in subsection (2) of section 56 and subsection (5) of section 58 are to be issued to members of the company, renounceable allotment letters for such shares cannot be issued, unless the right of renunciation is limited to a right to renounce in favour of another member.

There is no point in so limiting the issue, and we suggest that the words "to members of the company" be deleted from each of these subsections.

Section 58

Redemption of preference shares

Subsection (2) provides that, subject to the provisions of the section, the redemption of preference shares may be effected on such terms and in such manner as may be provided by the articles of the company.

This is sometimes inconvenient, and we suggest that after the word "articles" there be added the words "or the terms of issue of the shares".

Section 72

Variation of shareholders' rights

Subsection (5) provides that if an application is made under the section, the company must forward to the registrar of companies a copy of the order made by the Court on the bearing of the application within 15 days of the making of the order. We do not believe it is in general practicable to obtain a copy of the order within 15 days, and we suggest the time should be extended to 21 days.

Sections 108 and 411

Company's name on letter-headings, etc.

Under section 108 a company within the meaning of the Act must have its name mentioned in "all business letters of the company and in all notices and other official

publications of the company, and in all bills of exchange, promissory notes, endorsements, cheques and orders for money or goods purporting to be signed by or on behalf of the company, and in all bills of parcels, invoices, receipts and letters of credit of the company".

Under section 411 an overseas company must cause its name to be stated in all bill heads and letter paper, and in all notices and other official publications of the company.

We do not appreciate why the requirements should be on the whole less onerous for an overseas company than for a native company, or what is the point of the distinctions, e.g. "business letters" and "letter paper", "bills of parcels" and "bill heads".

Section 142

Special notice of resolution

The requirement that notice of the intention to move a resolution of which special notice is required shall be given to the company is quite pointless where it is the board of directors which resolves to submit the resolution.

We suggest that after the word "unless" there be inserted the words "except where the directors of the company have resolved to submit it".

Section 185

Retirement of directors

The case may arise where a director is under the Articles due to retire by rotation at the conclusion of the annual general meeting commencing next after he attains the age of 70.

In such a case it is not clear whether his retirement is by rotation under the Articles or is by virtue of the section. *Semble*, it must be taken that the retirement was not under the section, since otherwise an absurd result would be produced by subsection (6) which provides that a person re-appointed a director on retiring by virtue of subsection (2), or appointed in the place of a director so retiring, shall be treated for the purpose of determining when he or any other director is to retire as if he had become a director on the day on which the retiring director was last appointed before his retirement.

We suggest that after the word "Seventy" in subsection (2) there be inserted the words "unless his office is vacated at or before the conclusion of that meeting otherwise than under this subsection".

Section 217

Liability of husband of female contributory

We suggest that the liability under this section as a contributory of the husband of a female contributory married before 1883 can now safely be abolished. If this be accepted section 224 (3) can also be dispensed with.

Section 224

Contributory's petition

We suggest that a contributory's winding up petition should not fail merely because if an order were made there would be no assets available for the contributories. This is the effect at the present time of the decision in *Re Rica Gold Washing Company* (1879) 11, Ch. D.36, and this decision is not affected by the provisions of section 225 (1) —see *Re Kaslo Slocan Mining Corp.* (1910), W.N.13.

Section 225

Winding up on "just and equitable" ground

We see no reason to control in any way the exercise by the Court of its discretion to wind up a company on the just and equitable ground. If this suggestion be regarded as too drastic we suggest alternatively that subsection (2) should be amended to read as follows:—

"where the petition is presented by members of the company as contributories on the ground that it is just and equitable that the company should be wound up,

the Court shall not refuse to make a winding up order on the ground only that some other remedy is available to the petitioners unless it is also of opinion that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy."

Section 283

Declaration of solvency

A declaration of solvency delivered for registration on the day on which the resolution for voluntary winding up is passed is out of time, and this frequently causes great inconvenience.

We suggest that the words "on or" be inserted before the word "before" in subsection (2) (c).

Section 286

Vacancy in office of liquidator in members' voluntary winding up

Subsection (1) provides that the company in general meeting may fill a vacancy occurring in the office of liquidator, "subject to any arrangement with its creditors". These words date from the time when there was no distinction between a members' and a creditors' voluntary winding up; they fulfil no useful purpose at the present time in a members' voluntary winding up, and we suggest they should be deleted.

Section 306

Arrangement between a company and its creditors

In view of the analogous provisions of section 206 we suggest that this section should be abolished.

Sections 311 to 315

Winding up subject to the supervision of the Court

We suggest that winding up subject to the supervision of the Court serves no useful purpose and should be abolished.

Section 352

Annulling dissolution of company

Subsection (2) provides that any person on whose application an order was made declaring the dissolution of the company to have been void should deliver to the registrar of companies an office copy of the order within seven days of the making of the order, or such further time as the Court may allow. We do not believe it is practicable to obtain a copy of the order within seven days, and we suggest that this time be extended to 21 days.

Section 369

Receiver appointed under invalid charge

Where a Receiver for debenture holders is appointed out of Court and it is subsequently held that the charge purporting to be conferred by the debentures was invalid, the Receiver is liable as a trespasser in respect of his dealings with the assets. This may be a hardship and we suggest that a subsection be added to section 369 in the following terms:—

"Where a receiver or manager of the property of a company has been appointed or purported to be appointed as aforesaid and it is subsequently discovered that the charge or purported charge in respect of which he was so appointed or purported to be appointed was not effective as a charge on such property or on some part of such property the Court may if it think fit, on the application of such receiver or manager, order that he be relieved wholly or to such extent as the Court shall think fit from personal liability in respect of anything done or omitted by him in relation to any property purporting to be comprised in the charge by virtue of which he was appointed or purported to be appointed which if such property had been effectively included in such charge or purported charge would

have been properly done or omitted by him, and he shall be relieved from personal liability accordingly, but in that event the person by whom such receiver or manager was appointed or purported to be appointed shall be personally liable for everything for which, but for such order, such receiver or manager would have been liable."

We have confined our remarks to receivers for debenture holders who are particularly affected; we believe that hardship may be caused in the case of receivers in general, and it may be that an amendment to the Law of Property Act, 1925, is the appropriate reform required.

Section 371

Remuneration of receivers and managers

This section confers on the liquidator of a company the right to apply to the Court to have the remuneration of a receiver or manager of the property of the company fixed by the Court. There is, however, no corresponding provision entitling a company which is not in liquidation to apply to have the remuneration of a receiver or manager who is appointed under the powers contained in a debenture regulated by the Court. If the debenture incorporates section 109 (6) of the Law of Property Act, 1925, the receiver may apply to the Court to have his remuneration fixed if he wants more than 5 per cent.; but if the receiver will make no such application and retains out of the assets more than 5 per cent. or more than the amount fixed upon his appointment and refuses to apply to the Court or if the company wishes to allege that the rate of remuneration fixed upon the appointment of the receiver or manager was excessive, there is no procedure, it seems, for enabling the company to apply to have the amount of the remuneration fixed by the Court.

We suggest that this omission might be remedied. Alternatively, it may be thought a subject which concerns the position of receivers generally, and is not particular to the position of receivers of companies, and that therefore it is not a matter for legislation in the Companies Act.

Section 437

Change of registered office

Subsection (1) provides that a document may be served on a company by leaving it at or sending it by post to the registered office of the company.

In practice an interval of time elapses between the change in the registered office of a company and the record of the change by the registrar of companies. We consider, however, that persons dealing with a company should be entitled to rely on what is registered and we therefore suggest that a subsection be added in the following terms:

"For the purposes of this section, any document left at or sent by post to the place for the time being recorded by the registrar of companies as the situation of the registered office of a company shall be deemed to have been left at or sent by post to the registered office of the company notwithstanding the situation of its registered office may have been changed."

First Schedule

Table "A"

Clause 8. Issue of share certificates

We suggest that there be added at the end of the clause the words "where a member transfers a part only of his holding he shall be entitled to a certificate for the balance without charge".

Clause 41. Stock

The clause provides that the minimum amount of stock transferable shall not exceed "the nominal amount of the shares from which the stock arose".

What is meant is "the nominal amount of each share from which the stock arose", and we suggest that these words be substituted.

Clause 52. Ordinary business

The clause describes the appointment of auditors as business which is not special business, and accordingly not requiring to be specified in the notice of meeting. But if auditors other than those retiring are to be appointed "special notice" is required by section 160.

The final words of the clause from "the appointment of" should therefore be amended to read "the reappointment of the retiring auditors and the fixing of the remuneration of the auditors."

Clause 71. "Two-way" proxy form

The form set out assumes that only one resolution is to be proposed at the meeting, which is rarely the case.

The usual form of "two-way" proxy form refers to "Resolutions 1, 2, 3, etc." and provides (by putting a cross, or striking out "for" or "against") facilities for the member to indicate his wishes as regards the several resolutions to be proposed.

We suggest that such a form be substituted for that contained in the present clause.

Clause 84. Directors' votes

Subsection (2) (d) enables a director to vote on "any contract or arrangement with any other company in which he is interested only as an officer of the company or as a holder of shares or other securities".

"The Company" in Table A, means *primo facie* the company in whose articles Table A is incorporated, but in the passage quoted it is presumably meant to mean the "other company" previously referred to.

We suggest that the words "such other company" be substituted for the words "the company".

Clause 86. Directors' minute book

The final words of the clause require every director present at a directors' meeting to sign his name in an attendance book.

This is not, in modern sets of articles, a usual provision; and in the cases of companies to which this provision of Table A applies it is probably overlooked and ignored.

We suggest that these words be deleted.

Clause 87. Pensions, etc. for directors

Apart from being somewhat clumsily worded, this clause does not cover cases where it is desired to make provision for a former director, or the wife of a director who is still living; nor does it cover the provision of life assurance for a director. We suggest that the following be substituted therefor:—

"The directors on behalf of the company may grant or make provision for pensions, allowances and gratuities and life insurance and other benefits to or for the benefit of any director or former director who holds or has held any place of profit with the company, and to or for the benefit of the wife or widow or any other dependant of such director or former director."

Clauses 107 and 108. Managing directors

Clause 107 provides that the directors may appoint a managing director on such terms as they may think fit. Clause 108 provides that a managing director shall receive such remuneration (whether by way of salary, commission, or participation in profits, or partly in one way and partly in another) as the directors may determine.

Where articles are in this form the question is constantly arising in practice whether provision for a pension can be included in a managing director's service agreement without the authority of a resolution in general meeting, because a pension may be considered to be neither salary nor commission nor participation in profits.

We suggest that by analogy with clause 84 (3), after the words "such terms" in clause 107 there should be added the words "(as to remuneration and otherwise)", and that clause 108 be deleted.

Clause 118. Dividends

This clause, which is common form, enables shares to be issued ranking for dividend "as from a particular date".

In practice, where ordinary shares are concerned, it is not usually a question of newly issued shares ranking as from a particular date, but the terms of issue provide that they shall (or shall not) rank for some particular dividend, interim or final, announced or recommended. An article in the form of clause 118, is, in practice, treated as authorising the issue of shares on such terms, but there may be some doubt as to whether on a literal construction this view is warranted.

We therefore suggest that after the word "date" there be added the words "or to a particular extent".

Clause 127. Persons entitled to copies of balance sheet and auditors report

A legal personal representative or trustee in bankruptcy need not have been registered under reg. 31 in order to be entitled to have notice of general meetings under reg. 134. We suggest that for the words "registered under regulation 31" there be substituted the words "entitled to receive notices of general meetings under regulation 134 (b)".

Clause 131. Notices

There is a misprint in this clause. The word "or" where it occurs for the second time in the second line should be deleted.

Part 3

1. *Directors' duties (6)*

We think that any attempt to define the duties of directors more clearly would involve the risk that, since it would be impossible to define such duties exhaustively, there would be inevitable *lacunae* which might well make it more difficult to determine in any particular set of circumstances what those duties were.

We do not think it would be desirable to attempt to impose any general restriction on directors and officers dealing in the shares of companies of which they are directors or officers. Nevertheless the experience of some, at any rate, of the members of the Committee shows that the applicability to directors of the doctrine of equity that a trustee may not make a profit out of his trust (see *Regal (Hastings) Ltd. v. Gulliver*, 1942, 1. All E.R. 378) is not always appreciated. Such experience also shows that some directors are not averse from acting on information about the affairs of their company (e.g. a proposed repayment of capital) which they acquire as directors before it is made available to the public with a view to making a profit from dealing in those shares.

We feel that wider possibilities of publicity might assist to prevent such abuses, and accordingly we suggest that section 195, which provides for the keeping of a register of directors' shareholding should be strengthened. With this end in view, we would like to put forward the following points for consideration:

- (i) Subsection (1) should be extended so as to cover shares or debentures in which the director has a beneficial interest, even though the shares or debentures may themselves be held in the names of the trustees of a settlement or of nominees. We appreciate that difficulties may arise in view of the possible remoteness of the beneficial interests in some cases; we suggest however that the scope of the subsection could with advantage be extended by inserting at the end of the first paragraph and before the proviso the following:—

"or of which he is, or has any right to become (whether on payment or not) the beneficial owner, whether solely or jointly or in common with others."

- (ii) The register should be open to inspection the year round during usual business hours.
- (iii) Copies of the register should be available for inspection at every general meeting, not only the annual general meeting. We say copies advisedly because the section appears to contemplate the register being in two places at once.
- (iv) It should be for consideration whether the audited accounts should here required to contain also, in effect, a summary of the changes in the register during the period covered by the accounts.

We are not aware of any necessity to enlarge the provisions of section 199 as to disclosure of directors' interests.

We do not think that bodies corporate should be allowed to be directors.

2. *Shares with restricted or no voting rights (7)*

We know of no reason in law or equity why restrictions on voting rights which have been validly imposed on any class of shares should be abrogated or varied except in accordance with the law relating to such abrogation or variation as it now exists, or why there should be any interference with the powers of a company as they now exist to create and issue shares with any such restrictions attached thereto.

We see nothing unfair in principle in the control of a company being vested in the holders of shares which represent an interest which from the financial standpoint, is a minority interest: the holders of the remaining shares have acquired their shares with knowledge of the position as to voting, and of their own free will. The one apparent exception seems to be the case of a successful take-over bid for voting shares, where the consideration is non-voting shares and a dissentient's shares are compulsorily acquired under section 209; but anyone who acquires shares is always at risk under section 209, and it would not necessarily follow that, in the circumstances predicated, the dissentient would fail in an application to the Court under the section that his shares be not compulsorily acquired. The law is in our view sufficiently strong to prevent an abuse of control in such circumstances: and those who do not wish to subscribe for or purchase such shares are not under any obligation to do so.

We should add that the difficulties in the way of making practical and satisfactory provisions to confer parity of voting rights on all shares, or on all equity shares seem to us to be very serious.

Shares may be of different nominal amounts, so that to provide that each equity share should on a poll confer one vote per share would, by itself, not provide a solution. Equity shares may be divided into different classes, and any attempt to apportion votes on a poll by reference to proportions of the equity would be fraught with difficulty.

How would equity shares be defined for this purpose? The definition in section 154 (5) does not prevent the attaching of rights to shares which do not make them equity share capital within that definition but which, in a normal case, would in effect entitle the holders to a stake in the equity.

It would also seem to be logically necessary to limit the voting rights of non-equity share capital, unless those who attack the doctrine of *laissez-faire* see no objection to control by, say, the holders of preference shares.

3. *The protection of minorities (8)*

We feel that special consideration should be given to alleviating the real hardship which often arises in our experience with regard to the position of personal representatives, particularly as the personal representatives of a deceased shareholder acquire his shares involuntary, in contrast to other persons who may from time to time find themselves in the position of a minority. We would like to put forward the following points for consideration in this connection.

(A) Cases frequently arise in relation to private companies with few shareholders where on the death of a shareholder his personal representatives find themselves unable to get on the register of members or to realise their shares at a fair price; and often find that dividends (if any) distributed are not commensurate with the profits which on a reasonable view ought to be distributed. Experience shows that section 210 does not afford an adequate or timeous remedy.

We have considered whether it would be right in such cases to give personal representatives an unqualified right to be registered as members or to impose a statutory obligation on those who now control the company to purchase the shares of the personal representatives at a fair price, but these remedies appear to us to be too drastic. An alternative would be to require in such cases that the directors must state in writing their reasons for refusing registration.

If this latter alternative should prove acceptable, we suggest that a new section be added to the Act in the following terms:

"Notwithstanding anything in the Articles of Association of a company, if the directors of the company refuse in respect of any shares to register as members the legal personal representatives of a deceased member or refuse to register a transfer of shares by the legal personal representatives of a deceased member such legal personal representatives may by notice in writing given to the company within twenty-one days after notice of refusal has been given to the transferee require the directors to furnish to them a statement in writing of their reasons for refusing registration, and unless the directors shall have furnished such statement within twenty-one days after being so required they shall be bound to effect the registration."

(B) It should be made clear that personal representatives of a deceased shareholder can petition for a winding up order or for relief under section 210; see *re Cuthbert Cooper & Sons* (1937), Ch. 392, at page 399.

(C) Many sections of the Act refer to "members", "holders of shares", etc. and it is not clear whether their provisions extend to unregistered personal representatives. We suggest that the following amendments should be made in order to clarify the position.

Sections 5 and 72: add subsection as follows:—

"For the purposes of this section a person entitled by transmission to any shares shall be deemed to be the holder of such shares."

Sections 24, 105, 113, 146, 158, 287, 353, 433: add subsection as follows:—

"For the purposes of this section a person entitled by transmission to any shares in a company shall be deemed to be a member thereof."

Sections 136 to 142: add new section at end as follows:—

"For the purposes of sections 136 to 142 inclusive a person entitled by transmission to any shares in a company shall if entitled to vote in respect of such shares at any general meeting be deemed in relation to that meeting to be a member of the company."

Section 164: add subsection as follows:—

"For the purpose of this section a person entitled by transmission to any shares in a company shall be deemed to be a member of the company and the holder of such shares."

Section 206: add subsection as follows:—

"For the purposes of this and the next following section a person entitled by transmission to any shares in a company should be deemed to be a member of the company and the holder of such shares."

Section 384: add subsection as follows:—

"For the purposes of this section a person entitled by transmission to any shares or stock in a company shall be deemed to be a member of the company and the holder of such shares or stock."

4. *Company and business names (24)*

By virtue of section 1 (d) every company, as defined in the Companies Act, 1948, carrying on business under a business name which does not consist of its corporate name without any addition is to be registered under the Act.

An overseas company (i.e. a company incorporated outside Great Britain with an established place of business within Great Britain) carrying on business under a business name different from its corporate name is not required to be so registered.

This seems to be a *casus omissus*, since section 411 of the Companies Act, 1948, enacts in relation to overseas companies provisions as to publication of names similar to the provisions of section 108 of that Act in relation to companies within the meaning of that Act.

5. *Securing proper disclosure of information in circulars seeking proxy votes (26 (c))*

There seems to be no reason in principle why a member seeking proxy votes by circulars should not conform to the standard required of an officer of the company by section 84 of the Larceny Act, 1861, which makes circulation by such an officer of a written statement which he shall know to be false in any material particular with intent to deceive or defraud any member shareholder or creditor or the company, a criminal offence. See also the standard required of an officer by section 13 of the Prevention of Fraud (Investment) Act, 1958.

Company Law practitioners occasionally see documents circulated by members to fellow members containing half-truths of a kind likely to deceive the recipient, and we think this is a gap in the protection given to members by Statute with regard to circulars which should now be closed.

A case might, we think, be made out for legislation on more general lines so as to secure proper disclosure of information whenever any circular seeks to induce a member of a company to act or refrain from acting in his capacity as a member of the company. We would not propose, however, that legislation should be extended to cover cases of mere carelessness or inattentiveness as opposed to cases of fraud or recklessness amounting to fraud, as to which see *Reg. v. Mackinnon*, 1959, 1 Q.B. 150.

July, 1960

APPENDIX XXXVII

Memorandum by the Trades Union Congress

1. This statement of evidence is submitted by the Trades Union Congress.

2. The interest of trade unions in improving company law stems mainly from their position as representatives of the many millions of workpeople who are employed in undertakings subject to the provisions of company law. Workpeople have a natural and legitimate interest in the affairs of the organisations on which they rely for their livelihood, and it is right that they should know what is happening and is likely to happen in the companies for which they work. Moreover, they rely for the maintenance and improvement of their wages and conditions on trade union action through collective bargaining machinery, and this cannot operate effectively unless employers are willing to make available adequate information. It is not conducive to the creation of the atmosphere of mutual trust on which effective negotiations and the honouring of agreements depend that the workpeople's representatives should have to depend on inadequate or imperfect sources of information. While many managements co-operate by providing reasonably full information, a substantial contribution to good industrial relations could be made by amending company law to make compulsory the disclosure of a much wider range of information than is at present required by law. In this respect the requirements of British law, which is concerned almost exclusively with the rights of shareholders (who frequently take little or no part in the running of the company of which they are members) and with the relations between shareholders and directors, compares unfavourably with legislative requirements in other European countries, such as Austria and Belgium, where the provision of financial information to workpeople's representatives is compulsory. (In this connection we would draw to the Committee's attention the Report of the British Institute of Management on "Presenting Financial Information to Employees", section 4 of which reviews current practice in the U.S.A. and Europe). The access which trade unionists have to published information about companies is in fact no more than a useful by-product of the obligations laid on companies for other reasons: we consider, however, that the importance of providing workpeople with adequate information should be explicitly recognised by the Committee, and should be fully taken into account in the Committee's recommendations.

3. The Cohen Committee took the view that the fullest practicable disclosure of information concerning the activities of companies would lessen opportunities for abuse, and, as a result of the Committee's recommendations, the 1948 Companies Act incorporated requirements for disclosing a much wider range of information than hitherto. Since 1948 the growing recognition of the contribution which the provision of financial as well as other information can make to good industrial relations, the increase in company funds, and the increase in the number of small investors have all emphasised the need to re-examine the Act's requirements in this respect with a view to extending their scope. The argument that further disclosure, particularly of trading account figures, might prejudice a company's competitive position by revealing information to rival firms is shown to have little if any foundation by the practice of many British, and the majority of American, companies in voluntarily disclosing information beyond that required by law. Nor has the argument that increased disclosure would overload the published accounts much substance: rather would it underline the need for greater simplification of the conventional layout of company accounts to present the salient facts in a more intelligible form.

Exemption provisions

4. There are, in our view, strong reasons for obliging all companies to file their financial accounts with the annual return. In 1958 there were almost 250,000 exempt

private companies in the total of 335,000 companies. Many unions regularly negotiate agreements on wages and conditions in respect of the employees of exempt private companies, but find themselves in the unsatisfactory position of having no financial information on the basis of which they can make a judgment of the companies' ability to pay. In the electrical contracting industry, for example, over 90 per cent. of the companies with which the unions concerned negotiate are exempt. Not all exempt private companies are small; some—as most of them in the commercial television industry—are very large, but even though the majority of such companies are comparatively small, that in itself is no reason for allowing them exemption from making their accounts public. All companies can obtain, on incorporation, the advantage of limited liability and it appears to us to be only reasonable that the enjoyment of such a substantial advantage should carry the duty of disclosure. Incorporation is a voluntary action, and the fact that many individuals forming companies have been in competition with other single traders and partnerships which are under no obligation to disclose their financial position is no reason for such a substantial concession. In Sweden, for example, all limited liability companies, regardless of size, are obliged to make their accounts available to the public.

5. Part III of the 8th Schedule of the Act exempts banking, discount and assurance companies from the disclosure of certain items in their accounts, and the Board of Trade has also granted shipping companies certain exemptions by regulation. We are opposed in principle to the continued exemption of these industries from the full provisions of the Companies Act. It is understood that the main reason for their exemption rests on the assumption that full disclosure would not be desirable in the national interest. We take the view, however, that if any company in these categories was in financial difficulties this would be in itself a reason for disclosure if only to indicate the true position to any future depositors or policy holders; fluctuations in the value of the assets of banks, discount houses and assurance companies can be considered a normal feature of these companies' business and their exemption from disclosure of their incidence can scarcely be regarded as a safeguard. One of the largest shipping companies has published its accounts since 1954 without recourse to the exemptions granted by the Board of Trade, the justification for which is strongly called into question by the fact that civil aviation companies, which compete in a similar field, receive no exemption. As it is, it is impossible for outsiders to form a balanced view of the activities of such companies, as the General Council of the T.U.C. discovered when preparing evidence to the Radcliffe Committee on Monetary Policy and to the Chandos Committee on the proposal to replace the Cunard "Queens".

Balance sheet

6. In their report the Cohen Committee supported the view of the Institute of Chartered Accountants that the function of a balance sheet is as a historical document which does not "purport to show the net worth of an undertaking at any particular date or the present realisable value of such items as goodwill, land, buildings, plant and machinery, nor, except in cases where the realisable value is less than cost, does it normally show the realisable value of stock in trade". The Committee justified this view on the grounds that, if the balance sheet attempted to show the net worth of the undertaking, the fixed assets would require to be revalued at frequent intervals and the information thus given would be deceptive since the value of such assets while the company was a going concern would in most cases have no relation to their value if the undertaking failed. The valuation of fixed assets in the balance sheet at cost less an amount for depreciation has the disadvantage, however, that in a period of changing price levels these values convey little indication of what these assets might fetch if the business were sold as a going concern. The policy of many managements to value conservatively the estimated life of their fixed assets has increased the discrepancy between the value of these assets in the balance sheet and their value to an outside buyer on a going concern basis. We consider that there is a strong case for indicating in the accounts the value of fixed assets on a going concern basis.

7. We recognise that the revaluation of the fixed assets in the balance sheet in this way would suffer from the drawback that the going concern values would fluctuate and that the values in the balance sheet at any one time might therefore be misleading. For this reason we would suggest that the values of fixed assets in the balance sheet should continue to be shown as at present, but that all companies should make periodic valuations of their fixed assets (say every five years) and include, by way of a note, a statement showing the values of these assets on a going concern basis at the most recent date of valuation. We take the view that employees and investors should be in a position to make a reasonable assessment of the current net worth of a company, and such a statement would at least go some way towards meeting this need. We appreciate that such information would bear little relation to the value of the fixed assets should the company go into liquidation, but the number of liquidations is so small in comparison to the number of companies (about 1 per cent.) that it could not be argued that this consideration outweighs the advantages of such a statement.

8. *Trade and other investments.* Trade investments are valued normally at cost in the balance sheet, and only through the receipt of dividends, which may not bear any direct relationship to the earning value behind the shares, can some indication be obtained of their realisable value. We consider that the realisable value of such investments should be shown by way of note in the annual accounts. We also take the view (cf. our comments on holding companies in paragraph 13) that companies should be obliged to disclose, in relation to any investment which exceeds, say, £10,000 or 10 per cent. of its total investments, the name of the company to which the investment refers, and the size and details of the holding.

9. *Stock.* We recognise that no one basis of valuation is appropriate to all types of business, but we suggest that the annual accounts should include details as to the basis of the valuation.

Profit and Loss Account

10. That the extent of disclosure which the Companies Act makes obligatory in the profit and loss account is inadequate is demonstrated by the increasing number of companies which voluntarily disclose information in excess of the minimum required by the Act. The main deficiency in the law is its failure to require disclosure of trading account items, publication of which would provide a useful way of comparing the efficiency of companies in the same industry. We find it difficult to believe that this proposal would be seriously resisted on the grounds that reasonable disclosure would jeopardise the position of companies: on the contrary, we see great advantage in providing this additional incentive to companies to sharpen their competitiveness. We suggest that all companies should provide a breakdown of the main items of the trading account, including turnover (with a split between home and overseas sales), cost of goods sold, administrative, distributive and selling expenses, and also information on the cost of raw materials, wages, and other important items of cost, and should also state the number of their employees. Apart from the United States of America, where the practice of disclosing trading account figures is general, the law relating to joint stock companies in Western Germany specifies that the profit and loss account must include particulars, amongst a wide variety of other types of expenditure, of salaries and wages, while in Sweden all limited liability companies are obliged to state the number of employees and the total sums paid out in wages and salaries.

11. The tendency in recent years for companies to diversify their activities has meant a growth in the number whose profit and loss accounts contain the results of several different types of business. This difficulty has been overcome in Sweden by imposing an obligation on joint stock companies to apportion the gross profit between the different activities. A single figure of profit gives the public, employees and investors no indication as to which activities have made a profit and which a loss, and we suggest that companies should be obliged to include in their total sales and gross profit figures an analysis of their composition, showing separately the results of any major activity which has accounted for over 10 per cent. of total sales, or of gross profit or loss.

12. *Treatment of depreciation.* Companies are already required to show in the profit and loss account the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets. The amount charged for depreciation is bound to vary according to the value of fixed assets, but in many companies it is a charge of considerable importance. It is not possible, under the provisions of the present Act, to compare the amount for depreciation with that charged by other companies with similar fixed assets. We suggest therefore that it should also be obligatory for companies to show in the profit and loss account the amount allowed by the Inland Revenue for wear and tear in the same period.

13. *Group accounts.* The Companies Act specifies generally that a company with subsidiaries must, except in certain defined circumstances, prepare group accounts and that these accounts are to include the accounts of the holding company and of the subsidiaries in so far as they affect the shareholders of the holding company. The advantage of consolidated accounts is that the public, employees and shareholders can form some opinion of the security underlying the shares, for the assets and liabilities of the companies in the group are brought together in one account. But their weakness is that they do not show which of the constituent companies are making profits and which losses, nor does the Act make it possible to ascertain the identity of the subsidiary companies, or the particular activities of the various companies in the group. There is a strong case for making obligatory an analysis of the totals of turnover and of gross profit to show the proportion contributed by each of the companies where such a contribution exceeds 10 per cent. of the whole. We suggest also that the present practice of some more progressive companies of giving details of the names of the subsidiaries and the nature of their activities should be made obligatory.

Subsidiary companies

14. Though evidence of a company's ownership or source of control can (except where control is exercised through nominees, as to which see paragraphs 20-21) normally be obtained through a search of the company's shareholders or by perusal of the information relating to directors, we take the view that information on the control and ownership of subsidiary companies is of sufficient importance to be disclosed in the subsidiary's annual accounts. We therefore propose that where a company is controlled, through a majority shareholding, by another company, details of the immediate holding company's name, business and shareholding in the subsidiary should be disclosed by way of note in the subsidiary's accounts. Similar information should be provided in respect of a subsidiary controlled by another company's ability to control the composition of its board of directors.

Availability and frequency of accounts

15. The position under the existing law is that the shareholders need not receive accounts for the year commencing 1st January, 1960, until September, 1961, and the accounts need not be filed with the Registrar until the beginning of October, 1961. The value of the accounts is obviously lessened by delays in publication, and we believe that it is both desirable and, in the light of the development of office mechanisation, practicable to reduce these delays. We therefore suggest that the period laid down under section 148 of the Act should be shortened from nine to six months and for overseas companies from twelve to nine months: the Board of Trade should continue to have power to extend the maximum time limit in exceptional circumstances.

16. There is in addition a strong case for providing more frequent information on the financial progress of companies, as annual accounts do not always provide information at sufficiently frequent intervals to cover changing conditions. Many of the larger public companies already publish half-yearly profit statements either independently or as a background to the announcement of interim dividend figures, and the United States Securities Exchange Commission requires companies to file abbreviated half-yearly statements. The majority of United Kingdom public companies are equipped with accounting procedures which would enable half-yearly figures to be

provided with little difficulty, and the provision of previous figures for relevant half-year periods would allow account to be taken of seasonal variations. We suggest therefore that all public companies at least should be obliged to file within three months of the end of their half year a statement of profit and loss covering the first six months of the accounting year. Such statements should give the profit or loss for the period together with the main expense headings and would not require a formal audit certificate.

17. It would also be of assistance in assessing the significance of the figures contained in the accounts if some indication were given, in the directors' report, of the company's progress since the date of the balance sheet and its prospects in the immediate future.

Take-over bids

18. Take-over bids, involving offers for their shares by the prospective purchaser direct to the shareholders, are only one of several ways by which control of a company can be obtained. There can be no objection in principle to the merging together of two or more companies to achieve greater efficiency or the more effective utilisation of assets, but employees take strong exception to a take-over in which the interests of neither the company nor the employees have been considered, and of which the objective is to realise the assets or to retain the shares only until an increased dividend policy can enable the shares to be sold at a profit.

19. It would, we recognise, be difficult to prevent this latter type of take-over by law without at the same time restricting the more desirable forms of amalgamation and acquisition. In our view the best means of tackling this problem is by exposing to public view the intentions and objectives of those who are seeking to acquire, and of those who are resisting the acquisition of companies in this way. We welcome the inclusion of disclosure provisions on take-overs in the draft regulations relating to licensed dealers recently issued by the Board of Trade. We would, however, suggest that it should be obligatory for all circulars relating to take-overs to be filed with the Registrar and that all shareholders, and representatives of the employees, of the company or companies which are the subject of any such offer, should receive, at the time of registration, copies of the offer. We propose, too, that these circulars should by law, include particulars as to the offeror's identity as well as his intentions as to the future of the company and the employees.

Nominee shareholdings

20. We fully support the view of the Cohen Committee that shareholders and the public are entitled to know in whom control of a company is vested, and to their entitlement we would add that of trade unions, which may find themselves in the position of not knowing the identity of the person or persons in control of the company with which they are negotiating. The development of the practice of take-over bids in recent years provides an additional argument for disclosure of the identity of beneficial owners. We were disappointed by the decision of the Government of the day not to incorporate in the 1947 Companies Act provisions to give effect to the Cohen Committee's recommendations, and we do not regard as an adequate substitute the power given to the Board of Trade under the 1948 Act to investigate the ownership of any shares of a company.

21. We recognise that to enforce the complete disclosure of nominee shareholdings would present administrative difficulties, but we are not convinced that those difficulties are insuperable. We would point out that the American Securities & Exchange Commission requires the beneficial owners of 10 per cent. or more of a company's equity share capital to file with the Commission an initial report of their holdings and subsequent reports of changes in such holdings. We therefore suggest that any person or institution holding or acquiring through a nominee or nominees a total of more than, say, 10 per cent. of the issued share capital or debentures of any company should file with the company a statutory declaration of the name, address, nationality

and description of the true beneficial owner. The Act should contain provisions for aggregating to prevent avoidance and should prohibit such avoidance devices as fictitious mortgages. We believe that this would ensure the disclosure of the vast majority of nominee shareholdings, and that any small minority of individuals or institutions which persisted in concealing their true identity should be put in the position of acting illegally and should bear the consequences of such action.

Non-voting shares

22. A common criticism of non-voting shares is that holders of such shares have no voice on matters affecting either the company's affairs or their own rights, and that managements can often impose a dividend policy in opposition to the wishes of non-voting shareholders. The tendency in recent years has been for the average shareholder to show a diminishing interest in company affairs and one of the principal concerns of the Cohen Committee was with this development. It is doubtful whether, since the report of the Cohen Committee was published, this tendency has been checked. Indeed, one of the reasons for the increase in the number of non-voting shares has probably been the indifference of many investors as to whether or not particular shares carry voting rights. The popularity of unit trusts with many investors is another indication of the small regard which many investors, particularly small investors, pay to the importance of voting rights. We doubt, therefore, whether the arguments for the abolition of non-voting shares should be accepted: if an investor wishes to buy shares carrying less than full rights he should be free to do so—provided that he knows what he is doing. This imposes a duty on companies to describe clearly the nature and defects of non-voting shares which they offer for sale: it is, for example, misleading to investors to describe non-voting ordinary shares as "A" ordinary shares without pointing out that the shares do not carry a vote, and the law should ensure that the limited rights attached to this type of share are made clear to any investor.

Unit trusts

23. It is almost certain that many investors are imperfectly aware of what is involved when they invest money in a unit trust and in particular are not conscious of the risks. Many are under the impression that all unit trusts have a guaranteed growth potential. Capital growth is possible but it is by no means certain, and investors should understand that they must accept some risk as the price for the prospect of a better return. The solution to this problem of educating prospective investors may lie in amending the Board of Trade Regulations or in an approved code of conduct laid down by an effective unit trusts association. Consideration should also be given to improving the Board of Trade's Annual Return on Prevention of Fraud (Investments). At present the only particulars published are the name of the scheme and the name and addresses of the management company and trustees. We suggest that it should in addition show the total number of units outstanding, the number of investors, the dividend paid in the previous year, the service charges, and the securities held (classified if necessary by industry groups).

Donations by companies for charitable and political purposes

24. We recognise that modern conditions require companies to accept social responsibilities, and take the view that they should not be precluded by law from making payments for *bona fide* charitable purposes, provided that full disclosure of any such payments is made by the directors in the annual accounts.

25. We do not regard donations for political purposes as falling into the same category. There is an obvious danger that great concentrations of wealth such as are disposed of by companies might be used to distort the pattern of normal democratic processes by, for example, the mounting of major advertising campaigns in support of one political party at election times: indeed, there was evidence in the 1959 General

Election that this is more than a speculative fear. We therefore urge that companies should be prohibited from making donations to the funds of political organisations and from incurring expenditure on activities the prime purpose of which is to further political objectives.

Winding up provisions

26. Section 319 of the Companies Act gives priority in a winding up to, among other items, wages or salary for a period of four months prior to the liquidation, subject to a maximum of £200, and to all accrued holiday remuneration due on the termination of employment before or by the effects of the winding up order or resolution. Over a period of time a number of our affiliated unions have informed us of deficiencies in the law or in its administration, and in the light of their criticisms we suggest that, in order to avoid hardships caused by delays in payment, liquidators should be empowered, where sufficient funds exist, to advance a proportion of the total wages given preference on liquidation, and that the maximum sum for wages or salary to which priority can be given to any one claimant should be raised from £200 to £400. We would also draw the Committee's attention to a case reported by one of our unions as a result of which none of the claims for wages by the employees of the company concerned were allowed to rank as preferential: details of the liquidation are given in the attached annex.

27. The Report of the Committee on Bankruptcy and Deeds of Arrangement Law Amendment, published in July, 1957, recommended that there should be a provision for a pre-preferential payment to the extent of one week's wages or salary, limited to £25, in respect of services rendered to the bankrupt during the week before the receiving order. The Committee made this recommendation to avoid hardship in cases where, although there appear to be ample assets available, it is impossible to pay such wages and salaries because other preferential claims on the bankrupt's assets are unknown, and could be large enough to mean an abatement of any claims for wages and salaries. We welcomed this recommendation, and propose that section 319 should be amended to include a similar provision.

Protection of investors

28. The increase in the number of small investors, many of them with little knowledge of financial matters, has drawn attention to the need for additional measures for their protection. We are concerned at the opportunities available for individuals and companies to invite deposits from the investing public in the light of the fact that organisations which solicit funds in this manner are not generally subject to the supervision of the Board of Trade under the Prevention of Fraud (Investments) Act, 1958. We take the view that organisations and individuals which invite deposits from the public should be subject to licence and should be required to adhere to specified standards as to disclosure, financial status, etc.

29. Many investors entrust their money to stockbrokers, who are members of Stock Exchanges. The Board of Trade, under the Prevention of Fraud (Investments) Act, 1958, can grant recognition to a Stock Exchange but we understand that the Board does not insist as one of the conditions that a Stock Exchange should have a compensation fund, and that at present compensation funds are operated only in the London, Birmingham, Edinburgh, Glasgow and Manchester Stock Exchanges. Some recent defalcations have underlined the need to protect investors against the possibility of loss from fraud and bankruptcy on the part of stockbrokers, and we suggest that the Board of Trade should insist, as a condition of recognition of a Stock Exchange or association of dealers, that a compensation fund be set up, the amount to be fixed in consultation with the Board of Trade. Consideration should also be given to making it obligatory for all other dealers in securities to whom the investing public may entrust funds to become members of a compensation fund.

ANNEX

Swallow Footwear, Limited (In Liquidation)

1. In *March, 1956*, the factory of Swallow Footwear, Limited, was closed down after Mr. and Mrs. Bloom, the only two directors of the firm, disappeared and abandoned the company without leaving anyone to conduct its affairs. As a result of this 50 employees were put out of work.

2. After an application to the Queen's Bench Division by a creditor, an Order was made by Mr. Justice Slade on the *6th March, 1956*, appointing a Mr. H. O. Raphael as Receiver and manager of the company. There was no Order at that time that the company should be wound up compulsorily and, indeed, at a subsequent meeting of creditors it was resolved that Mr. Raphael, together with the Committee of Creditors, should take all such steps necessary to oppose any petition to wind up the company.

3. Mr. Raphael was subsequently empowered by the Committee of Creditors to seek authority from the Court to realise such of the company's assets as were available to the benefit of the creditors, and on the *9th July, 1956*, Mr. Justice Barry in the Queen's Bench Division gave him the necessary authority to realise the assets and pay the proceeds into Court.

4. On the *4th October, 1956*, Messrs. Olds Discount, Limited, who were creditors for a substantial sum, presented a petition to the Chancery Division of the High Court and on the *22nd October, 1956*, Mr. Justice Roxburgh made an Order for the compulsory winding up of the company, appointed the Official Receiver as provisional liquidator, and expressed the view that the Orders which had been made in the Queen's Bench Division were an irregular substitute for the recognised methods of winding up insolvent companies.

5. Apparently the Official Receiver contended that employees' preferential claims for unpaid wages, wages in lieu of notice and holiday pay, amounting to £900, were not entitled to preferential treatment on the grounds that, under section 319 (1) (b) of the Companies Act, priority in respect of wages could only be given in respect of services to the company concerned during the four months immediately preceding the relevant date, and in this instance the relevant date was the 22nd October when the winding up Order was made.

6. The Trades Union Congress consulted the Board of Trade which, in a letter of 7th July, 1959, stated that "the claim of employees for wages in this liquidation cannot be dealt with preferentially. This does not arise, however, from any provision, or lack of provision, in the Companies Act, 1948. Section 319 (1) (b) of the Act makes provision for preferential treatment of wages for services rendered during as long as four months next before the date of the winding up order. There is also provision about preferential payments under section 94 (1) of the Act in the case of receiverships. The Board of Trade do not consider that the possibility of such an exceptional case recurring would justify consideration of any amendment of the Companies Act."

APPENDIX XXXVIII

Memorandum by the British Overseas Banks Association

Under the terms of Schedule VIII, part III, paragraph 23, of the Companies Act, 1948, banking and discount companies are exempt from disclosing in their balance sheets their inner reserves and from showing separately in their profit and loss accounts transfers to or from and provisions for such reserves. These exemptions were recognised as being justified by the Cohen Committee Report on Company Law Amendment, published in 1945.

The arguments previously put forward are still valid. It is essential in the public interest that confidence in the banks be maintained at all times. This cannot be achieved if transfers to inner reserves or allocations therefrom are to be the subject of public disclosure. Any disclosure of losses of, or accretions to, reserves would be associated in the public mind far too easily and too readily with the year's trading results, and public confidence in the bank concerned might be endangered. In the case of overseas banks particularly the values of their assets, including substantial holdings of Government securities, may well be affected temporarily from time to time by political disturbances and economic conditions.

Facilities for building up and holding undisclosed reserves are most important to British overseas banking companies. They have had to contend with unprecedented disruptions stemming from political developments. The growth of nationalism has created new problems. To publicise allocations to reserves against possible loss from such causes would be a fatal invitation to confiscatory action on the grounds that the banks would be losing nothing, having fully provided for the contingency. To meet possible adverse political and economic conditions, including the periodic necessity to write down net current assets to depreciated exchange rates, many banks operating overseas have deemed it desirable to maintain substantially increased inner reserves since the position was last considered by the Cohen Committee in 1945.

A consequence of political independence in certain countries overseas has been the foundation of central banks and the expansion and development of indigenous banking systems. Discrimination has been practised against British banks in a number of countries in recent years. One of the forms which this discrimination is apt to take is pressure against such banks to introduce more capital into the countries concerned, with little prospect of the banks being able to repatriate the funds or of their receiving reasonable profit remittances in respect of such capital. Pressure along these lines would undoubtedly be immensely increased if the published accounts of the British banks in question were to disclose substantial inner reserves.

In a number of countries trade union demands for increased remuneration for local employees of the banks have been stepped up to the point of becoming exorbitant; the payment of a bonus to employees has been mooted on the basis of a formula relating profits to capital and reserves. If banks incorporated in the United Kingdom were obliged to publish allocations to inner reserves, claims for this type of bonus would doubtless be intensified.

This Association accordingly feels strongly that the exemptions granted to banking companies in Schedule VIII, part III, paragraph 23, of the Companies Act, 1958, should remain undisturbed.

Certain members of this Association are chartered companies and as such are governed as to compliance with the Companies Act by the provisions of the 14th Schedule. These member banks feel that the limited requirements of unregistered companies under that schedule have worked well in practice and that there is no evidence calling for amendment or repeal. Such companies being chartered companies, statutory companies or companies incorporated under Deed of Settlement are usually companies of the highest standing.

It may be felt that under the heading "General" in section 119 (1) of the Companies Act, 1948, the words "His Majesty's dominions" and "in that part" should be given a more precise definition.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

Company Law Committee

FOURTEENTH DAY

Friday, 10th February 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C.

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. R. SMITH

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. H. S. MORGAN, MR. J. M. YOUNG, MR. F. A. PETITO, MR. G. A. BROWNELL and
MR. F. A. O. SCHWARZ *called and examined.*

4822. *Chairman:* It is a great pleasure for us to have you here, and I would like to say how greatly we appreciate the help you have given in your written evidence, and also your kindness in taking the time to travel very far to come and help us this morning. To keep the matter straight on the record, might I read over what I understand to be your correct descriptions; Mr. H. S. Morgan, Mr. J. M. Young and Mr. F. A. Petito, are partners of the firm of Morgan Stanley & Co., New York, who are investment bankers, and are also of the New York Stock Exchange?—*Mr. Morgan:* Yes.

4823. And you, Mr. G. A. Brownell and Mr. F. A. O. Schwarz, are partners of the law firm of Davis Polk Wardwell Sunderland and Kiendl, also of New York?—*Mr. Brownell:* Yes, Sir.

4824. *Chairman:* I will now ask Professor Gower to be so good as to open the discussion.

4825. *Professor Gower:* Gentlemen, I think it might be convenient if I followed more or less the same order as in my original memorandum.* Could I start

by asking you one or two questions about the *ultra vires* rule? As I understand it, most of the States now have statutory provisions about this, which in effect provide that the *ultra vires* rule does not affect third parties and merely operates internally as between the corporation and its directors; except that in some States, if a shareholder applies for an injunction while a contract is still executory, the Court may grant an injunction restraining the corporation from carrying out an *ultra vires* transaction. Would that be the position?—Before I reply to your question may I say, on behalf of my partner and myself, and also my other colleagues, that we are privileged to appear before you gentlemen today. We feel a little bit as though you ought to allow us, at the end of the session, to ask you some questions because, as I am sure you all well know, the problems that you have suggested to us are common ones and we have as much to learn from you as you possibly have from us. In fact, I think most of you are aware that it was to

* Appendix XXXIX page 1052.

England that we looked in 1933 when we adopted the first of the series of Acts that are now enforced by our Securities and Exchange Commission. However, maybe on some other occasion we can reverse the field and ask you for help on some of our problems, and I will now turn to Professor Gower's first question. The provisions of the Model Act to which you have referred have been adopted in about 13 of our States, and about 15 other States have statutory provisions on the same subject. That brings up at the very beginning the fact that we have 50 States, and the District of Columbia, making 51 separate jurisdictions, and on many of the subjects which you have dealt with in your memorandum our laws vary, sometimes substantially, between the different States. Nevertheless, in general, your statement is correct. The Model Act, and the proposed new New York Corporation Law recently introduced, provide that no act of a corporation which is otherwise lawful shall be invalid by reason of the fact that the corporation was without corporate powers, but the validity of that act can be attacked in three different ways: a shareholder may bring an action against the corporation to enjoin the doing of the act; an action may be brought against an officer or a director for loss or damage due to the performance of the illegal act; and in a special proceeding the Attorney General can bring an action to annul the corporation, if it performs acts which it is not authorised to perform. That is not universally the law in the United States today, but our tendency is in that direction, and the law of *ultra vires* is therefore not of such importance as it once was.

4826. These statutory rules have worked satisfactorily? They have not caused any technical difficulties?—They have worked satisfactorily in those States where those provisions have been adopted, yes.

4827. *Chairman*: Do you get many cases of *ultra vires*?—We used to have quite a few in the old days, but very few today.

4828. That is due to ingenuity in drafting your documents?—There is

an increasing tendency in drafting corporation charters to make the powers very broad. That is, of course, not always the case but, generally speaking, our larger corporations are given very broad powers in their charters. My partner points out that banks, insurance companies, public utilities and other companies of that kind are limited under our law to those specific functions. When I made my statement I was referring to industrial corporations generally.

4829. *Professor Gower*: It is also common, is it not, for the corporation statute to set out the common form powers, so that these do not have to be repeated in the charter of each individual corporation?—It is not unusual for the statutes today to contain a list of powers to be enjoyed by all corporations. Sometimes cautious draftsmen repeat those powers in the charters but that is not necessary.

4830. Have any of the States experimented with the possibility of saying that, for the furtherance of its objects, the corporation shall have all the powers of a natural person of full capacity, and stopping like that?—It is not usual for the language to go that far. It is usual, and the Model Act does contain such a provision, to put in a clause that gives the corporation power to do all acts that are incidental to or necessary to the accomplishment of its stated objects.

4831. I think I am right in saying that in America you do not have one complication that we have here, namely, that anybody dealing with a corporation is deemed to have notice of its public documents, which includes the charter and the bye-laws. It is argued that, if we were to introduce similar rules to yours, third parties might well be affected, because they would be deemed to know that the officer of the company was acting beyond the company's objects and powers. That is a complication you do not have.—The statement you have made is correct for practically all of our States. Our case law does not generally impose upon a person dealing with a corporation constructive notice of the corporation's powers. Of course, I should point out that you must bear in

mind in any such situation acts that are illegal rather than *ultra vires*. I think that where the corporation performs an act that is illegal, notice would be implied to the other side. Also, in cases where an act may be *intra vires* to the corporation, but nevertheless requires shareholder approval, notice might be implied to the third party.

4832. *Mr. Lumsden*: I think you said that if shareholder approval was required, and the act was not within the power of the directors, the outsiders would be deemed to have notice of that?—I believe, under the laws of most of our States, he would.

4833. Does that mean if it is laid down in the public statute or in the charter of the particular company that the shareholders' approval is necessary? Would he be deemed to have notice that in the charter of a particular company there was a requirement that the shareholders' approval was necessary for a particular act?—I would like to reserve the answer to that question and furnish it later, because I am not certain.

4834. *Professor Gower*: If he actually knew, apart from constructive notice, that shareholder approval was required, then he would not be protected?—I would believe that that would be the case.

4835. Could I now turn to the purchase by a company of its own shares; I gather from your memorandum that you regard this power as valuable and you do not think it has been abused?—*Mr. Schwarz*: We certainly do.

4836. As I understand it, companies must purchase their shares only out of surplus.—That is generally true. There are certain exceptions to that, particularly with preferred stock. Under the laws of many States capital can be charged directly when preferred stock is redeemed, and I think that turns a little bit on our growing conception that preferred stock is often not a permanent form of capital, but is in many senses like a bond which is issued for a limited period. We do permit in those instances a charge directly to capital. When you are talking of common stock, I think it is a fair statement to say that it can be purchased only out of surplus.

4837. As you probably know, under our law with redeemable preference shares, we have a rule that when they are redeemed an amount equivalent to that used in the redemption has to be transferred to a capital redemption reserve fund. You do not have that?—We do not.

4838. Assuming we were to widen this power for a company to buy its own shares, would you think that it would be a valuable protection to include similar rules to those existing here in the case of redeemable preference shares?—Of course, we are considering here the whole question of protection of creditors, and I think that in our view that is a matter of disclosure. Under our law we can always reduce the capital by action of the stockholders, and filing a certificate. As long as there is a disclosure of what the effect on capital is, we see no reason why there should be a freezing of the capital in the case of redemption of preferred stock.

4839. Of course, we are much stricter over here in allowing reductions of capital. But you do not feel that this power to buy in shares, and to reduce capital in this way, has led to any practical abuses?—We have not found it has.

4840. *Chairman*: If you do not have something like our capital redemption reserve fund, do you not recreate a surplus every time, so you can go on reducing your capital?—You do in effect. You may well purchase common stock out of a surplus, and then at the next annual meeting of stockholders take action to reduce your capital, and in effect recreate a surplus by retiring the shares. That is a very common practice, and again I would emphasise that our theory is that, as long as there is disclosure, the right to reduce capital should be very simple.

4841. *Professor Gower*: So that when the shares are repurchased they can either be retired or they can be held in the treasury and reissued?—Correct, and while they are held in the treasury, capital is not reduced.

4842. But the shares cannot be voted while they are in the treasury?—That is correct.

4843. *Mr. Lawson*: When that surplus is recreated as a result of cancellation of

shares, is that an earned surplus which can be used for distribution to shareholders?—That is a complicated question and, again, you have got to remember we have 51 different jurisdictions. I would think that ordinarily, as a matter of accounting, it would not be regarded as earned surplus. However, again, you must realise that under many of our laws dividends can be paid out of capital surplus. We are not restricted to paying dividends out of earned surplus.

Mr. Brownell: In New York State today we can pay dividends out of either earned surplus or capital surplus, and under our law today it is not necessary that a corporation disclose to stockholders out of which surplus those dividends are paid. There has been introduced at this session of the New York legislature a new corporation law which, if adopted, would require such a disclosure as to the nature of the surplus out of which the dividends are paid.

Mr. Schwarz: But would not prohibit payment out of any category of surplus; and there is a good deal of opposition to the proposed requirement of disclosure as to the nature of surplus out of which dividends are paid.

4844. *Mr. Brown:* On a proposal to buy in capital or to reduce capital, would there be any power for a bond holder or any other debtor to take action to prevent that, on the grounds that his position was prejudiced?—No, unless there was insolvency. If the reduction created insolvency, then of course he could do that.

4845. But if it did not technically create insolvency, but obviously made the position much less secure, he would have no power?—No.

Mr. Brownell: Mr. Young points out that sometimes the point that you raised is covered by specific covenants in the indenture under which debentures or bonds are issued, but you were addressing your remarks to the statute itself.

4846. Yes.—*Mr. Schwarz:* Very often in an indenture there would be a required ratio of capital to indebtedness. That is a protection.

Mr. Petito: There could also be a restriction in the indenture on the amount of dividends, and on the amount that could be expended in the purchase of stock from the date the bonds were issued, or from a fixed date, so in effect it would tend to freeze the surplus as of that date.

4847. *Mr. Lawson:* Could you tell us a little bit about the circumstances in which it would be customary for a company to buy its own shares? We know, of course, about open-ended trust companies about which we have had evidence. Would an industrial company buy its own shares, and in what circumstances?

—*Mr. Schwarz:* Yes, Sir, quite often. We have already spoken on the question of preferred stock. Leaving that aside, industrial companies will very often buy in their own shares and perhaps the most frequent instance is a purchase for the use of shares in employee bonus plans or profit sharing plans, or something of that kind. Mr. Morgan is a director of the General Electric Company. I am more familiar with the practice of the General Motors Corporation in that respect. The General Motors Corporation, as you probably know, have for many years had an extensive bonus plan. I believe that in the year 1960 there will be 14,000 people in the executive or managerial part of General Motors who will share in the bonus. The total amount distributed under the bonus plan runs to about \$85 million—a very, very large sum, of which about one-half is paid not in cash but in shares of General Motors; the theory being in effect—I am speaking very loosely—to give the recipient, on the average, enough cash to pay his taxes and to leave him with his bonus in General Motors stock, so that he will have an added interest and incentive by being a stockholder, and that will be his big incentive for the future. Rather than taking newly issued stock, and therefore increasing the amount of outstanding stock and increasing the capital, which is probably not needed and which would perhaps lay a company open to a charge of dilution of its equity, the practice is for General Motors to buy this stock in the market throughout the year as evenly as maybe, in the light of their expectation

of what the requirements will be for that particular purpose, and the stock is then taken in at whatever its average cost may be, valued at cost for the particular purposes of the bonus distribution. I am giving you just that one example of the use of this right to buy in stock.

4848. *Mr. Bligen*: Does that also apply not only to bonus plans but to stock option plans? Are they normally run in the same way?—Generally, it does not apply to stock option plans, because of course in stock option plans there is never an assurance that the man will ever exercise the option, and therefore the corporation may well be, in a sense, speculating in its own stock if it buys it for the purpose of the stock option. I am speaking generally, but there might be instances where it would be used.

Mr. Petito: There are a number of instances where companies do buy stock for the purpose of stock options.

Mr. Young: I would like to say one other thing, that we find that companies frequently buy stock in the market to have treasury stock for the purposes of future acquisitions of other companies, which we think is a very good business reason. I do not know whether you want our comments on the business aspects of this at the same time, but we do feel that it is a very wise provision that companies are allowed to buy their stock in the market under proper circumstances and without abuse.

Mr. Morgan: Might I point out that the General Electric Company has several different plans for their employees. In particular, we have a savings plan where the employee puts in money and a certain percentage is matched in stock by the company. The man does not get the stock until he has earned it out, and remained on the payroll for five years. That stock we try to buy in the market but, as Mr. Schwarz has said, we buy it throughout the year. We study the course of the market and naturally have to be very careful not to disturb the market in any way. In the annual report there is a complete statement of what stock has been bought, what it has been used for, and what is the balance

remaining, so that there is a complete public explanation of the transactions, with the net balance left. Then, of course, there is a statement of whatever additional shares have been issued for stock options or to complete required amounts when it has not been practical to buy the full amount in the market.

4849. *Mrs. Naylor*: To achieve the objectives of General Electric and General Motors, it is not necessary for the company to have powers to buy its own shares, is it? The same result could be achieved by the company providing cash to trustees who would buy shares on the market? Is that not so?—*Mr. Schwarz*: Generally speaking, I think that is true.

Mr. Morgan: Yes, but the fact that you give the man shares which he cannot take away, except under certain circumstances, and until he has earned out his time of five years, attaches him, we think, more firmly to the company. It is an incentive effort to make him more interested in the company.

4850. That could be done through a trustee arrangement, could it not?—Yes, perfectly possible.

4851. *Professor Gower*: But you can do it more simply. We have a more complicated arrangement, just as we have with our unit trusts.—This is the simplest way to do it, and as long as it is fully disclosed it seems perfectly proper.

4852. *Mrs. Naylor*: Could I ask Mr. Young what purpose is served by buying in the market in order to re-issue the shares bought in exchange for other assets? Why not issue fresh share capital?—*Mr. Young*: Frequently companies feel that they do not want to issue additional stock and dilute the earnings of the company. They would prefer to go into the market and buy stock and use it for the purpose of acquisition.

4853. The operation that you describe is in the reverse direction to dilution, is it not? It is concentrating the value of the stock.—It might be, yes.

Mr. Petito: The justification for it is that some companies generate more cash resources than they are able to use effectively in their business, or than they

care to pay out as dividends in view of our high tax rates. So rather than issue stock they buy their own stock on the market and then use that in acquisitions. It has a very important advantage in acquisition, because if they offer to pay for stock or assets of another company in cash, the sellers would require a premium to offset capital gains tax, to which they would be subject; whereas in an acquisition for shares, very often it can be arranged so that it is tax free to the seller.

Mr. Brownell: There is an additional reason of a legal nature. Usually, the corporation would not be able to sell its authorised but unissued stock for cash to employees or others, without first offering it to ordinary stockholders where pre-emptive rights exist. But pre-emptive rights do not exist with respect to treasury shares or pre-acquired shares.

4854. *Sir George Erskine:* Where a company has bought in its shares, can it equally sell those shares on the market afterwards?—*Mr. Schwarz:* I think it has power to do so. It would be quite unusual for a corporation to be trading in its own stock.

4855. There might be a fear that that might be the result, might it not?—Yes, and I think it would be regarded as a strange thing to do.

Mr. Young: It has to be registered, though.

Mr. Schwarz: Such sales would have to be registered just as though they were a new issue, so that disclosure would apply to treasury stock just as much as to the new issue.

Mr. Brownell: It would not only be strange, but under certain circumstances it would probably be improper.

Mr. Morgan: The directors would think twice before agreeing to that, because it certainly would be criticised, if it were not actually illegal.

Mr. Petito: But there have been cases where a company, which has had treasury stock for a good many years—maybe 10 or 15 years—has had occasion to sell

additional stock, and has thrust that in the pile and sold that.

4856. *Mr. Bingen:* Assuming that you buy stock and put it into your treasury, not for cancellation but for issue to employees or for the purpose of another acquisition, in the meantime, while this stock is in the treasury, what happens to the dividends?—*Mr. Brownell:* Dividends are not paid on that stock. If, however, the corporation should split its stock up, while there were shares in the treasury, or if by chance they should reclassify the shares, the split or the reclassification would apply to the treasury shares.

4857. So they are really in suspense?—*Mr. Schwarz:* Yes, and there is also no right to vote those shares, which is perhaps a very important point.

Mr. Petito: Generally speaking, the treasury shares are deducted from the outstanding number of shares, but if shares are held for a specific purpose such as bonus purposes, then they are carried on the asset side, and if it is a deferred bonus plan dividends may be paid on those shares to the recipient of the bonus.

Mr. Schwarz: Dividend equivalents.

Mr. Petito: Yes.

4858. *Professor Gower:* It would be true to say, would it not, that you have had certain difficulties about the accounting side of this? It has raised problems of how you should account for purchases and resales?—*Mr. Brownell:* There have been difficulties, and a great deal of discussion about the proper treatment of treasury shares in and out, but the subject is not only a very lengthy one; it is one that we do not feel completely qualified to explore with you. You might ask Mr. McDaniel this afternoon.

Mr. Schwarz: In my own view, I think that the discussions of the accounting treatment of these shares has been often more of a theoretical exercise than a really practical problem. I think the practical problem in most instances does not exist.

4859. *Mr. Mackinnon:* We are discussing this at the moment in the case of the

very reputable companies. I suppose that, in examining this, we have also to see whether it could lead to abuses by the less reputable companies, and I would like to ask you whether it has in fact led to abuses—I think we are not aware of any substantial abuses even by the less well recognised companies. I will not say there have not been cases of abuse, but I think the main protection against that has been the requirement of disclosure, which is so strong with us.

4860. Yes, because you have supervision by the Securities and Exchange Commission (S.E.C.) over this sort of thing, presumably at regular intervals?—And a great emphasis on disclosure in annual reports, and the extent to which the accounting profession has insisted on full disclosure of things of this kind.

4861. In fact, what I really want to put to you is that, if you have that system, you must have a very rigid disclosure system to check the abuse.—In one way or another. You do not necessarily have to have it through the S.E.C.

Mr. Petito: From the standpoint of creditors, would you not think a good deal of protection arises from the provisions in the bank loan instruments and the indenture provisions?

Mr. Schwarz: That is right.

4862. *Mr. Althaus:* Would the purchase of these shares be regarded as a normal and desirable function of the people who exercise it?—*Mr. Young:* It is perfectly normal. I think our companies decide in the light of their own circumstances, whether they feel it is wise to purchase shares in the market, or to use newly issued shares.

Mr. Brownell: I think I would answer your question this way. In discussing this with our associates in New York, surprise was expressed that you gentlemen did not have that power. They did not know all the circumstances under which you operate, but it came as a surprise to learn that British companies could not purchase their own shares. It is such a common thing and such a convenient thing for us.

4863. *Professor Gower:* You have explained the main advantages in the case

of a public company. Would I be right in saying that, in the case of a private company, it is also very useful if a shareholder wishes to retire, and the company can buy him out?—*Mr. Schwarz:* I would think very much so. It is actually used in many instances for that purpose.

4864. *Mr. Watson:* You are not saying that in that field the possibility of abuse is greater than in the case of companies whose shares are listed?—We are talking now of a small company, that may well not be subject to any S.E.C. regulation, or any governmental regulation. But again you have got the accounting profession, which would be very insistent on disclosure and the directors would be liable for any improvident or improper action. But of course under our law, directors' liability is greater than under your law. Directors are liable for negligence or wasting assets as well as for fraud, so that that is a counter-balancing protection even in the small corporation.

4865. *Professor Gower:* The abuse would not be very much greater, surely, than under our system where in practice the directors will buy shares themselves from the retiring shareholder. The only difference is that under your system it would be the corporation that would buy, and under our system it would be the other shareholders who buy. Most of the abuses are common to both, are they not, but not all of them?—I would suspect so.

4866. *Mr. Lawson:* I think our difficulty here might be in relation to the minority shareholders. In a private company, if the company's money were used to buy the shares from one shareholder, then that would greatly reduce the cash resources of the company, and so on. You would get the minority shareholders into a weak position.—I would suggest again, if the action is an improvident action, the directors who authorised purchase might well be held liable. I emphasise again that under our law directors may be liable for more than fraud.

Mr. Brownell: Our case law has taken care of the situation pretty well.

In a small corporation one of the directors might own 40 per cent. of the shares and wish to obtain control. If he conspired with his other directors to buy out enough of the other shares so that he would have over 50 per cent., and he used the corporate funds for that purpose, I have no doubt it would be regarded as an improper use of corporate funds and the directors would be appropriately surcharged, but we do leave that kind of question to the case law and, as far as our own experience is concerned, the case law has taken care of it pretty well.

Mr. Schwarz: In certain instances, where there is a very large amount of stock to be purchased—and I am not talking about day-by-day purchases for employee plans—but let us assume for a moment that the corporation finds itself, as a result of a sale of a proportion of its business, with a very large amount of cash, and it decides that rather than invest that in some new enterprise it would be desirable or worthwhile to retire some of its stock. It may well be that under those circumstances the fair thing to do, and the proper thing to do, is for the corporation to ask for tenders from all shareholders of the stock, probably at a fixed price, and then buy stock on that basis.

4867. *Mr. Böngen:* Apart from this tendering system which you use where you want to retire large amounts, it would appear that the general system means that directors have got to spend a good deal of their time watching the market day by day and deciding whether they should buy stock against employees benefit plans, as compared with the major operation, which of course is running the company profitably. How is this done? Do you remit it to a business committee, which watches the market day by day?—I think the answer to that is that in most instances they do not watch the market at all. There is a direction to the officers about the stock. Suppose you think you are going to want to buy a total of \$10 million of stock in a year. The direction to the officers will be "Spend that money equally as nearly as maybe on each trading day of the year", so that you thereby avoid an attempt to out-guess the market.

Mr. Petito: And having done that, they depend in many cases on a reputable brokerage firm to do the purchasing for them in a proper manner, which affects the market to the minimum extent possible.

Mr. Morgan: The directors may also establish a percentage of the total week's trading that may be bought in any one week. It may be 10 per cent. of a total week's trading, and a reputable broker will attempt to spread that in equal amounts each day.

Mr. Schwarz: Generally, I think it is accepted that one should avoid trying to out-guess the market.

4868. *Mr. Watson:* Is there any limit of time for retention of shares in the treasury?—No limit.

4869. *Professor Gower:* Do any of the States impose a limit on the proportion that may be held in the treasury?—I am not familiar with any limitation.

4870. Do you think that would be useful? Bearing in mind that this would be a new thing so far as we are concerned, would you meet possible abuses to some extent if there were a limited proportion that could be so held. This would make it very much more difficult for directors to use this power in order to enhance their own control or the value of their own holdings?—I can see how that might prove to be so here. I think we have not found the need for it.

4871. *Sir George Erskine:* In the instance you gave of the use of the tendering machinery where a company has large surplus funds which have resulted from the sale of assets, is there any advantage in using the tendering machinery as compared with adopting a plan of reduction of capital, which you can do without difficulty?—I think the advantage, if any, is that those people who do not want to sell any portion of their stock do not have to, and in that connection you must remember that we have a capital gains tax and, if you proceed by an overall or partial reduction of capital, you are forcing a tax on some shareholders who might well prefer to remain stockholders without incurring that tax.

4872. *Professor Gower*: Could I now turn to no par value shares? As I understand you, all of you think that the power to issue no par value shares is valuable both in the case of preferred and common stock.—*Mr. Brownell*: We have found it so. We think that our corporation law should give corporations, and the individuals who form them, freedom of choice both with respect to common and preferred, as to whether or not the shares should be par or no par.

4873. Do you have cases where you will get one company with some common par shares and some common no par shares, or if they have no par will they be all no par?—I cannot name a company off hand, but it is perfectly possible to have a company with no par common stock and par value preferred.

Mr. Young: There are also companies with two kinds of common stock.

Mr. Brownell: Par value common and no par value common would, of course, involve two classes of common, class A and class B.

4874. *Mr. Brown*: With different rights?—That is possible legally. I do not think that would occur so frequently, however.

Mr. Morgan: There have been instances where a company has changed from a no par stock to a stock with a stated value or par value, and *vice versa*, but that would affect the whole of the common shares.

Mr. Young: From our point of view, which is the investment banking point of view, we find it important to be able to have no par preferred stocks, because from a marketing point of view it is frequently much better to sell a preferred stock at a price less than \$100 a share, or less than what might be the normal par value, rather than having to sell at the par value of the stock, which we normally have to do under the laws of the various States. Frequently we want to sell preferred stock at 99 or 98 instead of having to sell at 102 or 103.

4875. *Professor Gower*: We have had evidence that difficulties have been experienced in the United States when no

par preferred stock is redeemed or repurchased by the company. Is that right?—*Mr. Brownell*: No, I am not aware of any such difficulties.

4876. *Chairman*: How do you assign a value to your no par preferred stock for the purpose, say, of winding up?—You assign it in the charter itself by specifying when you create the preferred that, in the case of voluntary liquidation, preferred shall be entitled to receive such-and-such an amount plus accrued dividends if they be accrued; and also you may state that in the case of involuntary liquidation you may get a slightly lower amount plus accrued dividends. It is specified in the charter.

4877. And would the preferential dividend be expressed as so many dollars?—That would be expressed in dollars and not in a percentage. It would always be expressed in dollars.

4878. All these things are fixed in the terms of issue?—Yes, Sir. That, of course, would be disclosed in any prospectus or other literature as a dollar rather than a percentage dividend.

4879. *Mr. Brown*: What figure would he set up in the balance sheet as the preferred capital?—The stated value would constitute the capital. In the case of the issuance of no par shares, the directors will fix the amount of stated capital represented by those shares. The law on that subject again varies in the different States, but that is the essential principle underlying it.

4880. Then that would be more or less the price received for the shares?—It could not be more than the price received for the shares, and it might be less.

4881. Even though the liquidation price, or the redemption price, was higher than the price?—*Mr. Schwarz* points out that, under certain circumstances too complicated to go into, my answer might be in the reverse. I think I should say that is the general result.

Mr. Petit: We came across a survey of preferred stock prepared by the American Institute of Accountants, and it showed the majority of preferred stocks were par value. Where you have

a no par value preferred stock I would think a proper practice would be to fix the stated value at a figure close to the price received for the shares. I do not believe it is very common to state it at the redemption price, but I think a good practice is to indicate the redemption price in a note in the financial statement, and that is certainly required under S.E.C. practice.

Mr. Young: While most of them may be par value, some of the very best and largest companies in America, notably General Motors, have no par value preferred stock.

4882. *Professor Gower:* Could I turn now to non-voting shares? As I understood your memoranda the position in the States could be summed up by saying that non-voting shares have been virtually eradicated in the case of listed securities?

—*Mr. Brownell:* I do not think that is quite a correct statement, and I do not think we quite said that in the memorandum which we filed with you. We have in the United States today 13 registered exchanges on which stock is listed. Under the rules and principles of the New York Stock Exchange non-voting common stock will today not be listed, and that rule has been in effect for such a long time that I am told by the Exchange that today they have practically no non-voting common stocks listed on that Exchange. However, the rules of the New York Stock Exchange with respect to preferred shares are quite different. Their minimum requirement for voting is that, if the equivalent of six quarterly dividends are in arrears, then the preferred shares voting as a class shall have the right to elect at least two of the directors. Non-voting shares are of course much more common in the case of small corporations, and family companies, where for one reason or another it is desired to give one group ownership in the equity without any share in the control. We find it a very convenient device and most of our States, if not all of them, allow it.

4883. In Morgan Stanley's memorandum they said that they believed strongly that all common shares of publicly owned corporations should have the same voting privileges, and in the

main that would be so, although there may be some listed on exchanges, other than New York Stock Exchange, where that would not be the position?—Before Mr. Morgan answers that question from the practical point of view, from the legal point of view I would say that, even though they do feel that way, there are so many other corporations where the need for non-voting stock exists, that our law should allow the alternative.

Mr. Morgan: That is exactly what I was going to say, that there are many circumstances under which non-voting shares are most desirable, and they should not be prohibited.

Mr. Young: But from the practical point of view, for publicly issued shares which we would offer, we would expect the stock to have a voting power, but we would not want you to get the impression that that means that every share of stock must have exactly the same kind of vote. Sometimes, on certain occasions, there are laws of a country, if it is a foreign security, which specify that no one shareholder can cast more than so many votes. Certain other companies have what you might call a weighted vote. But what we would call the most desirable course is for every share to have a vote, and every share to be exactly the same, but we cannot quite achieve that standard.

Mr. Petitto: Certainly we would feel that way about domestic companies in the United States.

4884. *Mr. Bingen:* You said that the New York Stock Exchange rules are now, and have been for some time, that any common stock which is listed must have voting rights. What happened with regard to any non-voting common stock which was in existence when that rule was first put into operation? Did the companies enfranchise?—*Mr. Brownell:* The Exchange did not delist the already listed non-voting shares, but over a period of years the companies have either granted votes to those shares or for one reason or another they have disappeared from the list.

4885. *Mr. Brown:* So could an exchange refuse to list any increase of existing non-voting shares?—*Mr. Young:* I think

they have. The companies were actually persuaded that modern practice was that the vote should be the same, and several large companies did give the vote.

4886. *Mr. Bingen*: It was a question, really, of stock exchange pressure on the companies to change their practice, rather than anything statutory?—Not only the stock exchange, but public opinion.

4887. *Mr. Brown*: Where any votes were given to the non-voting shares, was any compensation given to the existing voting shares for the loss of their privilege?—Not to my knowledge. That does not mean that there were not cases.

Mr. Petito: That would vary. If the stock were broadly held by the public, so that there was not a concentration of control, then there were cases where there was no compensation given to the holders of the voting stock. There were cases right after the war of tobacco companies that did just that without any compensation. On the other hand you do get cases where you have a concentration of control, such as in the Ford Motor Company, and at the time when they had their large public issue some years ago the Ford family was compensated for giving up its control of the voting stock. We had one case just recently in the U.S. Foil Company, which was controlled by the Reynolds family, which also controls Reynolds Aluminium. U.S. Foil was a holding company for Reynolds Aluminium. They recently had a reclassification of their two classes of stock, followed by a merger into Reynolds Aluminium. In the reclassification of the stocks of U.S. Foil, the Reynolds family was compensated with an additional share in the equity for relinquishing their exclusive control.

4888. Would you give a general summary of the reasons why, on the one hand, it is thought that non-voting shares should not be accepted as proper and, on the other hand, in what sort of cases non-voting shares would be deemed appropriate?—*Mr. Brownell*: The arguments against non-voting shares are that those who own the equity in the company should all have a voice in

selecting directors and management. I think there is a general feeling in the United States that it is undesirable for holders of a small percentage of the stock to control the destinies of the entire company. But in the case, particularly, of small family companies where you have one group that definitely should control and vote, and another group that should enjoy the equity and enjoy the dividends without participating in the selection of directors, it would be quite appropriate to have non-voting shares. In the case of preferred shares even with large companies, many of our bankers and others increasingly regard preferred shares as virtually a form of debenture, not directly interested in the ultimate equity, and therefore needing the vote only if the company gets in distress and if there are defaults on their dividends.

4889. *Professor Gower*: Even in cases where the shares are normally deprived of votes, most corporation statutes do provide that they shall be given votes in certain circumstances, do they not? They do not deprive the shareholders of votes for all circumstances all the time?—Preferred shares, even though non-voting, are customarily given a vote on a proposition to take away their preferences or on such a matter as winding up the company, or on certain mergers, and so forth. Again, our State laws vary widely, but the principle is as I have stated.

4890. *Mr. Watson*: Is it possible nowadays to establish a voting trust by putting in trustees' names a large block of equity stock and issuing certificates against that voting trust?—That is permissible under the laws of very many of the States. New York places a ten-year limit on the duration of any such voting trust, and requires that if you establish one it will be open equally to all shareholders who may wish to come into it.

4891. But by that means a share in the equity can pass from hand to hand, but does not have a vote.—That is true.

4892. And that practice goes on today, does it?—Yes. Voting trusts are created from time to time. I would not say that they are a frequent occurrence, but under certain circumstances they become very important.

4893. Are these voting trust certificates dealt in on the New York Stock Exchange, or on the curb only?—*Mr. Young*: I would say it is unusual for them to be dealt in on the New York Stock Exchange. There was one very important case recently in connection with T.W.A., where a very large block of approximately 75 per cent. of the shares of the company were put in one trust, and I do not think there is any question of having them listed on the Stock Exchange. No voting trust certificates are listed on the New York Stock Exchange today. Actually, the Exchange has a policy usually of refusing to authorise listing of voting trust certificates. Exception has been made in the case of voting trusts established pursuant to reorganisation proceedings under Court direction.

Mr. Morgan: There have been voting trust certificates listed in the past. It was used in various reorganisations about 50 years ago, to assure for a limited period of 10 years a continuity of vote for a reorganised company, and those voting trust certificates were listed and quoted on the exchange.

4894. But in practice today, if anybody wanted to set up a voting trust, would he have to get it sanctioned by the S.E.C., first of all?—*Mr. Brownell*: No, Sir, he would not.

4895. He is entirely free to do so, if he wishes to?—Yes, Sir.

4896. *Mr. Brown*: Obviously, at some time or other there was a switch over to the feeling that non-voting shares were not appropriate. Did that change of feeling arise in any way because of evidence or experience of abuse?—I think that there were some abuses, particularly in cases where holding companies might more easily get control of companies where there were a small number of voting shares and a large number of non-voting shares. I cannot give you any specific example by name, but I feel sure that in the absence of abuses of greater or lesser degree we would not have the general feeling that common shares, generally, should be entitled to the vote.

4897. Similarly, in the smaller company you feel non-voting shares are appro-

priate?—Yes, Sir, definitely. Under certain circumstances it might be quite important.

4898. Is there any evidence in those cases of abuse of voting control?—I recall none from my own experience.

Mr. Petito: I think, in the case of small private companies, the possibility of issuing non-voting shares greatly facilitates the formation of new companies. If someone has a new idea, and he has created the opportunity but does not have sufficient capital, instead of trying to get preferred stock capital, which today is unattractive, he will give someone a share in the equity but he would like to retain control himself, and if it is an attractive proposition people are quite willing to have non-voting shares for a participation in the equity.

4899. You are thinking there, really, of a company whose shares are not dealt with by the public?—Yes, we are talking of private companies.

4900. You would not really think that applied in a company that was wanting to get its shares quoted and held by the general public?—We would not.

4901. *Professor Gower*: Could I turn now to a rather different matter? This is a very small point, but it is of some interest to us. I think I am right in saying that in nearly all the corporation statutes in the States there are provisions whereby there has to be a minimum paid in capital before the company can get under way. Would you say that those provisions have a useful purpose?—*Mr. Brownell*: I do not think it is quite right to say that in almost all of them there is such a requirement. A rough check indicates that about 30 of our States have statutes requiring that a minimum amount be paid in before the corporation commences doing business. The amounts involved are not large. They run sometimes down as low as \$300 to \$500, and I know of no case where they have gone over \$1,000. It is a rather antiquated provision. We used to have it in New York but we eliminated it from the New York statutes quite a few years ago.

4902. *Chairman*: Have you got anything corresponding to our minimum subscription?—In some States we do. In some States the corporation cannot start doing business unless a certain amount of its capital is subscribed for.

4903. In the old days when they said there must be a minimum subscription, our people said that the minimum subscription shall be something quite nominal—£1 or something like that.—With us it is not as low as that, but it is not very high.

4904. But nowadays in a prospectus one has to state the minimum amount required to provide for a number of specified matters and that amount has got to be obtained in the form of subscriptions before the company can commence business.—As I say, in some of our States we have comparable provisions but disclosure of the capital situation and the balance sheet situation to creditors is really the answer to that kind of statute.

4905. *Professor Gower*: The problem arises here, I think, with a small one-man company which can, under English law, get away with a paid up capital of what used to be $\frac{1}{4}$ d. and is probably now a penny. There is no doubt that a great many companies are grossly undercapitalised when they start. I was just wondering whether even a minimum of as little as \$500 fulfils some purpose.—Not much.

4906. *Professor Gower*: I was going to ask some questions about cumulative voting, but as we are running behind time I feel it is best to cut this, unless any of my colleagues want to ask anything about cumulative voting.

4907. *Mr. Bingen*: I think it is interesting.—*Mr. Schwarz*: I would rather like to say, because it is a subject on which we do feel quite strongly, that we do not think there is a tendency in our country towards cumulative voting. I think there was a great tendency in that direction a generation ago or two generations ago. I think that has ceased and the growth in cumulative voting, if any, has been purely on the basis of permissive cumulative voting. We have practically got away from any movement towards compulsory

cumulative voting, and I think the majority view today is that cumulative voting should be permitted if the corporation wishes to have it; that in certain instances it might be helpful but that in many instances it is not. I think in that connection that the Committee should, perhaps, recognise that under our law the board of directors is supposed to manage the business. "The business of the corporation", the New York law says "shall be managed by its board of directors". In Delaware—New York and Delaware being the most important States as regards company law—the statute says "The business of every corporation organised under the provisions of this chapter shall be managed by a board of directors". It is not like the *Aufsichtsrat* in Germany, which just oversees the corporation. With us the board of directors has to manage the corporation. I think there are instances where cumulative voting is desirable and helpful, particularly in small corporations. But with any large corporations we have tended to move away from it on the theory that cumulative voting has all the weaknesses of proportional representation in politics, that it does void the principle that the directors should represent all the stockholders, that it leads to divided responsibility and divided loyalty, and that it tends to create inefficiency.

4908. *Professor Gower*: I suppose the objection that will be raised to making it merely optional is that it tends to be a bit of a sham, because the majority can always do away with it if they want to?—I would not think it was a sham. If you really felt it was so important to have it, you could provide in your charter that it should not be done away with except by a three-quarters vote. Even without that, it might always be a matter that the majority wanted to keep. But really, I do not believe that it should be compulsory. That is a personal view but I think it is not unrepresentative. There are differences of opinion on this. We get certain groups who agitate for it, but I think the belief that compulsory cumulative voting is a great principle of democracy has tended to be less strongly pressed than it was two generations ago.

4909. Could I now turn to minority protection? The trouble here is that this is a vast subject and we obviously cannot cover all of it by any means, but as I understand it you definitely take the view that the threat of an action by an individual stockholder is one of the strong checks on improper corporate action, and I gathered it was your view that actions of this sort should not be limited to cases where the directors have been guilty of something in the nature of fraud; that even in cases of negligence an action of this sort should be allowed if you are really going to ensure that directors do run corporations properly.—*Mr. Brownell*: That is what our law provides, and I think that both Mr. Schwarz and I believe it is correct and wise that minority stockholders' actions can be brought on behalf of the corporation against the directors, not only in cases of fraud but in cases of negligence, waste of corporate assets and so forth. Generally speaking, the right of stockholders to bring actions in such cases has a good effect in our corporate law, despite the fact that it often is abused.

4910. But as long as there was a sanction, as there would be here, that if you lost you would have to pay the costs, including advocates' fees on the other side, you would think that that might be a sufficient restraint?—I wish we had some of your safeguards in that connection. We do in some States.

4911. *Mr. Bingen*: I presume that if someone brings a minority suit for blackmailing purposes, it can be an awful nuisance?—It can be very much of a nuisance.

4912. *Mr. Mackinnon*: When you say that a minority stockholder can bring a suit for negligence for example, can the majority of the company in any way suppress the suit? I am taking a case where the majority are not the directors being attacked, and have no association with them, but may well form the view that it is not in the interests of the company to sue these particular directors. Is there any way of stopping the minority stockholders' suits, on the part of a *bona fide* majority?—If the majority of the shareholders, or a larger percentage of

them, have approved the conduct complained of, it is very strong evidence in favour of the directors who voted for it—not necessarily conclusive, but it is helpful. It bolsters the judgment of the directors. It certainly would not stop the suit.

4913. I think the point I am really on is this. Negligence is committed by the directors and an action has not been approved in advance by a general meeting, but then a general meeting decides "We know the directors committed negligence, but in all the circumstances we think it would be wrong to pursue them." How can that majority voice, itself, can it suppress the minority stockholders' suit?—That would not be the end of the suit. I think that if that occurred it would be called to the attention of the Court, and the Court would give it weight in coming to its conclusions.

4914. *Chairman*: Does the Court sometimes direct a stockholders' meeting in a case of this sort?—I have never heard of a Court directing such a meeting.

4915. I think that is sometimes done here, and in certain circumstances it may be valuable.—*Mr. Schwarz*: I think there have been cases where directors have been held liable, where I would guess 80 or 90 per cent. of the stockholders would have said "Do not let us go to Court". I suppose that Mr. Brownell and I have represented the people who have been on the receiving end of this thing, more than we have the other end. But despite that, and despite the abuse, I think we would feel that taken as a whole it has been a helpful thing. There is one little point that I might add that relates very much to this question of blackmail. It is not so much the stockholder who is concerned in this, because after all the money goes to the corporation and he has a relatively small interest in that. It is our brethren of the law who often are involved in these matters, because under our law, if they are successful on behalf of a stockholder in obtaining a judgment against directors, and a sum is paid to the corporation, the Court will allow a fee to the lawyers out of the funds recovered of up to a quarter or a third of the total; so it can be a very profitable exercise.

4916. *Professor Gower*: Could I follow up what you have just said, Mr. Schwarz? There have been some cases I believe where, despite the fact that there has been a stockholders' action, the Court has directed that the compensation recovered should be divided amongst the stockholders and not given to the corporation itself, which in a case where there has been a change of control—and alleged abuse in that connection—may merely mean the new controller gets most of the benefit. Could you tell us a little more about this?—*Mr. Brownell*: The situation described does not happen very often because usually the recovery is asked for in the name of the corporation. We have had recently a few cases where the majority of stockholders have sold out their stock under circumstances which have injured the minority of stockholders rather than the corporation. Speaking in broad terms—and I skip through it very quickly—if the majority of stockholders sold out and knew the buyers were going to try to loot the company, the individual stockholder minorities might recover. We had a case a few years ago in New York where majority stockholders of a steel company sold out to another company which desired to utilise control to insure a source of supply in a time of shortage due to the Korean war. The Federal Court of Appeals held under the circumstances of that case that the amount of the purchase price which might be attributed to the control element was held by the majority stockholders as fiduciaries and they were obliged to share this premium with the minority stockholders. That was an extreme case. *Perman v. Feldman*, 219 Fed 2d 173 (1955).

4917. I did get the impression though that these developments had made shareholders and directors rather more anxious about disposing of their controlling block unless everybody was going to share equally.—You refer to directors disposing of their controlling block. It is very seldom that with a large corporation your directors have even working control of the ownership.

4918. Of course this strengthens it still more. It is the case when a controlling shareholder in the United States

now considers whether to sell his controlling block, he is pretty worried about these developments, is he not?—Whenever one is confronted with that kind of a situation I think there is a definite effort to try to get the purchaser to make a similar offer to all shareholders so as to insure against any criticism, whether it be well-founded legally or not, and that very often is done. But it is not legally essential with us and under most circumstances majority stockholders can sell the control of the company to others, absent the type of considerations I touched on a moment ago.

4919. Could I turn now to pre-emptive rights? As I understand, it is generally accepted in the United States that issues for cash should be *pro rata* to the existing stockholders, unless the stockholders otherwise resolve. Is that correct?—*Mr. Schwarz*: I think that that is generally true. Again, the States vary a great deal in this. Under the law of New York and Delaware, the issue for cash would be subject to pre-emptive rights unless the certificate of incorporation otherwise provided. In Massachusetts however there are no statutory pre-emptive rights; and in New York if you start off a corporation let us say with five million shares, of which three million are issued at the beginning, the other two million may be issued within a reasonable time—two years or something like that—without being subject to pre-emptive rights, the theory being the stockholders authorised that much.

4920. There is a time limit?—Exactly.

4921. If the certificate of incorporation, if the charter otherwise provides, pre-emptive rights can be excluded completely? No State makes these rights mandatory?—That is right.

4922. Does the New York Stock Exchange have rules about this?—No. I think the position is that they are not particularly concerned about the matter, on the theory that in a company whose shares are listed on the New York Stock Exchange, any stockholder who wishes to maintain his proportionate interest can do so by buying shares on the Exchange. Let me emphasise again a

point that is perfectly obvious; the fact that there are not pre-emptive rights does not mean that the directors can go out and sell the shares to outsiders at an unreasonable price without running the risk of an action.

Mr. Young: I would say, Professor Gower, even though the charter does not require pre-emptive rights, absent important reasons to the contrary, we would recommend to our clients, the issuing companies, that when stock is issued for cash they should offer their shares to their stockholders for subscription.

4923. Some of the witnesses before us have suggested that pre-emptive rights should only be given where the stock being issued exceeds, say, 20 per cent. of the existing issued capital.—That would be a very heavy rate in America. I would say there is no rule of thumb, but one for ten would be likely, or even one for twenty.

Mr. Schwarz: 20 per cent. would be a very large issue. I would think that would make your pre-emptive right mean very little because an issue of five or ten per cent. is a large issue.

4924. None of the statutes that requires pre-emptive rights, in the absence of provisions to the contrary in the charter, puts any limits on the size of the issue?—None.

4925. *Mr. Scott:* We have been discussing pre-emptive rights as applied to equity shares for cash?—Correct.

4926. Would your remarks apply to preference shares?—If they have a voting right.

4927. *Mr. Brown:* A general voting right?—Yes.

4928. *Mr. Scott:* But preference shares with the ordinary limited vote right—probably they could be issued freely?—Again we have 50 States, and I think so, but I do not think it is clearly established. In principle I think there is no need for a pre-emptive right if you have a right to vote merely on a default in dividends and if you have no share in the equity. I mean, I see no reason for it.

Mr. Young: From the standpoint of the investment banking business, offering

of preferred shares to common stockholders for subscription is really not very effective because common shareholders most of the time do not want to have a preferred stock. Thus if we offer the preferred stock for subscription, and if at the end of the subscription period it has not been subscribed, we have a rather shop worn article for sale.

Mr. Schwarz: The more usual situation would be where you offered additional common stock. A good example is Pacific Telephone. Under the law of California they have always felt it was always necessary in issues of common stock to offer it both to their common and preferred stockholders.

4929. *Mr. Lumsden:* I think Mr. Schwarz said in the case of the original authorized capital there was a time limit of two years within which the originally authorised shares could be sold for cash by the directors without being first offered to the shareholders?—*Mr. Petito:* That is true under the law of New York.

4930. In the case of a subsequent increase of authorised capital, what happens? If the resolution authorising the increase goes on to say such shares shall be at the disposal of the directors—I do not know whether you adopt that procedure—would a similar time limit exist again?—*Mr. Schwarz:* I think that under our law—unless that were done by amendment of the charter—that resolution would not be effective to deprive a stockholder of pre-emptive rights, unless you got a 100 per cent. vote, and if you had a 100 per cent. certainly no one could object. But assuming you merely had a majority or two-thirds voting for this and an individual stockholder, having a pre-emptive right objecting to it, I think he should prevail.

4931. And an amendment of the charter would require what—three-quarters voting?—Perhaps a two-thirds vote.

4932. *Professor Gower:* What is the general position where shares are issued for a consideration other than cash? They can be issued to persons at the directors' discretion?—Yes.

4933. Even although they might be issued to acquire a completely different business?—Yes.

4934. The law does not require that shareholder approval should be obtained?—No.

4935. Even although it might have the effect of giving the control of the company to some other party?—No.

4936. *Mr. Lawson:* When you issue common stock to the existing common stockholders, are there any rules about prospectuses and so on, and does the S.E.C. come into that?—If a company issues its own shares for cash to its own stockholders, yes, it is required—assuming there is not some other exemption existing—to register with the S.E.C. that type of issue just as if it were offering to the public generally; and of course one reason for that is that this issue will be taken up not merely by the shareholders themselves but many of them will dispose of their rights and members of the public will buy this stock. On the offering of stock to existing shareholders we have a well developed machinery for so-called rights issues to stockholders. If the stock is listed on the New York Stock Exchange, the rights will be listed on the Stock Exchange and they will be traded on the Stock Exchange. People will sell their rights, or buy more rights, so the result will be that an issue of that type actually goes to a good many people who are not already existing shareholders.

Mr. Young: You might be interested in some of the common stock issues offered to shareholders which we have underwritten. We have distributed to the public approximately as much as 40 per cent. of the total issue, and we do that by buying the rights from the shareholders in the market, exercising the rights, and selling the shares through dealers and underwriters to investors located all over the United States and abroad. As Mr. Schwarz said, we do have exactly the same type of prospectus for rights issues but some of us are hopeful we might be able to simplify those prospectuses in the future.

4937. *Professor Gower:* If the new shares being issued are uniform with

those already quoted on the Stock Exchange there may surely be a case for saying there is no particular point in having a new full prospectus, because the public could equally buy the existing shares on the market?—*Mr. Schwarz:* That is a very good point you have raised, and that of course applies not only to a listed issue where there are pre-emptive rights but to any listed issue where there are no pre-emptive rights; and there has been a good deal of agitation to the effect that, in the case of an issue of additional shares of stock already listed and registered where regular reports are already being made, it seems quite unnecessary and extreme to require in addition all the information required by a registration statement and prospectus in the case of a new issue. I think it is very interesting that in his report to the President Mr. Landis indicated that through the development of a simpler form something should be done in that connection. I think it is now an undue exercise in printing and legal fees and paper work.

4938. On the other hand you would say wherever shares are being issued to shareholders, whether renounceable or not, there should be some statutory information given to the shareholders, especially if the shares are not uniform with those already quoted?—*Mr. Brownell:* Yes.

4939. It is one of the anomalies of our system that if you make a rights issue, although your circular is a prospectus, the Schedule of the Act laying down the statutory information to be supplied does not apply.—*Mr. Schwarz:* I think there is a great deal of work we hope may be done on this in the U.S. and I am sure there is room for improvement.

4940. Yes, it really means a simplified form.—*Simplification, yes.*

Mr. Petit: The New York Stock Exchange in 1952 made a proposal that additional issues of listed securities be relieved from the requirements of the Securities Act of 1933 on the ground that there already is a great wealth of information filed.

4941. If there are uniform shares already quoted on the Stock Exchange

our schedule does not apply, nor to the issue to the existing shareholders. Could I turn to mergers? We are very intrigued by the system you have in some States, including New York, whereby you can merge two corporations without one swallowing up the other or forming a new corporation for this purpose. Under English law one company would have to acquire the other or form a new company to acquire both. You have a system where there is a kind of marriage, as I understand.—*Mr. Brownell:* Merger laws are very broad and allow various changes and combinations. Under our New York law if A and B wish to marry, B can be merged into A or A can be merged into B, or they can be so consolidated as to form a new company. The same results are possible when corporations A and B were originally formed under the laws of two separate states, provided the laws of those States contain appropriate reciprocal provisions. Sometimes we have a situation whereby corporations of different States merge in such a way that the result is a corporation which is governed by the laws of more than one State. When that happens we refer to the resulting corporation as a multiple corporation. It occurs less frequently than it used to. Some of our railroads are multiple corporations. The modern corporation laws are drawn generally so that after a merger or consolidation you end up with a corporation governed by the laws of a single State.

4942. And that would be one of the two existing corporations or a new corporation?—That is correct.

4943. That is the same as our system then?—Our merger and consolidation laws I think are perhaps more flexible than yours. That may be why we fail to understand your take-over bid problem. I have felt one of the reasons we do not have some of those problems is that we more readily utilise the merger or consolidation machinery instead of having one corporation attempt to acquire by purchase or exchange the stock of another.

4944. *Mr. Bingen:* Is not that really similar to arrangements made under section 206? Does it not look as though the law in the United States is similar to ours?

4945. *Chairman:* And also, I think, section 208 which of course enables liabilities to be taken over as well as assets?

4946. *Professor Gower:* When you have this sort of merger in this country one of the problems is that pre-acquisition profits probably become capitalised. In other words we have the problem if there are free reserves in the two corporations being merged these may be frozen as a result of the merger. Would that be so in the United States or would it depend on the type of merger?—*Mr. Schwarz:* I think there are some new developments on that that will be very interesting. We have a scheme that is now called pooling of interests, where they carry along the surpluses of the two corporations.

4947. I get the impression that in the United States, whatever type of merger is adopted dissenting shareholders are normally given appraisal rights—rights to be bought out. Would you regard that as an essential safeguard? We do not always have it by any means.—We have almost universally and we do regard it as a very important safeguard.

4948. What is the procedure for appraising the value of the dissenters' shares?—It is quite complicated and that is one of its weaknesses. But a person must at the beginning dissent—I am speaking now generally, particularly of New York and Delaware law—from the proposed merger or consolidation. He must do it by the time of the stockholders' meeting. He must then in effect make an application to a Court to have his stock appraised, or the corporation could make such application. Ordinarily the Court will then appoint an appraiser or appraisers to take testimony and value the stock. The provisions of the New York law on this whole subject are very complicated. The provisions of the Delaware law are somewhat less complicated. I think the Court's tendency has been in these appraisal cases, if a company's stock is listed, to base the value on the market value immediately before the sale or merger. That is not universal but I think we have pretty well established it in New York.

4949. If, of course, the price has risen after the announcement of the merger

then he would have done better and avoided complication by simply selling on the Stock Exchange?—Not necessarily because here again two things can happen. You can have of course, particularly in an unlisted stock, a very different situation because you do not have any known market. Moreover, the New York rule I have told you about that follows the market is not necessarily followed in other States, and I am not sure it would always be followed in New York. Looking at it from another side, there has been something of a tendency of stockholders to try to use this right of appraisal as a means of getting more than they are really entitled to. Most statutes used to provide that all the expenses of the appraisal proceeding were imposed on the corporation so that this was in a sense a free ride. In many instances the corporation would say "rather than engage in all this expense we will pay you 20 or 30 per cent. above the market", and that was a very nice deal. That has been stopped to a considerable extent by some of the revisions of the appraisal laws in recent years which provide that if the corporation makes the stockholder an offer in cash for his shares and he has refused it, then, if the Court finally finds he was not reasonable in not accepting the offer, the expenses or a portion of the expenses may be assessed on the stockholder. That has tended to reduce this racket.

4950. But it does mean, does it, that in a merger of any kind a shareholder can really be sure of getting cash if he wants it?—That is right.

Mr. Brownell: But his appraisal rights do not preclude him from attacking the merger on the ground of unfairness, and seeking to hold it up. It is not a substitute right, it is an additional right.

4951. *Mr. Richardson:* It was mentioned we had a section 206 dealing with schemes for merger and so on. Those wishing to carry through the merger go to the Court for approval. Are these mergers we are discussing ones that have to be sanctioned by some Court?—*Mr. Schwarz:* No.

4952. They go right through without Court sanction at any stage?—In effect they require the approval of both the

directors and stockholders of both corporations but they do not require the Court's sanction.

4953. *Sir George Erskine:* What about the creditors? If company B is merged into company A presumably company B as a corporate entity disappears. What about the creditors of company B?—*Mr. Brownell:* All of the debts become debts of the resulting company, without anything else except filing the merger agreement. The merger or consolidation machinery, Sir George, is very simple if you wish to combine two companies. It eliminates the need for deeds and bills of sale. Titles pass by virtue of the act of merger and debts automatically go over.

4954. If it merely requires consent from the shareholders, is it not rather hard on the creditors?—Usually not. Of course it might be that A company might be very strong and B company very weak and when you put the two together, the creditors of A company might be worse off, but as a practical matter it seldom happens that way and I can think offhand of no case where creditors have been seriously affected.

Mr. Schwarz: But of course in many indentures you will find restrictions on the right to merge or consolidate unless certain conditions are met, so that is the way bond and debenture holders are protected.

Mr. Young: Or in issues which have been placed privately with a few investors you have to get the approval of the owner of the securities.

Mr. Morgan: That in effect is in the indenture.

4955. *Professor Gower:* It means, having these relatively flexible arrangements, the normal type of merger in the United States would be by a merger of undertakings and not by a bid to acquire the controlling shares, such as we get.—*Mr. Brownell:* We have it both ways but we use the merger or consolidation much more than you do.

4956. *Mr. Watson:* Supposing company A and B want to merge, is the process that company A offers two shares for every share of company B? Would

that be a fair illustration?—Yes. If A and B wish to merge there are normally initial conversations between the officers and in due course the matter would be considered by the directors. There might be much discussion as to the proper exchange ratio. They might finally agree on the two for one offer and the matter would then be submitted, with directorate approval, to shareholders of both companies. If the company is a listed company a proxy statement would have to be sent to the stockholders. I have with me a proxy statement applicable to a merger of three separate companies I handled a while ago. You will see how long a document it can be. It is not as long maybe as a registration statement in connection with a new issue of securities, but it gives stockholders a great deal of the information that would be contained in such a registration statement. Here are audited financial statements, balance sheets and profit and loss statements of both companies, earning figures for a period of years, particulars of the business of both companies. Then the shareholders meet and if the required percentage, usually two-thirds . . .

4957. *Professor Gower*: That is two-thirds of them all, not two-thirds of those present?—Of all, not of those present. I think under the laws of all the States it would be of all the stock and not merely of those present or voting, in the case of a merger. Then if the required percentages approve, the merger agreement is signed and executed and promptly filed in the appropriate State offices; and immediately upon filing, as though by waving a magic wand, the two become one and further than that the stock certificates represent the new shares from that moment on, rather than the old; of course, machinery is immediately put in motion for turning the old in and receiving the new certificates containing a proper description, but it is all done as quickly as that.

4958. *Mr. Watson*: But in these circumstances it is still possible for a shareholder who does not like the deal he is offered to seek to be bought out on some agreed valuation basis?—The man who does not like it can do two things. He can, as has been suggested,

object at the meeting and vote against the merger and then seek to have his stock appraised and take the appraised cash value; or go to a Court and say "Your Honour, this is grossly unfair, I object on this ground and that ground." And the Court might enjoin the carrying out of the merger. The existence of the appraisal right does not defeat the right to go to the Court, although the Court is much more cautious in granting an injunction where the appraisal right exists. I think they figure the man gets pretty fair treatment under the appraisal statute and unless it is pretty clearly an improper transaction it would be difficult to get an injunction where appraisal rights exist.

4959. If an offer made by company A to company B is accepted by 90 per cent. or more of the company B shareholders, then, in a similar situation in this country, those who have not accepted it are compelled to take the offer that has been made to them. Do you think that would be a good thing in America if it were adopted there?—We have something analogous to that in New York where one company has 95 per cent. of the stock of another company. In such a case the owning company can by a simple resolution of its directors and by notice to the minority stockholders of the owned company accomplish a merger of the latter into the former. However, if one of such minority stockholders objects he can obtain the appraised value of his stock in cash.

Mr. Schwarz: I see no objection in theory to your practice, if the man who is forced in is given the right of appraisal.

4960. *Professor Gower*: He is not in this country.—It seems to me he should be.

4961. *Sir George Erskine*: He has the right to go to Court.—But in our view I am quite sure the proposal would not be acceptable to our legislatures unless the man who was forced in were given the right of appraisal.

Mr. Brownell: The right of appraisal is so well established in our merger statutes that it would doubtless be carried over into any Bill that permitted what you have just outlined.

4962. *Mr. Bingen*: The scheme of reorganisation which involves two boards who have met and agreed the terms first and then put them to the stockholders and obtained the necessary majority—I can see that works when the two boards of directors are not at arms' length, when it is all dealt with on an honest friendly basis. But how do you deal with the sort of cases we have at the moment where there are conflicting bids?—If the two boards of directors differ on the question of whether or not there should be a merger, you get nowhere under our merger procedure. If corporation A and corporation B are to be merged and one board of directors objects to it, it would ordinarily be a practical impossibility. However, there are some States where it would be possible for the stockholders themselves to agree to a merger without the directors' approval.

4963. In the case where they are at arms' length you must have the same sort of conventional take-over offer we have in this country?—*Mr. Schwarz*: We have of course situations where people do not proceed by way of merger or consolidation or sale of assets but do go out and seek to acquire the stock by an offer or by purchasing stock of another corporation. You have an example of that at this moment, an attempt to acquire the stock of the Baltimore and Ohio Railroad by on the one hand the Chesapeake and Ohio and on the other hand New York Central, where there has been an attempt to seek the required stock by exchange. I think the difference we have is that all of this merely leads to getting enough stock so that you can secure the approval of the necessary majority to a merger. We have nothing of your kind. We have to take that step by merger or consolidation.

Mr. Brownell: As a second step.

Mr. Schwarz: And doing it as a second step, then you have a majority and vote your shares as a majority stockholder in favour of the merger; but because of that majority holding the Court is going to look at that merger more carefully.

4964. *Sir George Erskine*: Proceeding by making an offer for the shares of the

other company, can you equally offer your own shares as well as cash?—Yes, Sir.

4965. *Mr. Brown*: Can you make a conditional offer, in other words an offer to acquire shares for cash, providing 90 per cent. accept?—Yes, that is quite often done. One further thing: we think of the normal procedure in our country as being a procedure of what we call merger and consolidation, or sale of assets. There are, however, certain instances where a merger is not permitted. Under our law, for example a fire insurance or casualty insurance company cannot merge with a life insurance company although it may own the stock of a life insurance company. Therefore if, as happened a few years ago, a fire and casualty insurance company wished to acquire stock of a life insurance company, they had to do it by offering their own stock and acquiring in that case, I think, 97 or 98 per cent. of the stock.

4966. *Mr. Lumsden*: In a merger by sale of assets which you mentioned, I take it the approval of the stockholders is required for the sale of the assets, and the directors cannot sell the assets on their own?—*Mr. Brownell*: The law varies in different States. In New York State you have to get the consent of the shareholders. In Delaware, strangely enough, you do not. Normally you have to get the approval of two-thirds or a simple majority of the shareholders before selling your assets.

4967. *Mr. Brown*: That is where the whole of the assets is involved?—In most States it is the whole, but in New York we have a doctrine, not common, that you cannot sell any substantial part of the company's assets without shareholder approval.

Mr. Young: The provision relates to the whole or a substantial part of the assets.

Mr. Morgan: Generally, any thoughtful board of directors, if they were considering a step which involved a big sale of the company's assets, would put it up to their shareholders.

Mr. Brownell: They would in New York.

4968. *Mr. Richardson*: Where a bid is made for the shares of another company and it is conditional on 90 per cent., say, acceptance being received, are the acceptances as and when they come in binding on the acceptors? Are they entitled to revoke them?—They can be made binding in consideration of what others are doing. However deposits would almost invariably be required. If a man wished to accept he would have to deposit the shares with the bank.

4969. That is to prevent him revoking his acceptance?—Yes.

4970. If another more attractive bid came along the next day he is still bound by his original acceptance?—Yes.

Mr. Morgan: Then you get two different stocks; you get the same stock certificate but one of them will have a stamp on it saying the holder has assented to this plan, and the other one just an ordinary stock certificate.

Mr. Young: Generally, a stamped certificate will not sell as well as the unstamped. There are occasions when an offer will be made by one company and somebody else will come in and make a better offer but it does not happen frequently.

4971. *Mr. Richardson*: It is becoming increasingly frequent here.

4972. *Mr. George Erskine*: Mr. Brownell, when the company makes an offer for the whole of the issued capital of another company, has that offer to be approved by the shareholders of the offeror company?—*Mr. Brownell*: No, unless perhaps the offeror company wished to make its offer in shares and there are not sufficient authorised but unissued shares to make it good. The directors would otherwise have the right to make the offer without prior approval by their shareholders.

4973. *Mr. Lumsden*: On the question of an offer made conditional upon acceptance by 90 per cent. or such lesser percentage as the offeror may decide—the people who did accept would be bound even if the offeror only got 20 per cent?—I should say there might be a question as to whether that kind of

arrangement could be made binding in the absence of something like a deposit. You raise a question of contract law there. I would not venture to answer without further consideration.

4974. I was really thinking whether it would be permitted in the sense that it opens the way for the first offeror, who merely gets 20 per cent. and makes that binding, to re-sell at a higher price to a subsequent offeror. If he has less than 50 per cent., that is quite likely to happen. I wondered if you had any restriction on that.—*Mr. Petito*: There are no rules on that subject.

Mr. Young: Frequently you can accept whatever has been deposited. You do not have to have the full stated amount accepting the offer.

4975. *Professor Gower*: Making an offer conditional on 90 per cent. acceptance would be much less common in the United States than here, would it not?—*Mr. Brownell*: Making an offer conditional on 80 per cent. would not be at all uncommon because under certain circumstances that would constitute a reorganisation under the tax law and certain capital gains taxes would be avoided. That is too big a subject to go into, but since we have capital gains taxes that is a very important consideration in any of these arrangements for acquisition by issuing stock for stock; it does not affect ordinary mergers and consolidations which are more automatically within the reorganisation provision of the tax law.

Mr. Petito: I believe an offer might work in this way. It might be conditional on the corporation getting 80 per cent., which might make it a tax free reorganisation. But the company might reserve the right to take less than 80 per cent. if it so chose, but then the depositing stockholder would have the right to withdraw his stock because under those circumstances it would be a taxable transaction to him.

4976. *Professor Gower*: Next I would like to turn to the extent to which corporations should be allowed to make political and charitable contributions. I think in the United States a number of

State statutes do expressly permit charitable contributions within particular limits as long as they do not exceed a certain proportion of the annual profits, or something of that sort?—*Mr. Brownell*: That is not quite the situation. Very briefly, under our common law rule a business corporation would be regarded as acting *ultra vires* unless the contributions could be brought within the express or implied aims of the corporation by showing that they really benefited the corporation. The common law rule has been superseded by statutory enactments in most of our jurisdictions, and also the Courts in recent years have become much more liberal in construing what is a proper or improper gift by a corporation. Years ago a New York corporation could properly have given a donation to a local Y.M.C.A., in a mill town where most of the children of its employees spent their leisure hours, but it probably could not have given to the national Y.M.C.A. for the benefit of the youth of the United States. Today the Courts would not have any hesitancy in approving under our present statute a reasonable grant by a New York corporation to a national Y.M.C.A. A recent decision of the Court of Appeals of New Jersey strikes a note that we are hearing with increasing frequency. In discussing the validity of a corporate gift to Princeton University that Court said: "There is now a widespread belief throughout the nation that free and vigorous non-governmental institutions of learning are vital to our democracy and the system of free enterprise, and that withdrawal of corporate authority to make such contributions within reasonable limits would seriously threaten their continuance. Corporations have come to recognise this and with their enlightenment have sought in varying measures, as has the plaintiff by its contribution, to ensure and strengthen the society which gives them existence and the means of aiding themselves and their fellow citizens. Clearly then, the appellants, as individual stockholders whose private interests rest entirely upon the well-being of the plaintiff corporation, ought not to be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in

recognising and voluntarily discharging its high obligations as a constituent of our modern social structure." (*A.P. Smith Mfg. Co. v. Barlow*, 13, N.J. 145 (1953)). All the States have not gone as far as that, but certainly there is a trend in that direction, and the volume of corporate giving to educational institutions, hospitals and other organisations where you cannot trace a direct benefit to the particular corporation has been increasing.

4977. *Professor Gower*: That note you read is very different from the last English reported case with which Mr. Bingen will be familiar where in effect the Court said that it was all right for I.C.I. to give money for scholarships for scientists because they needed scientists—that was the sort of grudging line taken here.

4978. *Mr. Bingen*: That was in 1924.

4979. *Professor Gower*: There has been no reported case since.—Our late partner Mr. John W. Davis always insisted a corporation should limit itself to something that could be said to bring it direct benefit. If it wanted to help Princeton University it should give liberal dividends to shareholders and let them make the contribution. But there is a definite trend towards greater liberality among our State laws today.

4980. And there are statutory provisions in a good many States in addition to this?—Yes. The limitation in the statutes is usually expressed by the use of the word "reasonable". The percentage limitations which I think you referred to in your question are really in the tax laws. Our Federal income tax law allows corporations to deduct from their otherwise taxable income five per cent. on account of charitable, educational, religious and similar purposes.

4981. Would you say this express statutory permission has proved useful?—I am on the side of those who believe in it. I think that it is in the interests of our nation as a whole to allow corporations to help carry their share of the important load, particularly in these days when there are frequently such limitations on individuals' earnings and capacity to give. I believe that the New Jersey

Court was right in recognising that corporations have obligations as parts of our modern social structure. There are those who disagree.

4982. *Smith v. Barlow*, the case you mentioned—you might have felt happier if the corporation was incorporated under a State where there was a statute to do this, than in a State which did not expressly permit it? In other words you would have thought there was something to be said for dealing with this by statute?—The statute can help.

4983. Are there any provisions about disclosing the total amount of charitable donations?—In one or two States there are, and we think it is good practice for a corporation to disclose them in annual reports, but in most cases it is not required.

4984. The S.E.C. regulations do not?—They do not bear on it.

4985. *Mr. Brown*: You are referring to total, not individual contributions?—It might be either. I have seen corporations disclose the total amount and I have seen the breakdown.

Mr. Petito: Some take some pride in disclosing their individual grants for various purposes.

4986. What about political contributions? Is there any American law on this?—Generally speaking they are illegal by statute. It is a penal offence in New York to make a political contribution. There is a Federal statute making political contributions by corporations in connection with Federal elections illegal, I have not checked the laws of all the States but I believe there are similar prohibitions in practically all of them.

4987. *Chairman*: Would a corporation be allowed to campaign against a particular law which they contended would make their industry impossible to carry out?—Yes, but they would probably have to register under the various lobbying statutes, certainly in connection with the Federal law.

Mr. Schwarz: They could certainly spend their money to oppose legislation they would regard as objectionable. I

thought the question was directed to whether you could make contributions to the Democratic or Republican Parties.

4988. *Professor Gower*: Not entirely. Have you found a statutory formula which would enable corporations to oppose legislation of this sort and yet prevent them from giving money to the Republican or Democratic Party? How do you define political contributions? Could you send us a copy of one of these prohibiting statutes?—Yes.

Mr. Brownell: We will be glad to do that but I do not think you will find that they contain many words of definition as to what political purposes are. I think they leave that to the case law.

4989. If you could send that I think it might be rather interesting to look at it. Another thing analogous to this is the question of giving money away to your employees. English law—this is *sub judice* at the moment—apparently says as long as the company is a going concern, reasonable donations to your employees and ex-employees are all right, but that if the company is about to wind up or is not functioning then there must be no cake and ale and you must not give money to your employees. What is the American position?—Are you talking about Christmas bonuses?

4990. Rather more than that. A company with a lot of employees has sold its main asset and now wishes to do the right thing by the employees who are thrown out of work, say.—I think our law would be pretty strict on that, in fact much stricter than I understand yours is. Of course if it were a matter of Christmas bonus or a person who had served 25 years and so forth, there would be no difficulty at all.

Mr. Morgan: There may be a regular established policy as to what should be done in case a man loses his job, but in the absence of some pre-existing arrangement I think our law is pretty sticky. You cannot give it away. We require some consideration. You cannot, for example, just give somebody a stock option.

Mr. Brownell: We do not have any thing corresponding to the practice or

custom you have in the event of a merger, of making a payment to the directors of the company that is being acquired and who find themselves suddenly out of office. The right of the director to continue in office is not regarded as a vested privilege for which he should be compensated if he is deprived of it. We usually do not have in mergers and consolidations any provision for giving compensation to employees who lose their positions as a result of a merger, although it is not uncommon for officers of a company being merged into a larger one, to insist as a condition of agreement that positions be offered to all their employees, and particularly to all their older employees.

Mr. Morgan: And that they themselves might sign new contracts of employment with the new company.

(The witnesses withdrew)

Adjourned until 2.30 p.m.

MR. H. S. MORGAN, MR. J. M. YOUNG, MR. F. A. PETITO, MR. G. A. BROWNELL and
MR. F. A. O. SCHWARZ *further examined*

MR. C. D. McDANIEL *called and examined*

4993. *Chairman:* I should put it on record that we have now got with us Mr. C. D. McDaniel of Arthur Andersen & Co., and he, I understand, is responsible for the London office of the firm.—

Mr. McDaniel: For all of our European practice.

4994. *Professor Gower:* I wanted to ask next what is the position in the United States as regards fixing directors' remuneration. As I understand it, stock option schemes and bonus schemes generally are referred for stockholder approval and in a good many States have to be referred. With regard to normal remuneration, how is that fixed in so far as those directors holding service appointments are concerned? Is it entirely at the discretion of the directors themselves?

—*Mr. Brownell:* Directors generally have charge of fixing the remuneration of all officers, and directors have to approve the remuneration given to the officer-directors, although on occasion that has

4991. *Sir George Erskine:* Assuming these sorts of demands were approved by the shareholders, is there anything to prevent them then being met?—*Mr. Brownell:* Certainly if arrangements for termination pay were included in the merger agreement and approved by the shareholders and were reasonable in amount, I think they would stand. Payments to directors raise a slightly different question. I know of no case. I think it quite improbable it would ever happen. If they were moderate in amount I believe the Court would sustain them. There would have to be full disclosure of course and approval by the shareholders.

4992. If there were a contract of service, that would be a different matter?—The new company would have to take it over.

been approved actually also by shareholders. The practice of submitting stock option plans, special bonus plans and pension plans to shareholders varies. Under the rules of the New York Stock Exchange stock option plans must be submitted to shareholders if shares covered by the stock options are to be listed. It is regarded as good practice by most companies to submit such plans to the shareholders, but there are no general legal requirements. There are requirements in some States affecting plans for the sale of stock to employees. Our so-called outside directors, those who are not officers of the company, in years past by custom did not enjoy a remuneration commensurate with that which I believe is not uncommon over here. But in recent years the practice has grown of compensating outside directors, and most of us here today would favour that because you cannot ask the man to do the work of a director for nothing. Outside directors very seldom if ever participate

in stock option plans or other arrangements of that kind.

Mr. Morgan: Might I add to that; in many boards the outside directors, the non-officer directors, constitute a compensation committee which makes recommendations to the board with regard to the compensation of the director-officers and of other officers and employees of the company.

4995. It comes to this, that so far as directors themselves are concerned, apart from stock option schemes and bonus schemes, they vote their own remuneration?—*Mr. Brownell:* Yes, they do; the amounts vary greatly. There are still companies I believe that pay their directors an honorarium of \$20 for attending a meeting, or something of that kind, and they do not pay them any salary, but in more and more of the large companies annual salaries are paid to directors in amounts that may run to \$5,000 or \$10,000, or sometimes more. Of course, where the question is the salary of officer-directors, it is usually considered and passed upon by the outside directors or an independent committee of such directors.

4996. The next question I wanted to ask was about limitation on the number of partners. In England, as I think you know, we arbitrarily limit the number of partners in an unincorporated firm to 20; I know there is no such limitation in the United States. Has the absence of that limitation given rise to any practical problems?—We have no such limitation, as you said, and if you suddenly imposed one it would create considerable havoc not only in our firm, but also in Mr. Morgan's. Frankly, I have never heard it suggested; certainly the absence of the limitation has caused no trouble, and I cannot see any difficulty in having as many partners as the particular partnership calls for. In our firm we have 27 or 28.

Mr. Young: We have 21 general partners.

Mr. McDaniel: We have 186.

4997. Do you get trading partnerships in fact with more than 20, or is it only professional partnerships?—*Mr. Brownell:* I am sure there are some, but I

cannot name them. You mean engaged in commerce?

4998. Yes, I mean an ordinary manufacturing company or a selling company. —We have relatively few large companies engaged in trading that you will find in partnership form, but I am sure they do exist, and if they did exist on our side of the water I am sure there would be no objection to their having 21 or 50 partners.

4999. But it would be very unusual to find that, would it not?—I think it would be unusual because of the fact that it would be unusual to find partnerships doing that kind of work. If a partnership did it I would not see any reason with us for imposing any numerical limit on the numbers; it would seem to be rather arbitrary.

5000. I think the argument in the past was if you had to bring actions against an unincorporated body of any large size it raised various technical difficulties.—That would not be so with us.

5001. *Sir George Erskine:* Is your partnership a legal entity as distinct from the partners making up the partnership?—No, I do not think it is a separate legal entity; it is a partnership. We use the phrase "legal entity" as applying to a corporation and it is a separate and legal entity, but partnerships are groups of individuals.

5002. Every time you change a partner you change the firm, is not that the difficulty?—With us the law of partnership is in essence based on the law of contract. It really is a contract between certain individuals which is given a certain status by the State, and they are allowed to do business under a partnership name and certain consequences follow from their holding themselves out as partners; but with us a partnership is not regarded as a separate legal entity, although it sometimes enjoys some attributes of a separate entity.

5003. *Professor Gower:* May I turn now to the S.E.C. legislation, unless any of my colleagues want to raise any more points on general company law. Before I come to specific questions on this could I say a few words about the problem over here

as I see it. You have made it very clear in your memorandum that you have been operating under a Federal regulatory agency for some 20 or 30 years and that the reason why this Federal regulatory agency was established was because there was a crisis of confidence which led to its creation. Over here we have never had a similar crisis of confidence and have never had any regulatory agency similar to the S.E.C. On the other hand, I think it is probably true to say that there is in this country considerable suspicion on the part of the man in the street of the Stock Exchange and everything relating to it. I think it is also true to say that shareholding is not nearly as widely spread in this country as it is in the United States. We have of course got some regulation of the securities industry, but at the moment it is somewhat unco-ordinated. Part of the job done by the S.E.C. is done by the Board of Trade, part of it is done by the Stock Exchanges, part of it is done by the Courts, and I suppose part of it is done by the fraud squad. Some people clearly think that this lack of co-ordination does lead to inefficiency, to gaps in the law and generally to unnecessary trouble and duplication of effort. It seems to me that the greatest help you could give us perhaps is if you could first of all tell us, if we had to establish some agency similar to the S.E.C., whether we should find that too painful in your experience. Secondly, assuming that we could avoid doing that, which would be an extreme measure which I think would only be taken as a last resort, whether you can suggest to us any methods whereby we might co-ordinate our present regulations without going so far as to create a special agency for the purpose; and thirdly whether there are any rules embodied in the S.E.C. legislation or in "blue skies" legislation in the States which we could borrow, without necessarily setting up a new agency to administer them. Those I would have thought are the three main points on which we should like your help. Before I ask specific questions, which will be mainly I suppose directed to the third of those questions—whether there are any particular rules which we could borrow—I do not know whether there are any general observations you would like to make on

the general problem as I have tried to set it out?—Professor Gower, much as we want to be of whatever assistance we can to your Committee, I am afraid that we cannot attempt to answer most of the questions you have just propounded, because we do not really know enough about your system. It would be a little presumptuous of us to tell you we have found such-and-such to work very well and that we think you should do the same and it would cure all your troubles. Even if we did know enough to venture such a guess I think it would be a little bit out of place to say it to you. We would be glad to answer questions you may want to ask us about how the S.E.C. works with us and how we operate under it, and then against that, I fear, limited background, you gentlemen can decide for yourselves whether you should consider further some of the techniques and procedures we have adopted.

5004. It would be true to say that you have not found working with the S.E.C. unduly painful and that you do not think it fair to criticise its regulations on the ground that they have imposed undue restrictions on honest business just to catch a few dishonest rogues?—The answers to those questions depend on a lot of things; one is what you define as painful. Painful to some people may not be painful to others; and also the question covers a long period because the S.E.C. goes back to 1934. I have practised before it during that entire period. There have been times certainly when the operations of the S.E.C. were unduly restrictive and, in my opinion, inept. There have been times when I believe some of its regulations operated unfairly. There have even been times when it has been suggested—it was some time back—that some of their conclusions may have been affected in some manner by an eye towards the political end of the spectrum. So that I cannot give you a general answer that covers the whole 27 years the S.E.C. has been in operation, except to say that there have been many different commissioners, many different members of the staff, and that at the beginning it took them some time to formulate their procedures and techniques in a manner that made the Act fairly operable. In the early days it

was necessary for the commissioners themselves to advocate some changes in the law in order to make it workable. I can say this, however, that over the years the Commission's practices and techniques have been developed and greatly improved, and today on the whole it is a satisfactory Commission to work with. I have never found it difficult to get access to the proper members of the staff, to obtain fair consideration of any question that I or my partners had to submit to them. I suppose that they may have disagreed with our conclusions about as many times as they have agreed with them, but in cases where we have disagreed with the staff I have never been refused an opportunity to take the matter in question before the full Commission for decision by the Commission, after a hearing if I wanted it. You will not find that a body like the S.E.C. will please all of the people all of the time, but I think there are certainly no commissions in Washington which are regarded as operating more fairly than the S.E.C. and it certainly operates a great deal better than many of them do.

5005. Would you say that the great increase in the number of investors, especially small investors, and in the interest which they take in their companies is directly referable to the role of the S.E.C., or do you think this is due entirely to different factors?—If there is any effect on the number of investors I think it is purely secondary. It is hard to answer your question; I think it is a matter of opinion. I would certainly not say that the great increase in the number of investors in our country over the last generation has been due directly to the existence of the S.E.C. I think that very possibly it is a little larger than it might otherwise have been if we did not have an S.E.C. I think it is due primarily to the prosperity that the country has enjoyed, the larger amount of moneys that have been available for investment, the greater interest of our people generally in securities.

5006. I gather that the S.E.C. does in fact make considerable use of independent agencies such as the Stock Exchanges and the National Association of Security Dealers. This of course is very much in

the British tradition; we often tend to do this. Do you think we could borrow some ideas here? It is a very general question here again I am afraid.—That is true. It is a part of the policy of the Acts which the S.E.C. administers, and particularly the Securities Exchange Act of 1934, to utilise to the maximum the facilities of the Stock Exchanges and also of an organisation of dealers in the "over the counter" market called the National Association of Security Dealers, which was created under the specific authority of the 1934 Act. I have talked within the last two weeks with Mr. West, Vice-President of the New York Stock Exchange, and with Mr. Cohen who I understand is going to testify before your Committee next month; Mr. Cohen is the head of the Division of Corporation Finance within the S.E.C. I asked them the same question you put to me. Mr. West tells me that today the co-operation between the New York Stock Exchange and the S.E.C. is as close as one could imagine. Whenever the Stock Exchange makes an investigation of a situation or of some member, they send copies of it to the S.E.C. They not only carry out and help to carry out the S.E.C.'s own regulations but they adopt their own and go further in many cases than the regulations imposed by the S.E.C. Mr. Cohen tells me the S.E.C.'s relations with the N.A.S.D. are just as close as they are with the Stock Exchange. They have had from the officers and directors in that organisation the very closest co-operation. I am quite sure that if it were not for the utilisation of those organisations the S.E.C. would not be able to accomplish the job that it does. It may be that some of my colleagues would like to comment on that.

Mr. Young: I think the New York Stock Exchange and the other Stock Exchanges police a very substantial amount of all of the commission trading in the United States, by far the greater amount; those are listed securities. The National Association of Security Dealers—and one of our partners is one of the governors of it—I would say police or supervise the operations trading-wise of the dealers in the country, who may or may not be members of Stock Exchanges, in the "over the counter" market, and it has been an effective means of regulation.

There is a relatively small area where the firms are neither members of registered Stock Exchanges nor members of the N.A.S.D. that do some amount of business, but I would suspect it would be a rather small proportion of the total business done in the country. For example, in our investment banking business we, as members of the N.A.S.D.—and we were one of the original organisers of it—are allowed to do business with any registered dealer in the United States, but under the Rules of Fair Practice of the N.A.S.D. we are not allowed to give a commission or concession to any dealer who is not a member of the N.A.S.D. In exchange for being able to get these commissions and concessions they have agreed to abide by what we call the Rules of Fair Practice and high standards of trading. I think it has been a good method of operation. I think we would agree substantially with what Mr. Brownell said about the S.E.C. Sometimes you have arguments, and we usually end up by doing it their way instead of our way, and many of us feel strongly that there should be some simplification and streamlining of the operations of the Commission as regards certain types of securities, notably securities that are either listed on registered Stock Exchanges or meet certain standards of quality.

5007. I rather gathered from your memorandum, Mr. Young, that in your view the regulation and policing by the Stock Exchanges and the N.A.S.D. would not have been as effective as it is but for the fact that they are subject to overall supervision and co-ordination by the S.E.C.?—I think it would be fair to say that, having the S.E.C. looking over your shoulder, you are very likely to be doing or possibly adopting some things earlier than you would otherwise, and I believe generally speaking that the relationships have been pretty good.

Mr. Brownell: I think it is fair to say in our country the situation is different in many respects than yours. We would never have accomplished the changes that have been made in the last 27 or 28 years in our securities market without the existence of some organisation like the S.E.C., but you must remember that in

saying that we have in mind the fact that we have 51 different jurisdictions; that while the New York Stock Exchange is our leading and strongest Stock Exchange, it is only one of 13 or 14; that there is much less concentration in New York City of our securities market than there is here in London; that security dealings and security offerings throughout the country are much less subject to any influence or control by our New York Stock Exchange than are yours by the London Stock Exchange. I believe from what I have been told that with you most issues are listed on the Stock Exchange before they are offered; although of course many of our new issues are listed securities, I think I am right, Mr. Morgan, in saying most of the securities offered to the public are not listed until a later date.

Mr. Morgan: Definitely no debt securities.

Mr. Brownell: No debt securities are listed at all until a later date.

Mr. Young: Also many issues of stocks are not listed when first offered, excepting of course additional issues of stock that is already listed.

5008. Is it fair to say the S.E.C. has delegated to the Stock Exchange and the N.A.S.D. certain of its statutory responsibilities to be carried out by those two organisations under the supervision of the S.E.C.?—Mr. Brownell: That is a correct statement.

Mr. Young: I think also you should know there is some difference of opinion in the financial community itself as to the extent to which these powers should be granted to the S.E.C. For example, Mr. Petit mentioned this morning that in 1952 or thereabouts when a review was being made of the securities legislation in the United States the Stock Exchange strongly proposed that the public distribution of securities of companies whose shares were listed on the New York Stock Exchange should be eliminated entirely from the requirements of registration with the S.E.C. That did not go through at that time, and I should doubt that it would go through in the foreseeable future, although there is a strong body of opinion that feels that that is a proper

method of operation because of all the information that is filed and made public quarterly or annually by those companies.

Mr. Brownell: I think it would be fair to add that the S.E.C., particularly in recent years and for that matter throughout its whole existence, has been quite alert to improving its techniques and procedures, and they have made great simplifications and improvements. We all think they still have a long way to go in certain areas. The S.E.C. have adopted the practice of circulating for criticism any new rule before they put it into effect, and the members of the Bar, investment banking firms, stock brokerage firms and so on get copies of the proposed rule, with advice that criticisms and comments will be welcome. We make criticisms and comments, sometimes we go down and talk to them, sometimes they even go so far as to have a public hearing on a proposed new rule. Of course they do not begin to accept all the suggestions that are made, but they do accept some of them and I have known cases where they have substantially changed their proposals in the light of criticism they have had, and cases where they have abandoned a rule which, after receiving comments from the industry, they have concluded is not a practical one to put into effect. That shows the healthy and co-operative attitude which has made working with them simpler.

5009. I am afraid they were very general questions. Shall we get on now to the problem of new issues and the regulations under the Securities Act. You have supplied us with a number of registration statements which have to be filed when a security is issued. As I understand it, this rather massive document consists really of two parts; the first part is the prospectus which the member of the public would get, and the rest of it is additional information which would be filed with the S.E.C. but which will not have to be sent to each investor before he can invest. That briefly is the situation, is it not?—*Mr. Schwarz:* You are correct in your understanding. I should like to make one further point there, that different forms are prescribed and some forms are simpler than others. I have before me two current forms, both of them

in respect of issues by telephone companies, one a debt issue of the Chesapeake and Potomac Telephone Company, which is about to be put up for competitive bidding next week, \$20 million, and the prospectus is only 16 pages; that is Part 1. Part 2 is perhaps two or three pages. The second one is on form S.1, which is a longer and more complex form, in respect of a new common stock issue by the American Telephone Company. No one knows the exact price yet, but presumably it will be close to \$1 billion; and that is longer—the total prospectus is about 18 pages.

5010. Yes, the prospectus itself is not such a vast document.—You were smiling when I said only 16 pages.

5011. It excludes quite a bit of the formal data that the English prospectus would contain in very small print. On the other hand it does go in very much greater detail into certain things, mainly financial items; that would be a fair statement, would it not?—I think that is quite true.

5012. A description of the company's business and properties, and so on.—I think that is true.

5013. The whole of this registration statement will be scrutinised by the S.E.C. before any use can be made of it at all?—That is correct.

5014. How thorough, in fact, is that sort of scrutiny? Could you tell us how the S.E.C. go about this, or perhaps we could ask them when they come. Perhaps you could give us the consumer's point of view?—I think it would be helpful if you asked Mr. Cohen when he is here. I would say that it varies with the type of issue and that it varies from time to time. On issues that are well established and where the company has done a good deal of financing I think sometimes the companies feel it rather an insult to get any deficiency letter, so-called, from the S.E.C. On the other hand, in the case of a company which has never done any financing before, in a new field, particularly if the investment bankers, the company itself, counsel and accountants are not very familiar with the problems, it may be a very lengthy so-called deficiency letter. It varies very considerably.

5015. From your experience would you say that it is a very effective scrutiny in detecting omissions and mis-statements? Could you say there have been times when you have at the request of your clients put forward something that you have doubts about and they have spotted this?—I do not think I would quite say that, Professor Gower. I am not trying to criticise the S.E.C. in any way, I think they do a very remarkable job, but I honestly think that with good bankers, good accountants and good lawyers they will do an even more thorough job than the S.E.C.

5016. We ought to have got some shyster lawyers here to ask this!—I am not attempting to criticise the S.E.C., but I think that many experienced bankers, businessmen, accountants and lawyers are even more alert to the problem than the average person in the S.E.C.

5017. You think this preventive scrutiny is better than sanctions imposed afterwards?—I think particularly with small and medium size operations which are not well established and not listed on any Stock Exchange the arrangement is very worthwhile.

5018. I gather you take the view, Mr. Schwarz, that the S.E.C. would be quite wrong if they used this screening as a method of keeping out dubious issues; that your view was that as long as the dubious features were stated the issue should take place; it should not be used as a method of excluding issues on the basis of quality. I was not sure whether that was also Morgan Stanley's view. I rather got the impression they thought it no had thing if the preliminary scrutiny of the S.E.C. excluded issues of low quality, and I thought there was a slight disagreement between you there.—*Mr. Young*: I do not think so, Professor Gower; I think if the company files the information and gives complete disclosure the S.E.C. has no power to stop it.

5019. No, I think it is clear they have not theoretically any power, but it is sometimes suggested that they use their powers to insist upon disclosure to such an extreme extent that in fact this means the company does not make the issue?—I think there have probably been

securities in registration for months in the S.E.C. right now that may never come out, but actually, legally, I do not believe they have the power to stop the registration.

5020. *Chairman*: You remember the prospectus issued by a gentleman for building plots on the moon, to take an extreme case. If the S.E.C. had such a thing as that presented to them would they say on the face of it it was hopeless?—*Mr. Petito*: They could offer a bit of blue sky; if it were properly described the issue would probably have to become effective. They could stop your example by asking for information on drainage conditions on the moon.

Mr. Morgan: I think the fact is that this system of deficiency letters is some comfort to lawyers and bankers in making them feel that somebody else has concluded they have made an honest and complete disclosure. Of course, on the doubtful issue, it certainly should not be held up provided all the necessary information is supplied.

Mr. Young: Here is a prospectus regarding a \$150 million issue by General Motors Acceptance Corporation. This company will have been registered three times in less than 12 months. That type of registration statement would go through very quickly. On the other hand, there is some doubt whether we can get it through in less than the 20-day statutory period; but we would consider that par for the course, because the average time that it has taken in the last year, as I remember, for the average registration statement to go through is 59 days, contrasted with the 20-day statutory period. That is an unfair way of saying it because I would say we have really no difficulty with high-grade securities, but this very much longer period comes from the small inadequately prepared registration statements of the more speculative companies.

5021. *Professor Gower*: I gather from your memorandum that it is only in the last two years that the average time has become anything like as long as this?—Yes.

5022. Has the S.E.C. much flexibility within the regulations? There are standard regulations laid down; how far can

they adjust them to the requirements of each particular case?—*Mr. Schwarz*: I think there is a great flexibility in forms. When you once fit within one form or another there is a certain amount of flexibility. For foreign government issues they have never really prescribed a form, they have tried to fit the particular case. But by and large the flexibility within the form is not too great, and I think probably should not be too great. I am not talking about the wording now, obviously, but matters of substance.

5023. But you have no complaint there are rigid requirements which do not fit your case; that is not the kind of problem that faces you?—You sometimes run into that. Suppose you are offering to employees under a stock option plan, you run into the question whether one form fits or another. They have certain forms and they have permitted them to be used sometimes and not on other occasions. But ordinarily, I think—certainly with good securities—you do not have too much trouble.

5024. One great contrast between British and American prospectuses is that ours contain forecasts about future dividends and profits of the company, and yours do not. I gather the S.E.C. take the view that this is dangerous; what are your views on this?—That is right, and I think we have all become conditioned to what we are accustomed to, and it seems to us, perhaps being used to our system, that it is quite improper and dangerous and a sort of touting of the security to make a prediction as to future earnings or dividends. I think I should make it clear that I think all of us, the S.E.C., the bankers, corporations, the Bar that works on this, are very conscious of the importance of trends in earnings particularly, and if it appears from the examination made before a security is registered that a trend is adverse then the corporation, the S.E.C. and everyone will be concerned to disclose that fact through some comment relating to the most recent earnings. They are very conscious of that, but that does not mean we believe an attempt should be made to predict the future, certainly not publicly.

5025. *Mr. Brown*: Take the case of a property development company, whose

current profits are nil and whose property is going to cost so much to develop; if it is let for so much it will produce revenue of so much. That is a forecast but it is nearly factual. Would the S.E.C. prevent that sort of forecast?—No, I think it would prevent them estimating future earnings. I do not think it would prevent them giving the facts of a contractual arrangement.

5026. The calculation might be carried a stage further—on the estimated expenses of running the company there should be a profit of this order. That would be out?—I think so. I think we are very loath to go even that far.

Mr. Young: In pipeline companies though, you could say you buy at such-and-such price at the beginning of the pipeline and you sell at such-and-such price at the other end, and you give figures so that the buyer can get some idea of the earnings.

Mr. Schwarz: You can give gross figures, but I think the S.E.C. are very averse to carrying it through to net final figures.

Mr. Brownell: Not only would the S.E.C. hesitate, but remember, the penalties that are imposed for this fall on directors and on underwriters. Remember also one of the easiest things to prove incorrect is a forecast of future earnings because later on you can put the real figures right up against the estimates. I think almost any counsel would hesitate to encourage that kind of forecast statement.

5027. I think it is fair to say that forecasters here are pretty cautious in their wording, but nevertheless they do make one.—*Mr. Schwarz*: I think we lean even further back.

Mr. Young: You do not have the liability provisions in England that we have in America.

5028. *Professor Gower*: I do not know; under the Prevention of Fraud Act a misleading forecast imprudently or recklessly made gives rise to criminal action.

5029. *Mrs. Naylor*: On the subject of property companies, is it the case the

S.E.C. would not allow an appraisal, or valuation as we call it, of real estate properties; only the cost price that is paid can be given in the prospectus?—*Mr. Schwarz*: I think they would permit an expert's appraisal of value; I think they would.

5030. *Mr. Brown*: An independent expert?—Yes.

5031. *Chairman*: Would they permit such a statement as—"The new factory is capable of producing so many hundred yards of metal tubes per week."?—I think so.

Mr. Petito: That is factual.

5032. *Mr. Mackinnon*: One question about the trend of earnings. If you show the earnings over a period of years successively then there may be a trend one way or the other.—*Mr. Schwarz*: That is right.

5033. Supposing the trend is upwards. Anybody looking at the prospectus might presume that the trend was going to continue unless something is said to the contrary. In that case if it is thought unlikely to continue you would permit a statement, would you?—We would not permit a statement saying what the future earnings are going to be, but we would be very much concerned to put in textually, not in figures, some statement that the business had levelled off in recent months. Suppose you had given just a year's figures, you then say—"In recent months the earnings have been at a lower rate." You would be very eager to find some way to put the public or prospective buyer on notice.

5034. If you do not say anything at all in the case I have mentioned is not that as good as saying to the reader he can expect the trend to continue? Does that aspect come into consideration?—Every time we go over a registration statement we are concerned to see what the most recent earnings are and what the trend of earnings is, and what the expectation of the future earnings may be. If there is an indication that there is a declining trend or a changing trend I think we would not just rest on the figures but would try textually if not otherwise to indicate that change or reversal.

Mr. Young: Such as reduction in selling price of one of your principal products if you are a chemical company, for instance, or possibly increases in wage rates.

5035. The only point I was really trying to bring out was that if you say nothing you are in fact saying something.—*Mr. Schwarz*: Quite possibly. That mere presentation of a record without a qualification may be a misleading statement, I quite agree.

5036. *Mr. Bingen*: It is rather a curious position. The trend might be continuing, in which case you would say nothing, or the directors might think it was going up in which case you would also say nothing. But if it is going down you cry stinking fish.—I think that is just about what it is; it is perhaps sometimes leaning over backwards.

5037. *Professor Gower*: Would the S.E.C. in fact make enquiries to see whether there are any facts to suggest the trend was not going to continue? What I have in mind is this. Suppose a company had made large profits because it was working on some new process; it had got first in the field with a non-patented process; any of its rivals could start, and as soon as they did start the profits might go down. Would the S.E.C. in fact make enquiries about this and insist that some statement be put in?—I think they might but I think the bankers and counsel would be more likely to; the S.E.C. cannot do everything.

5038. It would not in fact get left out? A statement would be placed in an American prospectus drawing attention to this fact?—*Mr. Young*: If we had reason to believe it.

Mr. Schwarz: I do not think you have to guess about every possible misadventure that could occur, but I think you try and see, and I think certainly the tendency has been along your lines, to emphasise the bad and the dangers rather than the good. Under the law an omission to state a material fact which results in making what you do state misleading is as bad as an affirmative mis-statement.

5039. *Sir George Erskine*: How do you deal with the case of the marketing for the first time of an equity where the

company has in the past adopted an extremely conservative dividend policy, and now the dividend policy is going to be quite different? Are you not allowed to forecast that?—I think you might meet that by having the board of directors announce before the issue is marketed that they plan or expect or anticipate that beginning such-and-such date they will raise the dividend to such-and-such figure. Mr. Morgan reminded me a moment ago that that very thing happened a month ago with the American Telephone Company. The same day that the board of directors announced they were going to offer 11 million shares to the public, they also announced they had decided to increase the dividends payable next June, which will be after the shares are outstanding.

Mr. Young: I think, Sir George, we would feel it incumbent upon ourselves to advise our clients to arrive at a dividend policy which they think would be reasonable and could be continued, because it is in the light of that that we will in effect fix the price they will receive for their security. I would say that without exception—and we have done quite a number of these introductions of issues of companies that have never been publicly offered before—we have a statement in the prospectus about the proposed dividend.

Mr. Schwarz: That is based on some formal determination by the board of directors.

5040. Would that be repeated in the prospectus?—That would be repeated in the prospectus, yes.

5041. *Professor Gower:* You must have seen a great many British prospectuses as well as American ones. Would you agree that one of the contrasts is that in an American prospectus you will get the adverse features emphasised to a greater extent than in the average British prospectus, which still tends to be designed to sell the shares rather than perhaps to bring out all the relevant features for the benefit of the investor?

5042. *Chairman:* In the case of prospectuses which are issued in this country I should have thought they invariably

take the greatest pains to present a true and balanced picture of the whole thing; and very often one used to sit up the best part of the night trying to do it.

5043. *Professor Gower:* I have never seen an English prospectus with a large statement across the front of it: "This is a speculative security," as I have in America. Nor have I seen a statement like this: "It should be noted the offering price of the company stock is approximately 60 times the latest earnings for the latest fiscal year, that approximately 70 per cent. of the company's present business is related or indirectly related to the government's defence programme." That sort of statement is not found in a British prospectus.—*Mr. Brownell:* I must correct you on one inference that you may be making. This legend you refer to—"this is a speculative security"—does not appear on the prospectus on the suggestion or instance of the S.E.C. and is not part of their rules. We also have in most of our States "blue sky" laws, and you cannot offer securities in the States without complying with those laws. There are one or two States which insist on that legend on certain types of securities. The S.E.C. does not even to that extent attempt to force a statement as to whether it is speculative or not speculative, but they do force a statement of what the situation is and allow the buyer to make his mind up.

Mr. Young: I think we want to go one step beyond Mr. Brownell, and that is even if it is not required by "blue sky" laws we insist on it ourselves.

Mr. Morgan: And have done so in certain issues.

Mr. Schwarz: On your first question there, I really do not think I am competent. I do not think I know enough of the British practice.

Mr. Young: Our prospectuses are selling documents too.

Mr. Schwarz: Under-statement sometimes is a very effective selling point too.

5044. I have heard it argued that the more speculative you make it appear the more you will sell, but at least the buyer knows what he has got. A registration

statement of this sort will be required on a rights issue, as you told us this morning.
—Yes, Sir.

5045. Where there is an issue of shares in exchange for other shares?—Yes, actually that is perhaps even more complicated, because in that situation it is quite likely that the prospectus and registration statement will have to contain financial statements both of the offering corporation and the offeree corporation. I have before me here a prospectus of the Federal Insurance Company relating to an issue of perhaps \$5 million. That is a small fraction of the American Telephone issue I referred to earlier, but the prospectus is much longer—some 70 pages—because the offering involves an exchange of shares with another small insurance company and very lengthy financial statements of both companies are called for.

5046. It would certainly be your view if a man is being invited to buy shares in exchange for shares he already has got he should get as much information as if he is invited to buy shares for cash?—I want to stop there just a moment because again when we go through our merger procedures or when we go through a statutory merger or statutory sale of assets we do not require a prospectus. We do require much of the same information through the proxy statement at least if the corporation is listed. So there is in a sense a gap in our thinking on this; where it is done by law through a merger or consolidation or a sale of assets then the man votes rather than tenders securities. But where it is an exchange of shares there we do certainly require information to an even greater extent than in the case of cash.

5047. *Chairman*: Then you have to depreciate in your statements both lots of shares comprised in the exchange!

5048. *Professor Gower*: Could I ask you about the waiting period. I gather you have evolved a technique whereby in effect the investor has 20 days to chew over the information in the prospectus. This astonishes our issuing houses over here. Can you explain more fully how it operates?—*Mr. Young*: It astonishes us at times. Under the Act, suppose we file a registration statement today, the statutory period when it becomes effective

would be 20 days from now, but the registration statement as filed is incomplete, certainly as regards price to the public and the underwriting terms, and of course in some cases there is accounting information that is not available at the time of the first filing. During this 20-day period the underwriters will hold a meeting with the officers of the company, in which we review the registration statement and the prospectus. If necessary or desirable we will have inspection trips to one or more of the plants of the company that is involved. During this same period of time the underwriters and dealers who expect to be members of the selling group will be discussing the issue with potential investors, presumably if it is a common stock with private investors, pension funds, insurance companies and so on, and if it is a debt security largely with institutional investors, and be getting ideas as to the marketability of the issue. We are allowed under the law to discuss the issue with potential investors but not to agree to make a sale. In the normal course of events, having received the deficiency letter if there is one, and having finished our examination of the issues, we will obtain from the various principal underwriters or the underwriters in whose price views we have particular confidence their ideas as to what the price of the issue should be to the company and to the public. The managing underwriter, which is the part of the business we particularly specialise in, is the one who gets information from all types of underwriters and from prospective purchasers in all parts of the country. For example, an issue may be going unusually well in New York or Boston and be very slow in Chicago, San Francisco and Philadelphia. The managing underwriter takes into account the views of the underwriting group as a whole and he negotiates probably on the evening of the 19th day, the proposed public offering price with the issuer. It is an arms-length negotiation which usually results in an agreement on price and terms between the seller and the managing underwriter on behalf of all the other underwriters. Then as of the morning of the 20th day we file an amendment with the Securities and Exchange Commission, which puts in the underwriting terms and the offering price, and

as soon as that amendment has been made effective by the Securities and Exchange Commission we are free to offer the issue to the public. Usually, we get an effective registration statement late in the afternoon of the 20th day, although sometimes we get it in the morning, and our official formal offering is made in the newspapers on the following day. There is one further point: during the 20-day period we do send out to hundreds of investors, and in some cases to thousands of investors, what we call a "red herring" prospectus, and it can be either a complete prospectus or a summary prospectus, a smaller more concise document. It is on the basis of these documents that the underwriters and the dealers may go around and in effect solicit orders although if somebody says to me—"I want to buy 100 bonds or 100 shares."—it would be against the law for me to say—"I will sell them to you."—we have to wait until the registration statement is effective to confirm a sale.

Mr. Brownell: I think the record might show why it is called a "red herring". It might be misleading to the casual reader. It has been since the beginning of practice under the Act customary to put across these prospectuses which are not official a legend, always printed in red ink, and early in the game they were called "red herring" prospectuses. The legend merely informs the reader should he read it that the registration has been filed and that no one can sell the securities described in the prospectus until it has become effective.

5049. *Mr. Scott:* Are there in fact any dealings which take place unlawfully on the basis of the "red herring"?—*Mr. Morgan:* The price is not fixed; therefore you cannot come to final agreement.

5050. The price is never known?—*The price is not known.*

Mr. Schwarz: The registration statement will usually be made effective on the same day the price is filed. There is not a long waiting period: it is either the same day or the next day.

5051. *Professor Gower:* But supposing I am the man in the street: I know that a company is about to make a new issue and

I want some shares—how long in fact shall I be able to chew over a pretty complete prospectus before I have to make up my mind? Is that 20 days?—*Mr. Young:* Theoretically 20 days. I do not think there is any question about it. Some people do "beat the gun". But it is illegal to do it, for anyone to agree to sell a security to anyone before it is an effective registration. We have had underwriters in our issues who have sent out information about new issues which was not properly prepared, and as a result of which we have had to require them to drop out of the underwriting. But we try to make these rules work.

Mr. Brownell: But Professor Gower should remember that the "red herring" prospectus, as Mr. Young has indicated, is put in the hands of investment analysts and the various security houses, and is studied by them, and some basis of formulating a judgment is offered before the offering date: and after the offering date the full prospectus is available and the prospective purchaser can obtain copies of the prospectus and study it at his leisure. He may buy the security in the secondary market at a later date. It has often been said many prospective purchasers do not read those prospectuses. On the other hand it is true that they are studied carefully by banks and brokers. It is true that large investors read them, or their advisers read them. It is true they are available; and certainly I think we all agree that our investors, as a result of them, get infinitely better information about new securities than they did in the '20s.

5052. *Mrs. Naylor:* Am I right in thinking when you file the amendment to the registration statement to give the price, that is technically an amendment; and the S.E.C. could insist on another 20 days?—*Mr. Young:* That is correct.

5053. And when they let you go right away, that is an accelerated registration?—*Yes.* The first concept was that the price and everything would be filed in the first instance; but of course it was obvious to anyone who knew anything about the business that was not possible.

5054. *Professor Gower:* But it would be your view, as I understand it, that some

time is needed for people to be able to chew over the information. This philosophy does not work unless people have time to chew it over?—It depends on the kind of security which is being offered.

5055. You make this point in your memorandum. Sometimes, you suggest, 20 days would be too long. Under our system the waiting period is three days: it need not be more, unless the underwriters themselves decide to make it longer; and our industry over here argue that is quite long enough and anything longer is impracticable.—I do not know the real background of the three days, and I do not think we ought to express an opinion.

5056. *Mr. Mackinnon*: Do you think yourself that 20 days is too long?—I think it is substantially too long for high-grade securities of companies of established credit. However, I would say that, purely from the technical point of view, even if we could eliminate the waiting period entirely we would not do so because in 27 years since the Securities Act the investment banking business has changed its method of operation, and we find it very convenient to have a period of time during which we can discuss this proposed issue with a client. When you have 20 days for a very high-grade issue, nobody really gets to work on it in fact till about the last week or so; but what may eventually happen is that on certain types of issues you have a substantially shorter period of time and may be able to proceed with more despatch.

Mr. Schwarz: Until a year or two ago, before the S.E.C. was so pressed, it was very often possible with high-grade issues to get them effectively cleared 10-15 days after the filing. That met some of this problem, but that has not been done in the last 18 months or two years—but hopefully it will again be the case, so that you will have some flexibility on this, and may vary your period from anything from 10 days.

Mr. Young: I think this General Motors Acceptance issue that we have now will probably become effective in maybe around 15 days, which is excellent co-operation from the S.E.C., particularly in view of the great pressure on it.

Mr. Petito: I think we suffer from another disability too, in that the S.E.C. interprets the law so as to prevent any announcement before a registration statement is filed. For instance, a company cannot announce to the general public and to its stockholders, that it is planning to make an issue of \$150 million, because the S.E.C. interprets that as really a selling manoeuvre. Therefore we cannot begin to discuss the new issue until after the registration statement is filed. So we need a certain amount of time just for the mechanics.

5057. *Mr. Althaus*: Part of this question of the difference in period arises from the difference in the methods of issue in our two countries?—*Mr. Young*: I would say so.

5058. Because here the document invites subscription to a central clearing agency, and the list opens and closes automatically, whereas your underwriters are mainly concerned in the subsequent sale of the securities, if I understand it correctly, and therefore there is a nation-wide—or at least a very wide—selling campaign involved in it which needs rather more preliminary discussion than is the case with us. Is that correct?—Yes, I think so. For example, in rights issues, we feel you should have an extended period of time between the time the prospectuses and subscription warrants are sent out and the time the rights expire so that the shareholders will all be given ample opportunity to subscribe. I believe the Stock Exchange prescribes 14 days as a minimum, while under some circumstances we have gone as long as six to seven weeks. I think it all depends on the circumstances. We could actually get a very high-grade bond sold in a considerably shorter period of time than we would need to sell a common stock issue—there would be a different type of buyer.

5059. *Professor Gower*: Can you tell us which issues you do not require registration statements for?—*Mr. Schwarz*: There are various exemptions, and I can run over them, I think, fairly quickly and without going into great detail: any government security, U.S. Government or State or Municipality, is exempt. Any bill of exchange or any security issued by

a person or organisation operating exclusively for religious, educational or beneficent purposes; securities issued by a building and loan association; any security—and here come some important ones—issued by a common or contract carrier, the issuance of which is subject to certain conditions applicable to the industry (really that excludes almost all railroads). Also certificates issued by a receiver; an insurance or endowment policy; any security exchanged by an issuer with its own existing security holders without payment of any commission. Also banks do not have to register securities, but insurance companies do.

5060. *Mr. Watson*: Could I understand a little more about this "red herring" prospectus. Is this document completely irregular, in the sense that it is not scrutinised by the S.E.C.?—It is the document which is filed with the S.E.C. It is usually the original prospectus which is filed: it is distributed. If the S.E.C. comes along and says, "This is terrible, you have to make a good many changes.", then you will be required to send out to every person to whom you have given the "red herring" prospectus a correct prospectus.

5061. I follow.—Ordinarily, if there is just some minor change in wording, that would not be required. If the thing was an extreme case you might even be required by the S.E.C. in a covering letter to call attention to the facts.

5062. *Sir George Erskine*: Is there any exemption related to the amount?—There are certain exemptions. I think issues for \$300,000, under certain circumstances, are very much simplified—one or two-page documents.

5063. *Chairman*: Could you tell me, when you come to the distribution of the actual effective prospectus do you make any use of the newspapers? In this country almost all prospectuses are published in full in the Press. Do you do that?—Yes, there is in the newspaper what we call a "tombstone advertisement", which does no more than give the title of the issue and the price and the principal underwriters and reference to the place where the prospectus can be

obtained. There are rules of the S.E.C. under which a newspaper prospectus may be published; and I believe that at one time Morgan Stanley in particular made use of this right of publishing a newspaper prospectus, which might take up half a page or a quarter-page, and was summarised. I think they have not done this for a long time.

Mr. Young: We have not in recent years. I think it is just a matter of cost. The cost of advertisements, even the "tombstone" prospectuses in some cases, runs to \$75,000, and we just cannot afford, with the present spreads, to use that kind of advertisement.

5064. *Chairman*: You were showing us prospectuses of a fair number of pages, and I was just thinking it could cost a large amount and would use a lot of advertising space.—It would be an enormous expense.

5065. *Mr. Scott*: And you do not advertise any application forms which could be cut out and used—would that be unlawful?—We have a preliminary advertisement which carries a form of that type, as I remember, where a man can express interest in the security; but we have never used one ourselves.

Mr. Schwarz: I think it would be helpful to the Committee to recognise that though the *New York Times* and the *Wall Street Journal* have a very wide circulation throughout our country, generally speaking, we have thousands of newspapers—or at least hundreds—in which such advertisements would have to be inserted. It is very different from your situation, where a few newspapers may cover the whole country.

5066. *Mr. Althaus*: One of the consequences of advertising the full prospectus in the Press here is that it immediately excites widespread comment in the technical and lay Press. Is there any such consequence in your issues, is such comment made when the prospectus becomes available to the public at large?—*Mr. Young*: I would say that the day we file the registration statement we release a brief Press notice relative to it. I would also say that the people in industry and business are so aware of all

that is going on in financing in their field that the moment a company that is of interest to them files a registration statement they will get a copy of it from the local investment bankers if they wish; and then we advertise not only in newspapers from coast to coast but in magazines such as *Time* and *Newsweek* and the financial magazines.

5067. My point really was by the publication of these things you immediately excite technical comment and comment in the financial columns of papers which are, by that very fact, made available, for what they are worth, to a wide public of millions of people.—Yes. We also have services such as Standards and Moody's, and every new issue of any size and substance is analysed by these services, and cards, such as your Exchange Telegraph cards, are sent out to thousands of subscribers and investors around the country. Services such as Standards and Moody's will come out with a recommendation of what they think about the issue, and not only that, but what they think the price ought to be—much to our chagrin at times.

5068. *Mr. Richardson*: And that occurs during the waiting period of the filed statement?—Yes.

5069. And in your experience are there any issues which in fact are not made because of the publicity they attract within that waiting period?—I think there have been a number of issues that have been filed that have never been completed: whether it is due to the publicity or the fact that the underwriters miscalculated the saleability of the issue, I do not know.

5070. Of course, if you are talking in terms of 1959 conditions in the S.E.C., you might easily find an issue which would become unsaleable through a change in the market conditions during the period you have to wait for clearance, might you not?—*Mr. Morgan*: Yes, I think it has happened.

Mr. Schwarz: It sometimes works the other way, of course.

5071. Of course, but if it is going to be a period of about two months, it must be difficult for the buyer to predict what the

price will be at the time of the issue of the first prospectus.—It is really impossible. The way we work it when we start discussing a possible issue with a client—it may be two or three months beforehand—is that we express what you might call a range of view. Almost invariably, the day before or two or three days before we file the registration statement we have another meeting with them after all the work has been done to bring our marketing views up to date; but they of course recognise that we can only give them our own view of the matter, because frequently it is very secret information and we do not talk to anybody outside of our own firm. And then they recognise that during the waiting period market conditions may change and it can turn out that the issue is not too attractive to the market, and you have to adjust price views in relation to that. On the other hand sometimes during the waiting period we find we can sell the issue better than we thought we could.

5072. *Professor Gower*: Nobody is on risk during that period?—No. The only case where you are on risk for any extended period of time is in common stock underwritings, which are usually offered at some discount from the market.

5073. Is there any limit of time laid down by the S.E.C. between issues, so as to avoid a plethora of issues at any one time—is the market spaced in any way, or not?—No, Sir: there is no such thing as the Capital Issues Committee. We have always thought that the market itself is a good adjuster of that. I would say that we and other investment bankers follow the practice, if we have a really important piece of financing, of advising our Treasury through the Federal Reserve and, if it involves foreign financing, the State Department as well. That is the only kind of information we give out ahead of time.

5074. *Mr. Bingen*: And subsequent to that you can place this issue at any time you like, even though it is a billion dollars?—Yes.

5075. *Professor Gower*: Could I turn now to the Securities Exchange Act? First, the Act regulates brokers, dealers and exchanges. You have given us some

information, and I gather you think it has been very effective in eradicating undesirable market practices?—Yes.

5076. Then secondly it requires that companies and other firms who have filed registration statements should file reports with the S.E.C. and with the Exchanges upon which they are listed. There are three types of reports, and they are annual reports; half-yearly financial statements; and current reports after certain major occurrences have taken place—is that what it comes to?—*Mr. Brownell*: In respect of all securities listed on any of the Exchanges, the companies have to file the reports to which you have referred, and also non-listed companies which register securities under the 1933 Act have to agree they will submit reports, so-called annual reports, on Form 10K (which we have furnished to the Committee), and current reports within at most 10 days after the end of each calendar month, reporting any changes in certain circumstances of the company. We have also given you copies of those. The current reports need not be filed unless a change has occurred in certain specified matters. Then on another form half-yearly financial statements must be filed. As a matter of fact, the New York Stock Exchange supplements that by requiring quarterly financial statements regarding all listed securities.

5077. The annual reports and current reports are not just accounts—they give certain information designed to bring the original registration statement up to date?—That is true of the annual reports. The half-yearly reports are financial statements. The current reports cover recent developments and events.

5078. In these reports, what information has to be given about subsidiary and associated companies—is the information required limited to the company itself?—The annual reports have to give names of the subsidiary companies and also of the parent companies.

5079. The names of both?—Yes.

5080. And accounts may have to be consolidated?—*Mr. Schwarz*: Form 10K has to have it consolidated.

5081. But in the United States, assuming these regulations apply, anyone can

find out what the subsidiary of any company is and what the holding company is?—That is right.

5082. And have there been complaints that this is giving away valuable information?—*Mr. Brownell*: I myself have never heard any serious complaints raised on that score.

5083. There is no exemption because the company operates abroad?—I have never heard any objection from the companies I have worked for—maybe somebody else has?

Mr. Young: There is one exemption in the case of a company operating abroad where you do not have to give figures.

Mr. Brownell: There is also exemption for any information involving national security: there is no problem on that.

5084. Are there any requirements about associated companies that are not subsidiaries?—What do you mean by associated company?

5085. One company holds 45 per cent. of the shares of another.—I think that would not be referred to as a subsidiary and would not have to be disclosed as a separate entity.

Mr. Petito: In the Schedule of Part II, you have a list of subsidiaries.

5086. A company holding 45 per cent. of the shares of another presumably would have to register under section 16?—*Mr. Brownell*: It would depend on whether the stock was listed. It probably would not be a listed security.

5087. *Mr. Lawson*: This information is just placed on the file?—*Mr. McDaniel*: Just placed on the file, which is public.

5088. And the published accounts can take the form of a consolidated account, can they? In this country we have to publish both the parent company's accounts and the consolidated accounts of the group. Am I right in thinking that in your country you need not?—Sometimes, when certain conditions are met, you can avoid publishing accounts of the parent company by itself.

5089. *Professor Gower*: Thirdly, the 1934 Act requires certain information when proxies are solicited. You have

been kind enough to supply us with various specimens of proxy statements which, as I understand it, have to be cleared with the S.E.C. and accompany any solicitation for proxies on behalf of the management or of other people: if the voting relates to a merger the proxy statement may be long?—*Mr. Brownell*: But normally they are much shorter than a registration statement. Our proxy statement is intended to give the stockholders the information they ought to have before them before they vote their shares at a meeting. These proxy statements must be sent to shareholders and must be filed only where there is to be solicitation of proxies from holders of listed securities. They are filed with the S.E.C.; under the Act and Regulations, if the S.E.C. does not object they become operative in 10 days. The S.E.C. sometimes points out errors, and it is their usual practice to write and tell you they see no objection to the statement. Then you go ahead and print it; but you are cautioned not to print till you have heard that it is all right. There is a good deal of agitation to extend the use of the proxy statement to non-listed securities.

5090. *Mr. Birgen*: Quite obviously every company has to file a gigantic amount of material over the years with the S.E.C. Can I, as a member of the public or a stockholder, go and search the file?—*Yes, Sir, you can. You might have to wait some time before finding out what happened ten years ago. There is a room of some size in the S.E.C. with a delivery desk—something like in a public library—and one can go and ask for the reports filed this year by the directors of such and such a company with respect of their shareholdings. The girl will disappear and come back pretty soon with the reports, and you can sit at the table and thumb them over. Or you can ask for a certain registration statement of a certain company, and you can get it. Also, for a reasonable fee, you can have photostats taken and take them away with you.*

5091. *Mr. Brown*: But you would have to go to Washington presumably?—*You can write and get photostats; and I think you can get some of the material at*

the Stock Exchange in New York. But I think Washington is the only place you can find a complete file.

5092. *Professor Gower*: A considerable amount of this material is published in various business manuals, and therefore gets out to the business world that way?—*That is right.*

5093. I think one of the things the proxy statement always has to give is information about any substantial interest, direct or indirect of each director, officer or other person soliciting proxies, and their associates; that is one of the more important things that has to go into every proxy?—*Yes. Directors, officers and holders of more than 10 per cent. of the company's stock, and their associates as defined in the rules, must disclose any material interest in company transactions for the past year, or in transactions there proposed. Also candidates for the office of director must disclose their shareholdings.*

5094. I see that "associate" is widely defined so as to include husbands, wives and relatives living in the same house. Has that caused any difficulties?—*No, not really: we get queries about visiting cousins but no serious problems.*

5095. Now in the memorandum of the S.E.C., they say this is perhaps their most effective disclosure device—the proxy regulations. Would you agree?—*They are certainly an effective disclosure device. I do not know that I would use the superlative in all respects. The reports called for under section 16 of the Securities Exchange Act go a great deal further than what you have to disclose in a proxy statement. However, the proxy statement does call for some disclosures, and I think it is fair to say that proxy statements are more often read by individuals than prospectuses—maybe because they are shorter and because they relate directly to the way in which the man might vote at a shareholders' meeting.*

5096. And the proxy-form must always be a two-way one, must it not?—*That is a little box where you can vote "yes" or "no" is it? Yes, except that on votes for directors they do not have to be two-way. If you want a change of directors you have to take other steps.*

5097. And this screening by the S.E.C. applies not only to the original proxy statement but also to any follow-up literature which is sent out?—The screening does apply to the original proxy statement. I think you had better ask Mr. Cohen about the extent to which they screen supplementary information. I strongly suspect that often it is just filed with them. However, Mr. Cohen can advise you better than I can.

5098. Has it succeeded, in your view, in eradicating a lot of indiscriminate mudslinging? Is there now a tendency to be fair and responsible in the statements made about the other side?—Well, I do not know if I could go that far.

5099. Turning to Insider Trading, section 16 of the Act, we are interested in this because we have section 195 of our own Act, under which directors are required to register their holdings, but this does not seem to be very effective, possibly because it is not open to the public. We are also interested because these provisions of section 16 apply to shareholders who hold more than 10 per cent., and we are considering the extent to which one should try to reveal the beneficial ownership of nominee holdings. I gather generally that your view is that this section has been salutary and has materially diminished the abuse by directors and others of inside information.—That is too broad a question to attempt to answer with a "yes" or "no". Section 16 of the Securities Exchange Act is divided into three parts, a, b, and c. Paragraph (a) requires all directors and officers of listed companies—and I should point out the entire section refers only to listed companies and not to unlisted ones—to file with the S.E.C. their holdings of shares and their changes of holdings from time to time, their purchases and sales. It also makes the same requirement of those who hold 10 per cent. or more of the company's stock—not only that directly held but stock beneficially held. Paragraph (b), which applies to those same individuals, imposes a very strict and very arbitrary penalty on directors, officers or 10 per cent. holders, who make a profit from the sale or purchase, or purchase and sale, of their company's stock within a six-months' period. If it is six months and one day, they are not touched; but if it is five

months and 29 days, they are caught. I will come back to that paragraph. Paragraph (c) is a simple provision that the same class of people may not sell stock short—which gives cause for little comment. In New York it is a penal offence for a director to sell stock short, and many other states have prohibitions of a like character.

You ask whether all those provisions have worked well and whether they have produced proper disclosures, and so forth. As to paragraph (a), we believe it has worked, and that directors and officers and 10 per cent. stockholders have conformed to it to a very remarkable degree. I say that with the greater confidence because in our work we have never encountered any case where the proper reports were not filed, except through inadvertence. We have had enquiries not infrequently as to how you count up to 10 per cent., and these enquiries often seek interpretation—who are associates, and things of that kind. I have also talked with Mr. Cohen about the extent to which those reports were filed, and he tells me that he believes the officers and directors and 10 per cent. stockholders of all these listed companies are really meticulous in filing them and that during the years he had been with the S.E.C. he thought the number of proceedings instituted for failure to file were less than ten. There is in the 1934 Act a general clause to the effect that wilful violation of that section would carry a fine of up to \$10,000 and a possible prison term of up to two years; but as far as I know this has never been imposed. As regards paragraph (b), as I said, it is a very arbitrary rule. It does not touch the director who goes into the market just before the dividend is increased, which he found out about just two days before it was announced, and buys the stock and gets the benefit of the increase and then some years later sells it and profits by it. It does not catch the man who learns of the losses that are going to be disclosed in the year-end statement and rushes out and sells his stock, that is unless he has bought some in the six months preceding (or in the six months following), in which case if he made a profit he would be caught. When Professor Loss appears before you, you might ask him about it. In his treatise

he discusses both the pros and cons of section 16. It does reduce short-term inside trading. I think it will stay on our Statute Book till someone devises something better, and until then I do not think Congress will touch it. I think frequently it operates arbitrarily and sometimes harshly. Is it lived up to? Yes it is. I told you these records were public, and I myself have been in that room and I have seen at the tables in the little library knots of two or three young men or young girls who go through those statements of directors' purchases and sales, trying to find somebody who bought and sold within a six-months' period. They are probably down there for lawyers, who then institute suits against the officer or director if he did not account for his profit. We have had individuals who, through complete oversight and negligence, failed to make a refund. All you can do is advise them to draw their cheque and turn it over to the company. There is no defence. We have had cases where it is not perfectly clear that the shares bought and sold were comparable—for example, common stock as against convertible preferred, or the acquisition of stock options as against the sale of common stock within the six-months' period. There are a lot of people who are diligent in seeking out such cases, because usually lawyers who bring the cases are allowed an appropriate fee on any amount recovered for the company.

5100. *Mr. Scott:* Supposing he buys in, say, November, having already got quite a lot of stock, is there any presumption as to which stock he has sold?—Yes, the presumption is against you: it is always the worst. This is unlike our rule in the case of capital gains tax, where you can take any share you wish and sell the one that results in the lowest capital gains tax.

Mr. Schwarz: The Courts allow for this by looking six months forward and back and taking the transactions that will result in the highest amount of profit, irrespective of whether they have any connection with so-called inside trading.

Mr. Brownell: It may be harsh, though maybe it has brought home to people that inside trading is wrong: but it may be the director bought or sold the same stock

within the same period for reasons which might have nothing to do with information he has obtained as a director—he would be obliged to turn over his profit just the same. It does not matter whether it is the result of inside information or not.

Mr. Schwarz: By the same token he can avoid any accountability under section (b) by waiting six months, though in fact he may have taken advantage of inside information. It is purely arbitrary.

5101. *Professor Gower:* Nevertheless the dates on which he bought and sold will appear on the register, and if he bought two days before a directors' meeting, where a high dividend was announced, this will be brought to the attention of his colleagues even though he may not have to account for his profit?—The reporting requirements do not require specification of date: it requires the month, but not the day of the month.

Mr. Young: Professor Gower, I think it is fair to say that while people generally support the complete disclosure requirements of section 16(a) there are many people who feel section 16(b) is unreasonable.

5102. This requirement for disclosing holdings over 10 per cent.: is that the only requirement for disclosure of shares in nominees' names?—*Mr. Brownell:* Yes, as far as the 1934 Act is concerned.

5103. *Mr. Brown:* As regards the general law of accounting for profits within the six-months' period, having defined what is wrong—which is making a profit within six months—is there any general feeling that it is perfectly moral to take account of inside knowledge, as long as you do not make a profit within six months?—No, if anything it might be slightly the reverse; but certainly it is not what you suggest.

Mr. Morgan: It impresses it upon individuals that it is wrong to take advantage of inside information.

5104. *Professor Gower:* And now to accounting rules. As I understand it, by and large, identical rules apply to both the original registration statement and to the annual and current reports?—*Mr. McDaniel:* That is correct.

5105. What about half-yearly statements? How much detail is required in those?—Most companies give approximately the same information and the same breakdown that they give in their published annual reports to their stockholders. It is sometimes a little abbreviated, but not very often.

5106. The major respects in which they differ from the rules in this country are as regards turnover and sales?—That is correct.

5107. And officers' remuneration?—I think you are a little bit stricter on that than they are in the United States under that particular Act.

5108. Yes, our requirements are different; and information on the method of valuation and depreciation. Are those the three main respects in which there are contrasts?—I think the American would show turnover figures, the cost of sales and a reasonable breakdown of the other expenses.

5109. As regards turnover, as I understand it, you have to give figures of global sales?—That is correct.

5110. And separate figures relating to any class of business contributing 15 per cent. or more to the global turnover and sales?—That is not so.

5111. No longer?—Unfortunately, no.

Mr. Schwarz: May I interject there? I think it is true of a non-consolidated subsidiary, but for a consolidated subsidiary you do not have to give separate figures consolidated in the accounts, even if that subsidiary produces 15, 20 or 30 per cent. of the group profits.

5112. So really it is only the global turnover figure you give?—*Mr. McDaniel:* If I understand your question correctly, if you had a company that had two widely diverse lines of business, it would be only the total sales.

5113. That was the point.—That does not always result in a fair statement.

5114. No, quite. In the United Kingdom it is very often argued that if one had to give any figures about the sales and costs, it would involve giving deadly

ammunition to one's rivals. I imagine the same thing happens in the United States. Have these forebodings proved accurate?—In the United States in the late 20's we had approximately the same situation as regards financial disclosure as exists in this country today. We had exactly the same arguments as are heard here currently against additional disclosures. But I do not know of anyone who claims he has been seriously injured by the disclosures that have been made; and there is now very little objection to them.

5115. *Mr. Lawson:* Do you find that really this information is of any great value, bearing in mind what you have said about the need to give only figures of global sales. Most companies make quite a wide range of products, at any rate in this country, and if you give only total sales for the whole lot, where profit margins may vary a lot is it really of any use?—I think it is anyway a step in the right direction, and the way companies are evolving it would be desirable for more information to be given than is actually required now. It is quite true that many stockholders who get this information are not going to understand it, and do not read it, but anyhow I still think they are entitled to have it.

Mr. Young: In many annual reports, and certainly in registration statements and prospectuses, we deal with that problem by setting forth, in the order of their importance, the principal types of business that the company is engaged in. For example in the chemical business, how much of it may come from the textile end of the business—or paints and fabrics and so on—which gives an investor some reasonable idea as to the importance of the various parts of the business. The main thing which is not given, and which would, I think, be unfortunate from the standpoint of many companies, is the margin of profit on those respective parts of the business.

5116. The thing that one has to think about in this problem is that for the company which makes one product, or a very narrow range of products, this disclosure of turnover will in effect mean a disclosure of their margin of profit. A competitor may be part of a large group,

which discloses only a group figure of turnover, which has no meaning in relation to that particular product; so the small man is placed at a disadvantage in relation to the large. That is the type of problem we are facing.—I do not know about over here, but I do not think it has been found to be a serious situation in America. Of course, in the steel business you have a number of different types of steel and steel products. If a company were making just nuts and bolts, one might well know what its margin of profit was.

Mr. Schwarz: Although figures as to consolidated subsidiaries are not required to be given separately—accounts are not given separately—still under the registration requirements of the 1933 Act, at least in the S1 form, the description of the business is required in the following detail: "If the business consists of the production or distribution of different kinds of products or the rendering of different kinds of services, indicate, so far as practicable, the relative importance of each product or service, or class of similar products or services, which contributed 15 per cent. or more to the gross volume of business done during the last fiscal year." That is perhaps a compromise between those who would like to get the figures which show your exact margin on different lines of business, but the disclosure of which would be strongly resisted, I am sure, by many companies, and those who seek to get some picture textually of the relative importance of different lines.

5117. What puzzles me is how will you in fact avoid the small man having to give his margin of profit, which you say is damaging—how do you avoid that in the case of a business which produces only one product? There are certainly some specialised businesses here. How do you avoid this problem so far as they are concerned?—*Mr. McDaniel:* You cannot, in a case like that.

Mr. Petito: Such as a cement company, maybe.

5118. Yes, exactly. I understand Mr. Young said it was desirable to prevent that being disclosed.—If they are a public company and subject to the Stock Exchange & Security legislation, they

record their sales plus their cost of goods sold; so their margin of profit is known, whether a small single product company or a large multiple product company.

5119. It does not seem to cause any difficulty?—It has not so far. A number of companies give their turnover by product. For instance I was looking at some companies in the pulp business: they give paper, pulp and box sales. A diversified company sometimes breaks down the figures so that you can tell the attractiveness of the business.

5120. *Professor Gower:* As regards managerial remuneration, is it the position that there has to be disclosed individual remuneration of each of the three highest-paid officers, the individual remuneration of each director whose remuneration exceeds \$30,000, and the total remuneration of all directors and officers?—*Mr. McDaniel:* It is required on a registration statement and a proxy statement also.

5121. So you get those actual amounts?—*Mr. Young:* That does not mean that everybody agrees they ought to be shown to this extent.

5122. But you said earlier that we went further here than in the United States?—*Mr. McDaniel:* When I said that, I meant that you require this disclosure in all the published statements. In the United States the annual report to stockholders will generally not include this information. It is in the reports required by the Securities and Exchange Commission, and it is pointed out; it is public information and anyone can see it.

5123. But it has to be mentioned in a proxy statement?—Yes.

5124. So long as the management is seeking proxies it will be there?—Yes.

5125. Has this given rise to difficulties?—*Mr. Morgan:* It produces two things: the officers of one company see their opposite numbers, who they know very well are getting a lot more than they get. It produces jealousies and it produces some jealousy from the little fellow as against the bigger fellow. And one wonders whether a statement which gave the total remuneration of principal officers is not really what the stockholder wants to know.

He wants to know what his management is costing rather than who gets what.

Mr. Brownell: They like to know what the top men are getting, and I think we are getting accustomed to it; and while there was opposition to it in the beginning, in recent years I have not heard it strongly expressed.

5126. Do the S.E.C. accounting rules require or allow re-valuation of fixed assets?—*Mr. McDaniel:* If by that you mean re-valuation up to the current market value, the answer is no.

5127. When you say "no", you mean you are not allowed to do this periodically?—That is right.

5128. You have to keep the figure at historical cost less depreciation?—Yes.

5129. *Mr. Lawson:* Is that true all through?—The general rule is that fixed assets should be recorded at cost and depreciated over their useful lives. It would be possible for certain assets to be revalued upwards in a formal reorganisation under Court jurisdiction but this would be an exception rather than the rule. There are also exceptions for certain types of businesses such as investment trusts and insurance companies.

5130. Not without the Court's permission?—No.

5131. *Professor Gower:* What exactly is the position regarding subsidiaries and trade investments in associated companies? As regards subsidiary companies, their accounts are consolidated with the holding company, are they?—Yes.

5132. What is the position with regard to the sort of case I mentioned earlier where there is a 45 per cent. investment in the associated company?—That would be merely shown as an investment.

5133. *Mr. Brown:* With no reference to current values?—It would probably show the underlying book value. It would depend on the circumstances. If the other 55 per cent. of the company was scattered or had a market in the stock, that would be one thing; and if the other was closely held, so that there was no market in the stock, the underlying book value would be a measure.

5134. That would be given?—*Mr. Petitto:* May I bring out two points on subsidiaries? I notice the question was raised about foreign subsidiaries. The S1 form states that information with respect to any foreign subsidiary may be omitted to the extent that the required disclosure would be detrimental to the registrant, provided a statement is made that such information has been omitted. In such a case a statement of the names of subsidiaries omitted shall be separately furnished. Part II of the S1 form states that names of particular subsidiaries may be omitted if the unnamed subsidiaries considered in the aggregate as a single subsidiary would not constitute a significant subsidiary: a significant subsidiary is one the assets and sales of which exceed 15 per cent. of the assets and sales of the consolidated group.

5135. *Professor Gower:* Are there any exemptions to these accounting requirements for any particular classes of company?—*Mr. McDaniel:* The banks do not have to file accounts with the Securities and Exchange Commission. The practice by the banks is a little variable. Most of the larger banks publish fairly full statements of their accounts. Some of them publish only a statement of the financial condition (balance sheet) and do not give statements of income. Most of the smaller banks give only a balance sheet.

5136. Can they have hidden reserves, which are not disclosed in the published accounts?—Yes, it would be possible. In the case of the larger banks, their accounting is generally uniform and conservative. These banks are under Federal supervision and their statements are generally on a sound basis. In the case of smaller banks you do not have quite as much assurance of that.

5137. An American bank could, out of its profits for the year, transfer to a hidden reserve without anywhere disclosing what amount had been transferred or what its complete profits were; and also not put anywhere exactly what the state of those reserves was?—That is quite true. I noticed just this morning an article on this, together with the reproduction of some of the financial statements published by the First National Bank in

Chicago. They were rather complete: I have them with me in case you would like to see them, and some other statements of other Chicago banks. In one case there is only a balance sheet and it is not possible to determine from that what the earnings were or what the reserve transactions were for the year.

5138. And that could not be found anywhere in any public records?—No.

5139. *Mr. Brown*: Would it be filed anywhere?—Yes, the Federal authorities would have the information but it would not be available to the public.

5140. The Federal authorities would have a complete statement?—Yes.

5141. *Mr. Lawson*: Do not the banks have to have their accounts audited?—*Mr. Morgan*: Many banks do have audits.

Mr. Schwarz: And many banks do in fact disclose their credits and charges.

5142. If a public accountant were an auditor of a bank, would he pass the accounts if it contained secret reserves?—*Mr. McDaniel*: I would like to think he would not.

5143. But generally you think not?—I think the ones that are audited do not engage in this sort of practice.

5144. *Mr. Bingen*: What is the underlying thesis under which banks have been exempted from S.E.C. regulations? Are they subject to more stringent State control?—They are under State or Federal control. I think it might be a case of misplaced confidence as to how much good that control is as far as their reported statements are concerned. At the time of the passage of the laws which gave rise to this, there was a general tendency to exclude from the S.E.C.'s jurisdiction those companies that were examined or inspected by, or under the control of, another Federal power.

5145. You drew the distinction earlier between large banks which gave informative statements and the smaller banks which merely gave the balance sheet position, so it is not a very strong form of control?—We have in the United States a very wide range in the size of banks.

We have some very large ones and some very small ones. The variation in them is about the same as in any other line of business. You get down to the smaller ones and the chances are they do not do things in the same way the larger banks do.

5146. *Sir George Erskine*: Though the banks do not come within the orbit of the S.E.C., in the case of the large banks their shares are listed on the Stock Exchange?—They are not. They are traded in "over the counter".

5147. There is no rule in respect of stocks traded "over the counter" as to what must be disclosed?—*Mr. Brownell*: There is no rule in the Federal legislation which you are considering today. When the first Act was passed in 1933 the question was considered and I believe the conclusion was that the extent of the disclosure provision contained in the 1933 Act could not be safely made applicable to banks. In New York, of course, our banks are subject to periodic inspections by the bank examiners, who come in from time to time and without notice, and the precautions which are given to security holders in that manner were regarded as sufficient. It would be very difficult sometimes for banks to make complete public disclosures about the state of their accounts and various other matters. Railroads are also exempted from the 1933 Act, perhaps for somewhat less rational reasons. The railroads, at the time of the passage of the 1933 Act, made a strong protest against their inclusion, and Congress excluded them. The most important thing to remember is that a bank is under the control of the Controller of the Currency or the Federal Reserve Board, or under State supervision, or under two of them at the same time, and the Federal Deposit Insurance Corporation in addition. That supervision has been imposed to protect the public from the point of view of the

instances of disclosure with the banks, it

is either under a monetary Act—and that is true in many cases—or something that the accounting profession has helped to bring about.

Mr. Young: But would you not say, to all intents and purposes, the important banks, certainly those whose shares are held widely by the public, give quite complete reports and certainly reveal their transfers to reserves?

Mr. Schwarz: Yes, and I think the trend is for more and more banks to do it.

Mr. Young: We make comparisons frequently, and we have no difficulty getting figures.

Mr. Schwarz: The banks that are well known would all be making pretty complete disclosures.

5149. *Professor Gower:* And there is no exemption for insurance companies or shipping companies?—*Mr. McDaniel:* The insurance companies do have to register. Their financial statements are considerably different from what you would get from any ordinary commercial company. In the United States, the insurance companies are regulated by the Insurance Commissioners in each of the individual States. These Commissioners have, through an association, enforced uniform accounting by the insurance companies. This accounting is more concerned with liquidity and the protection of the policy-holder than with getting a right answer as regards earnings or income. The investments in shares are carried at market value, and investments in bond are carried at amortised cost; and things such as furniture, fixtures and so forth are in a class of non-admitted assets. The premiums that they get from selling insurance must be deferred and taken up into income over the period covered by the insurance, but the commissions that they pay to get those premiums and the cost of selling must be written off currently, so the reported income of an insurance company must be viewed in the light of those regulations rather than in terms of generally accepted accounting principles.

5150. But they cannot build up secret reserves, as our insurance companies can? —The reserve provisions are more or

less arbitrarily computed on a formula basis and are on the ultra-conservative side.

5151. I do not know whether there are any other points on accounting you would like to draw our attention to, or whether you have any views on the independence of auditors?—I think they should be entirely independent.

5152. The S.E.C. regulations are very much stricter, on paper, than here. You must not be a shareholder in the company you are auditing?—That is correct, and I subscribe to that 100 per cent.

5153. You are perhaps shocked by the laxity of our rules?—I find them a little different.

5154. *Mr. Lawson:* Could I follow with one or two questions? First, could we be clear exactly what companies are covered by S.E.C. regulations—is it only companies listed on the Stock Exchange?—No, Sir: With the exceptions that Mr. Schwarz read earlier, all other sales of securities have to be registered with the Commission, so there are many, many companies who sell securities and are registered with the Commission and have to continue to file annual reports with them that are not listed on any exchange. The securities may be traded "over the counter", or in some cases not be traded at all.

5155. Would registration cover almost everything except what we call private companies?—It would not go quite that far.

Mr. Brownell: Let me attempt to answer this as far as I can. The 1933 Act applies to public issues of securities but not to private issues of securities, and unless an issue is specifically exempted, whether it be by the American Telephone and Telegraph Company or a very small company, if enough shares are distributed to qualify it as a public issue it is covered by the registration requirements. How many offerees must there be in order to make the issue public? It is a question much discussed, and certainly under certain circumstances 100 or 200 offerees would make an issue public: any substantial number of that kind. As Mr. Schwarz pointed out, there are certain classes of

securities which are exempt and there are certain other exemptions applicable under the 1933 Act which I will not go into. Under the 1934 Act there are a lot of rules for the regulation of Stock Exchanges, and it also gives the S.E.C. jurisdiction over "over the counter" dealing. The Act requires regular reports by listed companies, and this requirement has been extended to unlisted companies that have registered new issues under the 1933 Act. Potentially, the S.E.C. can regulate "over the counter" transactions, and has already done so in various ways. Misrepresentations in connection either with the sale or purchase of securities in the "over the counter" market are covered by the rule issued by the Securities Exchange Commission only a couple of years ago. So you cannot generalise and just say one Act applies only to listed companies and the other applies only to unlisted companies. The Acts go much further than regulating only the listed companies.

5156. What about the companies which are not subject to S.E.C. regulations—is there anything equivalent to our system of audit?—*Mr. McDaniel*: We have nothing that is equivalent to your Companies Act, nothing that requires an audit. Many of them voluntarily do have audits, but there is no law that requires an audit or the filing of statements with a Registrar of Companies.

5157. *Mr. Brown*: So that there would be no way for the public to be able to see the accounts of those companies?—

Mr. Schwarz: That is correct, and you can sometimes get very large companies, whose shares are held by a relatively small number of people, who do no public financing and one really cannot find out very much about them. They would probably give their statements to their banks, because their banks will be lending them money, but so far as the public is concerned they would not be available.

5158. So trade creditors would not have anything available unless they managed to obtain it privately?—*Mr. McDaniel*: I think this condition we have just been describing was true of the Ford Motor Company until a few years ago.

Mr. Young: That was really unique, I do not remember any important large

company that does not have audited accounts.

Mr. Schwarz: I agree.

Mr. Young: Any type—whether listed or not listed.

Mr. Petit: I think it is also fair to say there are companies which are not subject to the regulations which follow the best practice of companies which are so subject.

5159. So your national statistics of trade profits do not include those companies which do not publish figures?—
There are the income tax returns.

Mr. Brown: Of course, tax returns in your country are not necessarily private. Here they are.

5160. *Mr. Lawson*: Could I come to quite a complicated question, which is important to us? Firstly, you are allowed are you not, some distribution to shareholders of a dividend from capital in certain circumstances?—*Mr. McDaniel*: It can be, provided the shareholders are notified that that is the source of the distribution.

5161. It is not illegal?—Not in most States, no. It is not considered good form to do it.

5162. But it is not illegal: and coming on to capital reduction, is there any way shareholders, without going to a Court, can reduce the capital of the company?—*Mr. Brownell*: Generally speaking, the answer to your question is that capital is reduced by action of the shareholders and it does not normally require Court approval. There might be Court procedure following bankruptcy or insolvency, or something like that.

5163. Normally it does not require Court approval, when it is just a return of capital?—That is right.

5164. Then we heard that when a company buys its own stock it buys it out of its own capital?—It would not generally be able to do so out of capital, but it could out of surplus.

5165. But when it buys stock it then creates a surplus by the very act of cancellation of the stock?—*Mr. McDaniel*:

The acquisition is made out of surplus; the cancellation restores that surplus to the extent of the par value of the stock.

5166. May that surplus be distributed?
—Not as a distribution of earnings.

Mr. Schwarz: I think it is going to depend again on the law of the particular State. In New York you could distribute that surplus. Perhaps from the point of view of tax law it would be described as a distribution or return of capital; but there would be nothing illegal at all. There are no restrictions on distributing to the stockholder a surplus created out of a reduction of capital. That shook you this morning, I imagine.

5167. It surprised me.—*Mr. Brownell:* But you have touched on a complicated subject now. A company purchasing its own stock out of surplus—that reduces the surplus, because that has gone. It cancels its stock so purchased. That does not change its capital. It can also go further and reduce its capital if it wants to.

Mr. Schwarz: Having a formal action of the stockholders, you file a statement of the reduction of capital; and then the thing is done. But there is no Court approval or other approval required.

5168. *Professor Gower:* Surely when it cancels shares it has bought, that reduces capital? A company buys out of surplus some of its shares and then cancels them—the cancellation of those shares is a reduction of capital.—*Mr. Brownell:* Not necessarily.

Mr. Schwarz: You mean the physical destruction of a certificate? No, not unless you file a certificate of reduction of capital in the State offices where your charter is filed. You must do that. The mere physical cancellation or cremation of the certificates, or writing them off your books, would not affect your capital. You have to file a statutory document called a certificate of reduction of capital in the same office where your charter is filed: and that is a notice to creditors and it is picked up in that way.

5169. *Mr. Richardson:* Does that require the sanction of the shareholders—that cancellation of the shares in that way?

—In certain instances, in the case of preferred stock, it could be done without the shareholders' approval; otherwise it requires the approval of shareholders.

5170. *Mr. Lawson:* We heard this morning of the system of mergers which you have in the United States. That results, does it, in the earned surplus of the two companies which merge—the earned surplus of both companies—being common to the combined undertaking?

—*Mr. McDaniel:* A merger in the States is a legal means of combining two or more companies together. Accounting-wise, if the intention is to pool the interests of the various parties, then the earned surplus of the companies carries forward and could be distributed as dividend. If the intention was to merely make the acquisition of a company, the earned surplus of the acquired company, on an accounting basis, would not carry forward and be distributed.

5171. Does that create difficulties in practice?—The concept of pooling of interest works very well in certain cases. I think in the last few years it may have been overworked a little bit. Where the large company acquires a very small one by filing a pooling of interests statement, they avoid the recording of goodwill and the subsequent charges to write that off, and in some of these cases it is difficult to see the thing really as a true pooling of interests. I think this is one of the areas that the accounting profession in the United States needs to study a little more and get a better answer on.

5172. *Professor Gower:* Could I ask you one final question? It is often argued that you give your shareholders so much information that they could not possibly digest it, and that this defeats the object of the exercise. I gather your view on this is that it is not so much directly to instruct the unsophisticated investor as to give information to his professional advisers, which will filter down to him sooner or later; and that the fact that there are civil penalties attached to non-disclosure of information will tend to encourage people not to make unfair proposals and that in this way, even if the investor never reads a prospectus or a proxy statement, he is indirectly protected. Would that be fair?
—I think there is a large body of thought

which runs along the line that you have just expressed—that the ordinary investor does not have experience enough to know what this is all about anyhow—but I do think we should keep in mind that this investor has been intelligent enough to accumulate the money to buy these investments in the first place, and maybe we should give him the benefit of the doubt and let him have the information.

Mr. Young: One other point: it certainly makes it available to the professional adviser and to the institutional adviser.

Mr. Morgan: And to the professional Press also, which analyses these statements and frequently writes articles on the subject.

5173. This system of full disclosure, as I understand it, tends to make people not put forward any dubious schemes, and this itself is a protection.—*Mr. Young:* Yes, I think it helps, but on the other hand some of us—I know this is not shared by all—feel that there certainly ought to be less onerous civil liabilities. And it seems to me to be going a little bit too far that a man can recover, even though he has never heard of the registration statement or the prospectus.

Mr. Schwarz: There are two points I would like to make in a general way, that though the *in terrorem* aspects of the liability provisions under the Acts we are considering are effective, there are some which still seem to us unfair. A man can recover for quite a long period under the Securities Act without establishing that he relied at all on the mis-statement. So far this may not have actually resulted in any great hardship. On the other hand, it is one of the things that leads all underwriters to seek from the companies whose securities they are underwriting, and obtain from those companies, pretty wide indemnity provisions against liability under the Securities Act. If you go back to very early days I think it would have been doubtful whether you could have got banking firms to incur the great liabilities under the Securities Act without that indemnity. Where such indemnity is not obtainable—and sometimes it is unobtain-

able because the sale is made not by the corporation but by a controlling person, which may be a trust which does not have the power to indemnify or may be unwilling to do so—very often insurance policies have been obtained from Lloyds and other insurers to protect the underwriters against the risks that are encountered. I think that while these penalties have had a good effect, there are some that go pretty far, and they are certainly something that people do not take lightly.

5174. But you would not go so far as to agree with the argument that you produce much too much information?

—*Mr. Brownell:* Generally speaking, I agree with what Mr. Schwarz said about the value of the disclosures required by our law.

5175. Then as regards the Investment Advisers Act, I gather you think this is not now a bad method of regulating financial tipsters. I think you feel they should be regulated?—We think that the recent amendments have put teeth into the Act, and that this was desirable.

5176. As regards investment companies our situation is that we do have fairly close regulation of unit trusts. With regard to closed-end companies, as you call them, we treat them just as though they were ordinary companies, there is no special arrangements to regulate them. You in the United States, more logically I think, have said, "The investment company is a separate and distinct animal and ought to be regulated."—We agree with that statement, but if you have any specific enquiries, we would prefer to answer them in a memorandum rather than at the moment. The subject is quite complicated. As regards investment advisers and management of investment companies, I think the view has been that generally speaking the operation of the Act has been good.

5177. I gather in the United States the open-end investment company has almost entirely superseded the trust we use here?—*Mr. Young:* I would not go that far. A number of the very important investment trusts are closed trusts.

5178. But the more recently-formed ones have been almost entirely on an open-end basis?—That is correct.

5179. Is it thought by you that this is a very convenient device, without any dangers that cannot be adequately taken care of?—I do not think I would want to express an opinion on that.

5180. *Mr. Watson:* I think it is probably true in this country that there have not been in recent years many new firms of closed investment trusts. It may be the conditions are not propitious for a development of that kind, but I gather from what you said, Mr. Young, there are a number of well-known closed investment trusts in existence in America?—Yes.

5181. And they do not come under the regulations of this Act we are discussing?—They do come under it.

5182. And how does that affect their activities?—Well, it does not affect them any more than the other companies.

Mr. Brownell: As I said, Mr. Chairman, we would prefer to get any questions, which you may wish to put in this field, in writing and then send you a memorandum.

Chairman: Thank you.

5183. *Mr. Althaus:* Mr. Brownell, I think you said you did not think you would have got where you have got without the S.E.C. As I understand it, the S.E.C. came into being at a time when there had been a disastrous fall in the markets and when there was a public climate of opinion which favoured the formation of a body of that kind and the passing of the new Acts. I imagine at that time people who were in the investment business were probably not as fully employed as they are today. What I have in mind is, supposing you found yourselves at the stage today where you wanted to set up such a body, would there not be some difficulty in finding suitable people to learn the business and would there in fact be a rather long teething period during which it might be difficult to work in a

new organisation over the existing bodies? —I think it would be difficult to create an S.E.C. and expect it to work perfectly and smoothly in the first year. We went through a teething period. I also think if anyone was starting afresh they might devise something less complicated than our present legislative layer cake, built by putting one Act on top of another. You will find them all described in the memorandum we filed with you. Steps have been taken to devise a simpler all-inclusive Act. One has been drafted for possible adoption in the various States to cover intra-State transactions which are not normally covered by the Federal legislation. I think if one were starting afresh one could do it more simply. As far as training personnel and operating the system is concerned, if you were starting from scratch today I doubt that there would be any extended difficulty in administering the Act. You say I said we would not have made the progress in security regulation that we have if it had not been for the S.E.C. I think that is true. Certainly it would not have been accomplished as rapidly as it was with the S.E.C. Generally speaking, in spite of the fact that there were rough edges, and in spite of the fact that there are things we would like to see simplified, and in spite of the fact that, as Mr. Young pointed out, there are various areas where corrections are called for—on the whole, gentlemen, the S.E.C. has operated generally satisfactorily. I am perfectly certain it would be unthinkable for our Congress to get rid of it. I think the great majority of people in the industry, and the lawyers who advise them, would agree with that.

Mr. Morgan: That is in the context of our situation in the United States?

Mr. Brownell: That is entirely that.

Mr. Schwarz: Just one point: I think, given our situation in the United States, and given among other things our rules as to liability of directors, the whole machinery we have and the existence of the S.E.C., on balance, is more of a protection than a detriment to the honest corporation, the honest banker and the honest director.

Mr. Brownell: And I would add one final word to say that most of us believe it is a protection for the capitalistic system in our country.

5184. *Chairman:* Well, gentlemen, that seems to have exhausted our questions to you. It only remains for me to say once

again how very grateful we are to you for coming and helping us. We have had a most instructive day, and I think we have all enjoyed it very much.—We have enjoyed it too.

Mr. Morgan: It was kind of you to invite us, and we felt honoured to come.

(The witnesses withdrew)

APPENDIX XXXIX

Memorandum by Professor L. C. B. Gower

Corporate Law and Practice in the U.S.A.

[This note, which was originally prepared by Professor Gower for the members of the Committee, was sent to the U.S. witnesses when they were invited to give evidence.]

1. The purpose of this Paper is to try to pinpoint those features of American law and practice which are most relevant to the Committee's task of reviewing the British law. It is therefore necessarily highly selective and does not purport to be in any sense exhaustive.

2. In considering the American position it is necessary to bear in mind that a clearer distinction is drawn than is the case in Great Britain between basic Company Law (or Law of Corporations as it is there called) and Securities Regulation. Each of the 50-odd jurisdictions has its own Corporations Act—unlike Canada there is no *Federal Corporations Act*. In general these States Acts are lax by British standards though there are exceptions, notably in the case of California. They differ substantially among themselves, although the Model Business Corporation Act sponsored by the American Bar Association and the American Law Institute has formed the basis of most recent revisions and has produced an increasing measure of uniformity. Moreover, as in Britain, the Acts do not attempt to codify the whole of company law, and the general common law and equitable principles have remained basically the same throughout the States and, indeed, are basically the same as the principles prevailing in Britain and throughout the Commonwealth.

3. In addition there is very extensive statutory regulation of issues and dealings in corporate securities. This legislation is both State and—unlike company law itself—Federal. The legislation, particularly the Federal, covers a considerably wider ground than that of our Prevention of Fraud (Investments) Act. It also includes the equivalent of the prospectus provisions in our Companies Act and much more besides. It is perhaps from this Securities Legislation, rather than from American Company Law proper, that we have most to learn.

Company Law

4. Before turning to the Securities Legislation, mention should be made of a few aspects of American Company Law which seem to merit consideration.

(a) *Pre-incorporation contracts*. The Americans, largely as a result of judicial decisions, have evolved a doctrine whereby on incorporation a company can adopt contracts made on its behalf prior to its incorporation. In some States (e.g., Michigan and Kansas) the matter is dealt with by statute—as it is in the Union of South Africa. This is a matter which seems worthy of the Committee's consideration. Under English law, ratification of the previous agreement is impossible: a new contract must be entered into after the company's incorporation. If the promotor has purported to enter into that previous agreement "on behalf of" the unborn company, he is personally liable on the contract: *Kelner v. Baxter* (1866) L.R. 2 C.P. 174. If, however, as is more likely in practice, he has signed "A B Co. Ltd., A B Director" it seems that the purported agreement is a complete nullity: *Newborne v. Sensolid (G.B.) Ltd.* [1954] 1 Q.B. 45.

(b) *Ultra vires*. This doctrine has been substantially eradicated, on the lines recommended by the Cohen Committee (paragraph 12)*, in virtually all the American States.

* Report of the committee on company law amendment, Cmd. 6659, H.M.S.O., London, 1945.

(c) *Purchase of own shares.* This is universally permitted, subject now to certain restrictions in most States. While clearly capable of abuse unless regulated, it has enabled U.S.A. to adopt a very much more straightforward alternative to the unit trust—namely the open-end investment trust company or mutual fund. It also facilitates employee share-ownership schemes and enables shareholders in private companies to be bought out more easily.

(d) *No par shares.* American experience was drawn on by the Gedge Committee* which recommended that optional no par shares should be legalised but that they should be restricted to equity shares. It is thought that American opinion would not support the recommended restriction to equity shares (there is no similar restriction in the U.S.A.) and that many Americans would argue that if no par's alleged advantages of simplicity and comprehensibility are to be attained, no par shares should be compulsory not optional.

(e) *Non-voting shares.* Corporation Acts commonly insist that all shareholders must have a right to vote on certain matters. Under the Model Business Corporation Act all shareholders have a vote on mergers (section 67), sales or mortgages of assets not in the regular course of business (section 73), voluntary dissolution or revocation thereof (sections 77 and 82), and certain amendments of the company's regulations (section 55). Under the Federal Investment Company Act (see paragraph 11 below) non-voting shares are banned in the case of investment companies and voting control has to pass to the preferred shareholders if their dividends are passed (section 18). And for many years the New York Stock Exchange (and a number of other exchanges) has refused to list non-voting equity shares.

(f) *Dividend control.* While it can hardly be said that the Americans have solved the problem of defining the "surplus" out of which dividends may be paid, they have in the various States tried every conceivable solution. A wealth of experience is therefore available if it is thought that this matter requires attention. A suggestion which is likely to be made to the Committee is that companies should be required to have a minimum paid-up capital. This would not fulfil much purpose unless stricter rules were introduced to prevent depletion of capital by payment of dividends.

(g) *Cumulative voting for directors.* This is a simple form of proportional representation which enables minority interests to secure representation on the board of directors. It is now compulsory in about half the States and optional in the others. Incidentally, it has recently been extended, on an optional basis, to two countries with Companies Acts based on the British model (Ontario and India).

(h) *Quorums at general meetings.* American Corporation Acts invariably prescribe more substantial quorums than the purely nominal ones which we require and which are frequently criticised as deplorably lax by American observers. Section 30 of the Model Business Corporation Act prescribes a quorum of a simple majority in the absence of contrary provision in the by-laws and prohibits a quorum of less than one-third. This is typical.

These substantial quorums, which make it necessary for American companies to get their stockholders to meetings either in person or by proxy, probably account in part for the greater interest which American stockholders take in the workings of their companies. They have also made it practicable for the Securities and Exchange Commission (S.E.C.) legislation, referred to below (paragraph 8 (d)), effectively to use the need to solicit proxies as a means of getting essential information to the shareholders. They also afford greater protection of minorities. On the other hand they have disadvantages; for example they may lead to deadlocks and enforced dissolutions and cause delay while the proxies are counted.

(i) *Minority protection.* A minority seeking to complain of an abuse of power by those in control is subject to difficulties, both procedural and substantive, flowing from the basic rule that the directors and managers owe duties to the company as such

* Report of the committee on shares of no par value. Cmd. 9112, H.M.S.O., London, 1954.

and not to the individual shareholders. On the procedural side this means that *prima facie* any legal action must be brought by the company acting either through the board of directors or the general meeting. In both Britain and America it has nevertheless been recognised that in some circumstances a minority may sue to enforce the company's rights. In Britain, however, this concession is bedged around by restrictions of great severity; for example, it is never permissible, it seems, unless fraud is alleged, so that a minority is not permitted to complain of negligence however gross: *Pavlides v. Jensen* [1956] Ch. 565. In America the rules are, in most States, less strict.

In America, too, there is a much clearer recognition that a minority shareholder's action (there known as a derivative action) is essentially different from the normal representative action and special Court rules have been promulgated to regulate it and to prevent collusive compromises: see, for example, Federal Rules of Civil Procedure, rule 23.

On the substantive side there have been two allied developments of particular interest. A number of decisions have held that controlling shareholders who sell corporate control may have to account, to the other shareholders, for any part of the price in excess of the true value of their shares as an aliquot part of the company's undertaking. In other words, they may be deprived of that part of the price which represents their power to control assets which belong not to them but to the company as a whole: see, for example, *Perlman v. Feldmann*, 129 F.Supp. 162 (1952), 219 F.2d 173 (1955), cert. denied 349 U.S. 952; 154 F.Supp. 436 (1957).

This has been possible because of the second development, namely that recovery need not be to the company itself (which, as in our *Regal (Hastings) Ltd. v. Gulliver* [1942] 1 All E.R. 378, H.L., will merely enure for the benefit of the undeserving purchaser of control) but can be divided among the individual shareholders who have failed to share in the spoils. This principle would not be a complete novelty in Britain for a step in that direction has been taken by section 193(3) of the Companies Act.

Rules such as these would have obvious relevance in circumstances such as those in the Carreras take-over.

The American Corporation Acts are also stricter in requiring class consents, and in affording shareholders "appraisal rights" i.e., rights to be bought out, when they dissent from corporate action on such matters as mergers, sales of the undertaking, and amendments to the charter.

(j) *Pre-emptive rights.* In the U.S.A., in contrast with Britain, it was held as a matter of law that when more capital was issued the existing shareholders had a right to subscribe for this, i.e., the issue had to be made as a "rights issue" so as to preserve the existing equality of the members. In most States this has now been substantially modified and, so far as publicly held companies are concerned, the present position is not substantially different in practice from that resulting from recent rulings by the London Stock Exchange that issues of equity shares for cash should be in the form of rights issues. However, in the case of private companies, the American pre-emptive rights doctrine does afford existing members greater protection than English law. Until the latest revision, Table A contained an article affording pre-emptive rights. For some reason this disappeared from the 1948 Table A and was not, as might have been expected, incorporated in the new Part II of Table A applicable to a private company.

(k) *Mergers.* The Americans have a system whereby two or more companies can be merged without a new holding company being formed and without the merged companies being liquidated. Some of those who are familiar with both the British and the American systems feel that the American system has advantages and it might be worthwhile to investigate this.

The British type "take-over bid" by conditional offer is unusual in the States, mainly, apparently, because sufficient acceptances would never be forthcoming since the acceptors would be subject to capital gains tax. Attempts to wrest control do,

of course, occur, the normal *modus operandi* being to acquire as many shares as possible by market purchases and then to wage a proxy fight. The latter will, in the case of quoted companies, then be controlled by the S.E.C. proxy regulations referred to below (paragraph 8 (d)).

Securities Regulations

5. I turn now to the Securities Legislation which, as already suggested, may be of particular interest to us. Until 1933, this, like company law itself, was entirely a State matter. Supplementing their basic Corporation Laws, most States had, and have, so-called Blue Sky Laws* under which Securities Administrators exercise a greater or lesser control over the issue of and dealings in securities. In some States these Laws contain nothing more extensive than anti-fraud provisions (only one—New Jersey—is now left in this position). In others these have been coupled with registration of brokers and dealers, and more recently, of investment advisers. In most States, however, there are provisions for registration of particulars of securities being issued coupled, in general, with scrutiny and control of quality by the Administrator. The only States at present without any regulation in these spheres are those last outposts of *laissez-faire*—Delaware (which once had a primitive anti-fraud Act but scrapped it) and Nevada.

The result was that any nation-wide public issue would have to take account not only of the Federal requirements, referred to below, but also of some 50 State Blue Sky Laws of a staggering variety and appalling complexity. Happily some order is now being produced from chaos. After years of patient labour Professor Louis Loss, formerly of the S.E.C. and now of the Harvard Law School, recently produced a Uniform Securities Act which has secured the endorsement of the Commissioners on Uniform State Laws, the American Bar Association and the North American Securities Administrators. The Act has already been adopted in substantial part by eight jurisdictions and individual provisions have been adopted in eleven more. It is now under active consideration in several others. The Act is divided into four parts (1) Fraud Provisions, (2) Registration of Brokers, Dealers and Investment Advisers, (3) Registration of Securities, and (4) General. This enables States to adopt the whole or part or parts according to the extent of their regulatory philosophy.

The Act is a model of clarity and brevity—the same can hardly be said of the Federal legislation. It would appear to repay careful study in relation to the Committee's task in connection with the prospectus provisions of the Companies Act and with the Prevention of Fraud (Investments) Act.

6. Federal legislation in this field is the product of the stock market crash of 1929–32. This led first to the enactment of the Securities Act, 1933, which was originally administered by the Federal Trade Commission. In the following year the Securities Exchange Act established a new Government agency, the Securities and Exchange Commission to administer it and the earlier Act. Subsequently there has also been brought under the wing of the S.E.C. the Public Utility Holding Company Act, 1935, the Trust Indenture Act, 1939, the Investment Company Act, 1940, and the Investment Advisers' Act, 1940. The Commission still administers these six Acts and, in addition, has certain functions under Chapter X of the Bankruptcy Act (which applies to the winding up of companies as well as to bankruptcy of individuals).

The Commission, an independent quasi-judicial agency, consists of five Commissioners (of whom not more than three may be of the same political party) who hold office for five-year terms, and a permanent staff of about 950 lawyers, engineers, accountants, investment analysts and clerks. Its head office is in Washington, D.C., and it has 12 regional offices of which the largest is in New York. It has a total annual appropriation of about \$7 million, of which about \$2½ million comes back to the Treasury in fees.

* The name is said to derive from bubble companies which were offering to the public nothing more concrete than a piece of the heavens. To the confusion of English law librarians it has nothing to do with Aviation Law.

7. *The Securities Act of 1933.*

(a) This deals primarily with the initial issues of securities rather than with their subsequent trading, i.e., it is similar to the prospectus provisions of the Companies Act rather than to the Prevention of Fraud (Investments) Act. With certain exceptions (e.g., for small and domestic issues) if there is any use of "mails or channels of inter-State commerce" (this formula being designed to ensure Federal legislative competence) a very detailed registration statement must be registered with the S.E.C. and a prospectus containing most of the information in it must be given to every buyer. As in our Companies Act, the contents of the registration statement and prospectus are prescribed in Schedules to the Act, but, unlike our Act, the S.E.C. is given power to add to or subtract from the prescribed requirements. This produces considerably greater flexibility than under our system (unless a certificate of exemption is granted under section 39). Basically the philosophy is the same as that of our prospectus provisions—disclosure rather than approval of the merits—in this respect the Federal Act differs from the State Blue Sky Acts. But the disclosure is far more extensive than that required under either the English Act or our Stock Exchange regulations. Those who feel that the British prospectus gives too much information would be critical of the size of a typical American prospectus—though there has been some progressive reduction in size as the S.E.C. has streamlined its forms. The view is taken that the purpose of a prospectus is not so much to enlighten the lay investor as to enable his professional adviser to assess the merits and offer his skilled advice. The same philosophy, of course, underlies our Prevention of Fraud (Investments) Act, with its attempt to channel circularisation through members of stock exchanges, or licensed and exempted dealers.

(b) More striking than the contrast in the amount of disclosures required is the scrutiny to which it is subjected by the S.E.C. Whereas the English Registrar of Companies merely ensures that a prospectus is formally in order, the officials of the S.E.C. scrutinise the registration statement to ensure that everything is stated fully and fairly (the adverse features being emphasised at least as much as the selling points) and, so far as possible, with scrupulous accuracy. Foreign observers of the British system are apt to be startled by the absence of any legal provisions for scrutiny of the information which we require to be disclosed. In fact, of course, a scrutiny does normally take place under the British system, but by private agencies—the Stock Exchanges and the Issuing Houses sponsoring the issue. We have been able to leave this essential screening to the Stock Exchanges because a public issue is rarely practicable in the United Kingdom unless the securities are to be dealt in on a Stock Exchange. In the U.S.A.—and this, perhaps, is the most important practical contrast between the financial organisation in the two countries—the number of issues traded in the over-the-counter market is larger than that on all the exchanges put together and it is only a minority of public issues which will be listed on an exchange (though in terms of dollar volume, over-the-counter trading is only about one-third of that on the exchanges).

(c) Although the S.E.C. cannot stop an issue merely because they think it is a bad bargain, the full amount of disclosure required and the scrutiny to which it has been subjected have not infrequently led to the terms of the issue being changed, so that there is in practice not all that difference between the Federal control and that of those States which insist that the issue must "qualify" on its merits before it can be made.

(d) Evidence from the States from those familiar with both the British and American regulations and their practical working would, I think, be critical of the British position in a number of respects.

They would probably argue that:—

- (i) A British prospectus is seriously deficient in accounting data—especially as regards turnover figures.
- (ii) Too much emphasis is placed on formal requirements rather than business substance and not enough information is given to enable the reader to assess the competitive position of the company. To give one example: A S.E.C.

official said to me "Your prospectuses of, say, a multiple store company will merely state that the company has stores in central positions in certain cities. I should want to know what competing companies had stores in those cities and how their positions compared with those of the company."

- (iii) We are not sufficiently strict in insisting that the adverse features are stated clearly and emphatically. Provided, say, that the rights of the various classes of shares are accurately stated we do not insist upon their implications being brought out—for example, that all the votes are held by one insider and that the maximum preference dividend of 12½ per cent. will only be earned after the ordinary shares have earned 30 per cent. (cf. the prospectus dated 21st January, 1960, of Federal Consolidated Investments, Ltd.—which was a case where a public issue was made without any application to a Stock Exchange for permission to deal and where in consequence there was no scrutiny of the prospectus).
- (iv) The exemptions from filing a full prospectus are too wide. Why should an investor get a full prospectus when he is invited to buy shares for cash but not when he is invited to buy them by exchanging other shares for them (*Governments Stock and Other Securities Investment Co. v. Christopher* [1956] 1 W.L.R. 237)?
- (v) The three-day waiting period between the opening and closing of the subscription lists, required under section 50 of the Companies Act, is far too short to enable the investor to obtain informed and skilled advice. Under the Securities Act, a 20-day waiting period is prescribed and, as a result of amendments in 1954, a satisfactory solution seems to have been found for the difficulty that underwriters are unlikely to be willing to remain on risk so long. Briefly, this involves circulation of a preliminary prospectus giving all the information required in a full prospectus except those figures which are necessarily dependent on the issue price to be decided later. But no contract may be entered into with a dealer or a member of the public until after he is supplied with a full prospectus after its registration.
- (vi) The scrutiny of the British Stock Exchanges is less likely to lead to the detection of inaccurate information than that of the S.E.C. Although the S.E.C. does not profess to warrant the accuracy of the information (a legend to that effect must appear at the top of the prospectus) in practice it is likely to detect mis-statements and to use its power to ensure that these are corrected before registration.

8. *The Securities Exchange Act of 1934.* This Act is similar in object to our Prevention of Fraud (Investments) Act, that is to say it is concerned with trading in securities already issued. However, it tackles this subject on such a broad front that it has had a considerable impact on company law itself, especially in the field of shareholder-management relations.

(a) *Registration of Brokers.* Under the Act all Stock Exchanges must register with the S.E.C. unless exempted, and whether exempted or not they are subject to the general supervision of the S.E.C. with respect to their rules, jurisdiction over their members and certain exchange practices (such as short selling). No exchange—not even the New York Stock Exchange—is exempt from this supervision. Over-the-counter brokers and dealers must also register and are subject to similar supervision; in their case the National Association of Securities Dealers (N.A.S.D.) exercises discipline and regulation of business practices to much the same extent as the Stock Exchanges and is a highly efficient and tough organisation, of which almost all over-the-counter brokers are members.

This part of the Act, therefore, is similar in concept to sections 1 to 9 of the Prevention of Fraud (Investments) Act, 1958, but the control over professional dealers in securities is much more extensive. In the United Kingdom all Stock Exchanges and their members are free from any outside supervision so long as the Exchange is "recognised" under section 15 of the Prevention of Fraud (Investments) Act. This

recognition extends not only to Stock Exchanges strictly so called, but also to the Association of Stock and Share Dealers, a London body of external brokers, and the Provincial Brokers' Stock Exchange. An informed American critic would probably argue that whereas exclusion from control of members of the London Stock Exchange may be justified, the same can hardly be said of all the provincial Exchanges or of the Association of Stock and Share Dealers.

(b) *Anti-Fraud Provisions.* Again, like the United Kingdom Prevention of Fraud Act, the Securities Exchange Act contains a number of provisions designed to protect buyers or sellers of securities from being duped. A large portion of the Commission's staff is constantly engaged in investigating alleged breaches of these and similar provisions in the other Acts, and in assisting in the prosecution of offenders. Perhaps of particular interest, from our point of view, is that although these provisions specify criminal sanctions only, the American Courts have held that victims have a civil remedy; it is doubtful whether the English Courts would place a similar construction on sections 13 or 14 of the Prevention of Fraud Act. It seems strange that civil remedies are available for breaches of the Companies Act on an initial issue but not, apparently, for corresponding breaches on subsequent trading.

The most sweeping and significant of these provisions is section 10 and the famous rule 10 b—5 made under it. But it will be convenient to postpone reference to this until turning to Insider Trading (see paragraph 8 (f) below). Mention should, however, be made at this stage of the fact that the Act, and the rules made under it, contain much more detailed and effective provisions against stock-market manipulation than anything we have in this country. To make a take-over bid, not with the intention that it should succeed, but with the object of causing the market price to rise so that the bidder could sell his holding at a profit (or sell short before announcing the withdrawal of the bid) would be a criminal offence in the States, and would subject any broker who had participated to disciplinary proceedings by the S.E.C.

(c) *Reporting.* All listed companies and others which have made large public issues must file annual reports giving much the same information as is required for new issues under the Securities Act. Filing is required both with any Stock Exchange on which the securities are listed and with the S.E.C., and the reports are available to be public. This means that much more financial information (including turnover figures and the individual remuneration of directors and of the three highest paid officers, if exceeding \$30,000 each) is available to the investor. Since 1955 the Commission have required half-yearly figures to be reported, and reports must also be filed after certain extraordinary occurrences such as changes of control. Moreover the Stock Exchanges may require even more frequent reporting—the New York Stock Exchange demands quarterly statements. This mass of financial data is collated and published in the standard financial manuals, and results in the American investor and analyst having much more information to draw on than has his British equivalent. Requirements regarding auditing are also stricter—especially as regards the independence of auditors; they are disqualified not only if they are officers but also if they (or near relatives) are shareholders.

(d) *Proxy Regulations.* These and the remaining provisions of the Act apply only to companies whose securities are listed on a stock exchange. This means that many large public companies are excluded and this is a recognised weakness. Efforts extending over many years have been made to remedy this, but neither the Frear nor Fulbright Bills which would have accomplished this has yet succeeded in getting through both Houses.

Under section 14 a very detailed code of regulations applies whenever the management or anyone else solicits proxy votes or shareholder consents. As previously mentioned (paragraph 4 (h)), the management will normally need to do this at any general meeting because of the high quorum requirements and in any case the Stock Exchange may require an undertaking (as the New York Stock Exchange does) that proxies will be solicited.

In effect, what the S.E.C. has done is to seize this opportunity of ensuring that full information is disseminated to the shareholders. A proxy statement must be sent to the members after registration with and clearance by the S.E.C. where it will be subjected to the same scrutiny as the original registration statement. This must give full information about the resolutions on which the members are being asked to vote and detailed information about those who are soliciting proxies. In the case of solicitations by the board of directors a considerable amount of information must also be given about the company's affairs. All follow-up circulars must similarly be cleared with the S.E.C.—and this includes not only circulars in the narrow sense but any publication or broadcast designed to sway the votes. In other words, not only do the rules provide for disclosure, but they operate as a body of Queensberry Rules designed to ensure that the fight is conducted fairly.

There is here a very marked contrast with the position in the United Kingdom, where, if explanatory circulars are sent at all, they say as little as is consonant with the common law rule that they shall not be "tricky or misleading", and where mudslinging is controlled only by the law of libel (cf. *Gordon Hotels*).

A further point—though this has little to do with S.E.C. legislation as such—is that of recovery of expenses of a proxy fight. In the United Kingdom the existing management pay out of the company's coffers; the opposition pay out of their own pockets (which, of course, may mean out of the coffers of another company). Whether, if the opposition win and get control, they can then re-imburse themselves is uncertain. There is some American authority for the view that, if authorised to do so by a resolution in general meeting, they may re-imburse themselves their reasonable expenses: *Rosenfeld v. Fairchild Engine and Airplane Corporation* 309 N.Y. 168 (1955). Section 140 of our Companies Act suggests that the position may be the same here. How one decides what expenses are reasonable is another problem; only in relation to public utility holding companies has the S.E.C. attempted to lay down financial ceilings: rule 65.

(e) *The stockholder-proposal rule.* Another rule (14a—8) made under section 14 of the Act contains effective means of enabling individual stockholders to submit proposals to a general meeting. Whereas the comparable section 140 of the British Act can only be used by 100 members or by members holding one-twentieth of the voting rights, in America any member can insist on any proposal (with certain exceptions) being included in the management's proxy statement, together with a supporting statement of not more than 100 words. The sanction against abuse is that the proposal cannot be re-submitted within three years unless it has secured a prescribed measure of support.

Considerable use of this provision has been made by certain proponents of corporate democracy—notably by the redoubtable Lewis Gilbert—and I think it is generally accepted that it has fulfilled a useful purpose by permitting ideas to be ventilated. It is obviously unlikely that the proposal will be passed if opposed by management (I do not think that this has ever happened) but persistent ventilation of grievances—such as excessive executive remuneration or holding the general meeting at an inconvenient place—has not infrequently led to a change of heart on management's part.

(f) *Insider-trading.*

(i) Section 16 (a) of the Act requires that details of holdings and share-dealings shall be filed both with the S.E.C. and with the Stock Exchange by any officer, director or any person "who is directly or indirectly the beneficial owner of more than 10 per cent. of any class of equity security" of the company.

(ii) This resembles section 195 of the British Act but goes much further in that it covers all officers and all holders of 10 per cent. of any class of equity shares, as well as directors. Further, the information is always available for public inspection both at the S.E.C. and the Exchange, and the Government Printing Office publish the information in all reports in a monthly pamphlet which has a wide circulation. Hence, far from cloaking the information in a veil of secrecy—as the British section

does—it is given the widest publicity. This in itself puts some teeth in the section in contrast with the British one.

(iii) However, the real sanction is provided by section 16 (b). Under this, any profit made within a period of six months must be accounted for to the company. These short-swing profits are recoverable whether or not there has been disclosure in accordance with section 16 (a) and either the company or any member of it on behalf of the company may institute proceedings to recover the profit if the "insider" does not voluntarily disgorge. In interpreting these provisions the Courts have held that the section applies whether or not there has in fact been any misuse of inside information and that profits are calculated by matching the lowest price in with the highest price out during any period of six months. This may mean that, as a result of matching of particular transactions, an insider may have to hand over "profits" to the company although he has suffered a net loss from all his trading during the six months' period. Finally, it may be mentioned that one of the things that has to be mentioned in the management's proxy statement is amounts due from officers, directors or their nominees and associates; this has been held to include anything due from them under section 16 (b).

(iv) The result has been to render dealings by insiders a singularly hazardous occupation. Purchases and sales are not forbidden but the insiders have to operate as if in a gold-fish bowl and unless they buy for long-term investment they are likely to find their operations unprofitable. Making use of inside information for their own short-term profit is only practicable if they are prepared to face the possibility of criminal prosecution by operating through nominees willing to aid them in their crime.

(v) Nor is this all. Rule 10 b—5 also is relevant here. This rule is not limited to the activities of insiders, nor is it limited to dealings in listed securities; in both respects it is wider than section 16. On the face of it, it is a perfectly normal anti-fraud provision in the same terms as section 17 of the Securities Act. It reads as follows:—

"It shall be unlawful for any person, directly or indirectly . . .

- (1) to employ any device, scheme or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any persons,

in connection with the purchase or sale of any security".

On the face of it this goes no further than section 13 of our Prevention of Fraud Act—if indeed it goes as far. How it has come to be a potent weapon for use against insiders requires some explanation and is only explicable if viewed in the light of developments in the general law.

(vi) Although a few States—Georgia, Kansas and perhaps some others—were prepared to hold that directors stand in a fiduciary relationship towards their individual shareholders so that if they buy shares they must disclose all material facts to the shareholders from whom they buy, most States followed the opposite English rule exemplified by the much criticised decision in *Percival v. Wright* [1902] 2 Ch. 421. On the other hand the American Courts have always been more ready to hold that if special facts (e.g., a proposed merger) were known to the directors it would be fraudulent to buy without disclosing these facts: *Strang v. Repide* 213 U.S. 419 (1909). In other words, even at common law most American Courts would probably have decided *Percival v. Wright* differently on the actual facts of that case. This "special facts" doctrine (which is not entirely unknown to English law—see *Allen v. Hyatt* (1914) 30 T.L.R. 444) was gradually encroaching on the orthodox rule. This process has been greatly hastened by rule 10 b—5. In a number of cases it has been held that the rule is broken and the shareholders have a remedy in damages if an insider (which will include a majority shareholder as well as directors and officers) buys

shares without disclosing material inside information known to him: the leading cases are: *Kardon v. National Gypsum Co.* 73 F.Supp. 798 (1947) and *Speed v. Transamerica Corporation* 99 F. Supp. 808 (1951). In the latter, Leahy C. J. said:

"The rule [i.e., 10 b-5] is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers."

It has been held (though the decision has been criticised) that the same applies if the insider sells rather than buys—for the rule is worded to cover both sales and purchases. It is therefore almost true to say that sales and purchases by insiders have become contracts of the utmost good faith demanding disclosure of all material facts.

(vii) If rules similar to these were adopted in Britain it would undoubtedly be a potent sanction against abuse of inside information. Not only would the insider have to account to the company for any short-swing profits on dealings in the company's securities, but, if he bought or sold with inside information (for example of a take-over bid or a forthcoming dividend distribution), he might be liable to the other party to the transaction.

9. *The Investment Advisers Act of 1940.* This Act resulted from a study made by the S.E.C. of the new profession of investment advisers which sprang up in the inter-war years. Its object is (a) to protect the public from unscrupulous tipsters and touts and (b) to safeguard the *bona fide* investment analysts from the stigma of the activities of those tipsters. Accordingly it contains provisions for registration of those who, for compensation, give advice as to securities. There are various exemptions to exclude, for example, bankers, lawyers and accountants and "the publisher of any *bona fide* newspaper or financial publication of general and regular circulation." But a freelance financial journalist writing a syndicated column would need to register. The provisions for registration are comparable to the registration of brokers under the Securities Exchange Act, but the registered particulars have to give greater information regarding business history. On the other hand powers of control are laxer than those over brokers and this is a recognised weakness. However, some of the State Blue Sky Laws go further in this respect.

In the United Kingdom there is at present no control whatever over investment advisers as such, although the profession is one in which there are obvious opportunities for misconduct, which can have grave public consequences, and such misconduct has occurred. The present legal position is confused and unsatisfactory. Most advisers are probably in constant breach of section 14 of the Prevention of Fraud (Investments) Act unless they obtain licences as dealers, which seems to be possible only if they are rewarded by commission on profits—a method of doing business frowned on in the City.

10. *The Trust Indenture Act of 1939.* This Act regulates the contents of debenture trust deeds. Criticism was made to the Cohen Committee that debenture trustees were often passive recipients of their remuneration, sometimes with personal interests conflicting with those of the debenture-holders, rather than efficient watch dogs. That Committee, however, went no further than to recommend that indemnity clauses should be banned (paragraph 64—see now section 88 of the Companies Act). A study undertaken by the S.E.C. led to an Act which goes considerably further. A registration statement under the Securities Act will not be accepted in respect of debentures unless the trust deed has been approved by the S.E.C. as meeting the statutory requirements. These are mainly directed to ensuring the competence and independence of the trustees. One at least of the trustees must be an American trust corporation with a prescribed capital—a similar proposal was rejected by the Cohen Committee (paragraph 62). An elaborate series of provisions seeks to ensure that the trustees are fully independent—the Cohen Committee (without a reference to the

American provisions) also rejected this (paragraph 63). In addition, certain of the contents of the trust deed are prescribed; for example, provision must be made for six-monthly reports by the company to the trustees (and for access by debenture-holders to these reports) and for annual reports by the trustees to the debenture-holders. Of particular interest is section 316, which severely limits the extent to which an individual debenture-holder's rights may be modified without his consent; the right to receive principal and interest when due may not be impaired except that the deed may provide that, with the consent of the holders of 75 per cent. of the debentures, payment of interest may be postponed for not more than three years.

Once the Commission is satisfied that the Trust Deed contains the requisite safeguards (a model Trust Deed has been prepared which is in general use) and that there is an independent trustee it has no further functions; the independence of the trustee and his amenability to suits for violation of duty assure automatic operation.

11. *The Investment Company Act of 1940.* This Act imposes control over investment trust companies and unit trusts which is much stricter than that exercised over other companies. Not only is greater disclosure required but the industry is subject to a considerable measure of regulation.

The Americans have in this respect been more logical than we have. We have recognised that unit trusts—fixed or flexible—require special treatment and regulation and this has been forthcoming under the Prevention of Fraud Act. Yet we have treated investment trust companies as if they were just ordinary companies. As previously mentioned (paragraph 4 (c)) the fact that American companies can purchase their own shares has enabled them to accomplish in the form of a company what we can only achieve through a complicated trust arrangement. It seems to be recognised that if Britain were to legalise the open-end investment trust company or mutual fund on the American model, it would be necessary to subject it to special control comparable to that over unit trusts. But little thought seems to have been given to the existing (closed-end) investment trust company, although it presents many of the same special problems. The Americans recognised this 20 years ago.

The Act, which is the most complicated of those commented on here, has very much the same aims as those of the unit trust provisions in the United Kingdom Prevention of Fraud Act, but, as already mentioned, it applies to companies (closed and open-ended) as well as to trusts, and its regulation is greater. It controls the selling practices of the companies and the price at which shares or units may be sold or re-purchased and requires additional information in the prospectus. It tries to secure honest and unbiased management and greater control by the shareholders over management. It regulates the type of capital structure that may be adopted. And it prescribes more detailed and more frequent financial statements. Among other means of assuring compliance, the Commission make routine inspections of the companies concerned, though as yet this has only been possible on a limited scale.

12. *Chapter X of the Bankruptcy Act.* Under this Act the S.E.C. acts as adviser to the Court on corporate reorganisations. At the request of the Court, or with its approval, the Commission participates as a party in order to provide independent expert advice. It also prepares formal advisory reports on reorganisation plans submitted to it by the Court.

It may well be a weakness of the English system that we have no comparable procedure in connection with schemes of arrangement or capital reductions requiring the Court's approval. The "adversary" system adopted by British (and American) Courts makes it very difficult for the Judge adequately to carry out the needful enquiry into the economic merits and basic fairness of complicated reorganisations. Independent investigation and advice might be invaluable. In Scotland, a step in this direction has already been taken, for schemes may be referred by the Court to an independent accountant for report. Evidence of the practical results of the American (and Scottish) procedure might be of interest.

13. *The Public Utility Holding Company Act of 1935.* The basic object of this Act, which has been largely achieved, was to break up the vast concentration of control of public utilities by holding companies and the resulting unsound and top-heavy financial structures through which the control was exercised. Since in the United Kingdom public utilities have mostly been nationalised, this particular problem does not arise here. On the other hand the Committee is concerned with the general problem of control through pyramiding and the resulting abuses. On these questions, the Act, and the experience of the S.E.C. in working it, has some relevance. Of some interest, too, is section 12 (h) forbidding political contributions.

14. There are, of course, many other aspects in which American Law and Practice in this field diverge from the British. It is believed, however, that this memorandum refers to the major matters in which American experience may be relevant to the Committee's task, and which are therefore deserving of closer investigation.

March, 1960.

APPENDIX XL

Memorandum by Davis Polk Wardwell Sunderland & Kiendl

The Secretary of your Committee has communicated to us certain questions on which you wish our views and comments in connection with your current review of the English Company Law as a result of which you intend, we understand, to make recommendations to the Board of Trade as to changes that may be desirable. He has also sent to us a Note* by Professor L. C. B. Gower which discusses a number of subjects relevant to your Committee's task and has asked us for our comments on that Note, together with any other points which we consider pertinent.

We are glad to be of whatever assistance we can in your project. The subject is, of course, a large one with many ramifications. The problems raised call for a familiarity not only with our American law but also with the English law. We have had experience with the former, but our contacts with the latter have been only occasional. We are sure that you will therefore understand that whatever contribution we can make will consist primarily of advice as to how our law operates, with very limited, and certainly without reliable, expression of opinion as to whether in any given areas our system would be well suited to your English requirements.

It also seems to us that it would be preferable for us to confine ourselves at this stage, at least, to giving answers to specific questions or views on specific points, rather than to attempt all-inclusive discussion. Hence we shall limit this memorandum to brief comments on Professor Gower's Note and certain of the supplemental questions which your secretary has brought to our attention.

The introductory observation in paragraphs 1, 2, and 3, of Professor Gower's Note (which we shall refer to as the "Note") are in general correct so far as they apply to our law. However, we would hesitate to agree with his comment that in general the Corporation Laws of our 50 states are lax by British standards. There is, unfortunately, a very wide difference between the Corporation Laws of the 50 states, and some of them are by no means as complete or as carefully drafted as others. But in the states where most corporations are organised—that is, in the states where there is a preponderance of business and industry—our Corporation Laws are by no means inadequate. There have recently been important and desirable revisions in a number of our states, based in varying degree on the Model Business Corporation Act sponsored by the American Bar Association (sometimes referred to herein as the "Model Act"). The latest state to undertake such a revision is New York, where a Legislative Commission is now making an extensive study of the subject. We concur in the Note's comment that the various Corporation Laws do not attempt to codify the whole of our Company Law, and that, as in Britain, the case law goes well beyond the statutes in establishing a common law of corporations which, with important exceptions, is basically the same throughout the states, and, so far as our experience shows, not fundamentally different from that prevailing in Britain.

In the field of securities regulation, however, there are considerable differences in the British and American statutes and techniques. Until the 1930's, American statutory law lagged far behind the English Companies Act in provisions dealing with the sale and distribution of securities. The subject had previously been dealt with in various ways in the so-called Blue Sky laws of the several states, but it became apparent in the 1920's that these state statutes, which vary greatly in scope and in effectiveness, were quite inadequate in their totality to regulate a national and interstate business such as the securities business very largely is. The first result was the passage of the Securities Act of 1933, a Federal law applicable equally throughout all the states. This was followed in subsequent years by six other Acts administered by the Securities

* Appendix XXXIX.

and Exchange Commission (the S.E.C.). The original Securities Act, and a few provisions of these other statutes, reflected some provisions that had for years been contained in the English Companies Act, but in many fields went well beyond the British precedents. You will find in an excellent treatise entitled "Securities Regulation" (written by Professor Louis Loss of the Harvard Law School, formerly Associate General Counsel of the Securities and Exchange Commission) interesting initial chapters discussing the English precedents and the American background and history which led up to the adoption of the 1933 Act and the laws that followed it. That treatise, which is a lengthy one, also contains able analyses of other parts of our present system of securities regulation in extensive detail.

We turn to the specific paragraphs of the Note and make our comments under the same captions that divide Professor Gower's discussion:

Company Law

(a) *Pre-Incorporation Contracts*. The Note points out that under American law generally a company on incorporation may adopt contracts made on its behalf prior to incorporation, whereas under English law ratification of a previous agreement is impossible. The Note further points out that, under certain circumstances, it is not possible for the new company to take over a contract made on its behalf before incorporation in such a way as to discharge the promoters from liability. As stated in the Note the American result usually follows from holdings in our case law rather than from specific provisions in the corporate statutes. It is with us often of great convenience, and not infrequently of great importance, for a new corporation to be able to adopt a pre-incorporation contract in such a way as to remove liability from the individuals who executed it, and if the British case law at present casts doubt on the free use of that technique we would think that in considering amendments to the Companies Act it would be desirable to give consideration to eliminating the difficulty.

(b) *Ultra Vires*. The Note contains the comment that this doctrine has been substantially eradicated in virtually all of the states. This is not exactly correct, although it is true that the doctrine has been greatly watered down in the cases and is not favoured by the Courts as a defence.

The present New York Corporation Laws contain no specific provision on the subject of *ultra vires*. In the proposed revision introduced at the last session of the New York State Legislature (which is still subject to much discussion and amendment) the new sections introduced specifically provide that no act of a corporation "which is otherwise lawful" shall be invalid by reason of the fact that the corporation was without power to perform that act, but that the lack of power may be asserted (1) in an action by a shareholder seeking to enjoin the act, (2) in an action brought by the corporation or in its behalf against an incumbent or former officer or director for loss or damage due to his unauthorised act, or (3) in an action by the attorney-general to dissolve or annul the corporation or to enjoin its transaction of unauthorised business. The Legislative Commission which drafted the provision has stated in its official comments that this is in effect a codification of existing case law in New York. Since modern corporate charters in the United States contain extremely broad powers and generally permit a corporation to engage in any business except those governed by special law (e.g., utilities), the whole subject of *ultra vires* has lost much of its importance.

(c) *Purchase of Own Shares*. As stated in the Note this is generally permitted under our corporation laws, and this power is of great convenience and frequently of real importance. However, there are important safeguards, expressed either in the statutes or established by case law. The New York Penal Law, for example, makes it a misdemeanor for a director to concur in the purchase of shares of his corporation's stock except out of surplus. The Model Act permits such purchases out of earned surplus generally, and out of capital surplus if authorised by the articles of incorporation or the affirmative vote of two-thirds of all voting stock; but in no case at a time when

the corporation is insolvent or when the purchase would render it insolvent ("Insolvent" is defined in the Model Act as insolvency in the equity sense—that is, inability of the corporation to pay its debts as they become due in the ordinary course of business). In the absence of statutory provision this last result would doubtless follow under the case law of the several states. Certain purchases of the corporation's own shares are permitted by the Model Act to be made out of capital—viz., purchases for the purpose of eliminating fractional shares, collecting or compromising indebtedness to the corporation, paying dissenting shareholders entitled to payment under the Act, and effecting retirement of redeemable shares by redemption or purchase at not to exceed the redemption price and subject to other appropriate restrictions. All of these exceptions are useful, and our experience has not shown that they encourage abuses.

Of course, the purchase by a corporation of its own shares is also subject to the general rule controlling the board of directors, e.g., that it must be done for a proper corporate purpose and that it cannot be done to give advantage to any one stockholder.

The proposed new New York Corporation Law also contains a specific provision that an open-end investment company (as defined in the Federal Investment Company Act of 1940) may issue preferred, special or common shares which are redeemable at the option of the holder at a price substantially equal to the shares' proportionate interest in the net assets of the corporation and, upon compliance with the requirements of the Investment Company Act, a shareholder may compel redemption of his shares in accordance with their terms. This provision, taken in conjunction with the clause mentioned above which allows redemption of shares out of capital, facilitates the creation and operation of open-end investment companies.

The following are other illustrations of the way in which the power of a corporation to purchase its own shares may be used to the advantage of a corporation and its shareholders:

- (1) A corporation which does not have available authorised but unissued shares may wish to purchase outstanding shares in order to have them available for sale or option to employees under various types of incentive plans. While it would be possible to make unissued shares available for such purposes by increasing the authorised capital stock, there may be reasons for not doing this, particularly where the additional amount of stock needed is small. Furthermore, authorised but unissued stock may not be issuable for cash except subject to pre-emptive rights of the stockholders whereas under our corporate laws treasury shares which were repurchased by the corporation are not subject to pre-emptive rights when sold.
- (2) In the case of closely held corporations one stockholder (the estate of a deceased stockholder, for example) may wish to dispose of his shares, and the other stockholders may wish to avoid bringing any new stockholders into the picture and at the same time not be able to buy any more shares themselves. In such situations it may well be desirable for the corporation to make the purchase.
- (3) It is very often in the interest of a corporation that preferred shares be redeemable by the corporation at its option. Also, charters frequently provide sinking funds for preferred stocks under the terms of which a corporation may purchase stock with sinking fund money if such purchases can be made below the call price.
- (4) Apart from any sinking fund operations it may be desirable for a corporation and its common stockholders to have the corporation purchase preferred shares in the market where they are selling well below par, thus eliminating high dividend requirements coming ahead of common stock, although of course there might be circumstances in certain cases where such purchases would be improper.

(d) *No par shares.* Our firm was consulted in 1953 on the subject of no par shares by Lord Harcourt when he was a member of a committee appointed by the Board of Trade in 1952 to consider the desirability or otherwise of amending the British Companies Act so as to permit the issue of shares of no par value. We understand that this is the same as the Gedge Committee referred to in the Note. Mr. Brownell of our firm wrote two letters to Lord Harcourt, dated February 9, 1953, and December 4, 1953,* on the subject, referred to in the Committee's report and printed in the exhibits to that report, to which you doubtless have access. These two letters reflect generally our views on the subject of no par shares in this country.

We would question the suggestion in Professor Gower's Note to the effect that in the opinion of many Americans no par shares should be compulsory and not optional. One type or the other may be preferable, depending on the circumstances, and we see no reason for depriving corporations and their stockholders of the ability to choose.

It is less usual to create preferred shares without par value than common shares. We have not encountered difficulty in having a single corporation issue shares of both types, and we have not heard it suggested over here that corporations should be limited in their right to use both types.

(e) *Non-voting shares.* Our present New York law allows the certificate of incorporation or proper amendment to provide, except in certain cases, that the holders of any designated class or classes of stock shall not be entitled to vote or that the respective voting powers of the several classes of stock be otherwise limited. As pointed out in the Note, the Model Act also permits elimination of voting rights for certain classes except in specified matters. However, the rules of the New York Stock Exchange (though not of the smaller exchanges) require that common shares, in order to be admitted to the stock list, must have full voting rights, and as a result common shares issued by the bulk of the larger companies enjoy full voting rights. There are many cases, however, where it may be quite desirable to provide for non-voting shares as long as a stockholder is not inequitably deprived of a right to vote on important matters directly affecting his own stock. For example, any one of a number of reasons may make it appropriate that one group of shareholders of a small corporation have a share in the voting greater or less than its financial share in the company. There are also occasions where for legal reasons it is desirable that a person or corporation be a stockholder in a company without any share in voting control.

(f) *Dividend control.* It is certainly true, as stated in the Note, that the American Corporations Laws have not completely solved the problem of defining the "surplus" out of which dividends may be paid, and also that the various states have tried many solutions. The subject is lengthy and involved. Some of our states' statutes, for example the existing New York statute, contain little more than a provision that a corporation shall not declare or pay dividends which impair its capital. In New York this is bolstered by provision in the Penal Law making it a misdemeanor for directors to make a dividend except from surplus. In some other states the statute goes into elaborate detail describing the surplus out of which dividends may be paid, and laying down fixed accounting rules dealing with the method of charging surplus when a corporation pays dividends or purchases its own shares. In the present draft of the proposed new New York law provision is made that no dividend may be paid when the corporation is insolvent in the equity sense, or if the dividend would render the corporation so insolvent, and further that no dividend may be declared except out of "surplus" if the net assets of the corporation remaining after such declaration or payment shall not at least equal the amount of its stated capital, with an exception in case of corporations with wasting assets. However, the proposed new New York law contains a provision, found also in laws of some of the other states, that if a dividend is paid from sources other than earned surplus there must be appropriate disclosure to that effect.

* Minutes of evidence taken before the committee on shares of no par value, pp. 362-367, H.M.S.O., London, 1954.

our opinion been quite adequate to protect the stockholders. A further procedure for carrying out combinations exists in the form of a sale by a corporation of all its assets for stock of the purchasing corporation, after which the selling corporation dissolves and distributes these shares *pro rata* to its stockholders.

If we correctly understand what the Note means by its reference to the "British type take-over bid by conditional offer" it is by no means unknown in our country. The use of the device is not substantially limited by our capital gain tax if the acquisition is made in the form of an exchange for voting shares of the acquiring corporation, because in that case if as a result of the exchanges the acquiring corporation ends up with over 80 per cent. of the shares of the acquired corporation (as defined in the Act) the Revenue Act exempts the selling stockholders from capital gain tax under the so-called reorganisation sections. If the acquisition is made for cash, capital gain taxes are applicable. We do not have anything comparable to the convenient provision in the English law whereby if one company acquires 90 per cent. or more of the stock of another it may, with court approval, force the remaining minority stockholders to sell their shares to the acquiring company at the same price as was paid to the majority stockholders. We could, however, accomplish somewhat the same result in such situations by putting through a merger or consolidation of the two companies involved, or by a sale of all the assets of the acquired company to the acquiring company. Needless to say, such procedures require that the acquiring company act with the utmost fairness to the minority in fixing the consideration to be paid to them. Dissenting stockholders are generally given the right to demand payment for the stock at its appraised value, but this right does not deprive them of their right in a proper case to enjoin the transaction on the ground of fraud, overreaching or unfairness.

Securities Regulations

The greater part of Professor Gower's Note is devoted to a brief description of the Acts administered by our Securities and Exchange Commission, with specific comments on parts of those Acts which set forth principles or techniques which apparently have no counterpart in existing British law, and therefore might be worthy of consideration by the Committee. The subject is again a large one, and we will limit this memorandum to preliminary observations.

Perhaps the most important difference between the regulation of the securities markets in the two countries results from the part played in the United States by the Securities and Exchange Commission and the absence of any such organisation in England. In England, as we understand the procedure, the prospectus provisions in the Companies Act and the provisions in the Prevention of Fraud (Investments) Act are usually enforced in the Courts either as a result of actions instituted by the Crown or of suits by private parties. In addition, it seems that some of the functions performed by the S.E.C. in the United States are assumed by the Stock Exchange and other official or semi-official organisations. In the United States, while the Blue Sky laws mentioned above continue to operate in the several states, Federal supervision and enforcement of the Federal securities laws is vested in the Securities and Exchange Commission, with additional provision, as pointed out in the Note, giving private individuals the right to bring suits based on violations of the federal laws and the regulations issued thereunder by the S.E.C. An organisation like the S.E.C. is essential to the operations of our present Federal securities laws.

The creation of such an administrative commission or agency is a technique that has been frequently employed by our Congress. It is a technique based on the proposition that in certain complex areas affecting interstate business governmental regulations can best be achieved by an administrative body basically independent of both the judicial and the legislative branches of government, which will build up an expertise in the particular area in which it operates. We have today, among others, such federal commissions as the Interstate Commerce Commission (which is perhaps the earliest one and has to do primarily with the regulation of railroads); the Civil

Aeronautics Board, the Federal Power Commission, the Federal Trade Commission, and the Federal Communications Commission. On the whole, the S.E.C. has functioned at least as well as any of the other commissions, and certainly better than several of them. When it was first created it was viewed with great concern by many businessmen, investment bankers and brokers, but we venture the guess that if its former critics were polled today, they would vote heavily against its abolition. At the same time, many believe that the Commission is subject to criticism for having sought to extend its authority in certain areas beyond the limits believed to have been contemplated by the original legislation. In the country as a whole the S.E.C. is regarded as having done a satisfactory job, and in Congress the tendency would be to increase rather than decrease its authority.

Whether or not such a Commission would be a desirable adjunct to the British system is a question that we obviously are not qualified to answer. It seems to us, however, that among the factors that were responsible for its creation there are at least two that have no counterparts in Britain. When in 1933 it became apparent that our securities laws needed strengthening we did not have in existence any nation-wide machinery. There are active securities markets in various locations in the United States, and we have no single stock exchange like the London Stock Exchange whose effective controls operate throughout the country. Furthermore, as pointed out in the Note, the bulk of our new securities issues are not listed, whereas in England we understand that listing on the London Stock Exchange is a practical prerequisite in the case of a new issue. Secondly, the size of this country, its scattered security markets, the existence of 50 separate state governments and the past history of the securities business made strong centralised control in Washington important.

You will, of course, also have in mind the fact that there are many features of administrative commissions that involve problems that in this country, at least, have by no means yet been solved. They have the great disadvantage of combining in one administrative unit the function of investigation and prosecuting and the function of sitting in judgment on the very case that they have investigated and prosecuted. To be sure, efforts are made to segregate these functions between different personnel groups, but in the last analysis one commission sits at the top of the organisation. The fact that its judgments are subject to judicial review only partly meets the point because of the great difficulty of reversing or changing on appeal commission determinations of questions of fact.

The Securities Act of 1933

The Note comments that the disclosure requirements of the 1933 Act are far more extensive than those required either under the English Act or the Regulations of the London Stock Exchange. It is certainly true that the prospectuses describing registered American issues are more detailed than those of issuing companies in England. This is due to the regulations of the S.E.C. issued under the Act rather than to detailed requirements in the Act itself. The severe penalties imposed by the Act for mis-statements or omissions to state material facts which might be necessary to keep what is stated from being misleading are undoubtedly also responsible for much of the material put in prospectuses and which may not be specifically called for by the prescribed forms. At one time the fear of penalties produced prospectuses of almost absurd lengths, but as the issuers became more familiar with the techniques and practices, and under pressure from the S.E.C. itself, the modern prospectuses prepared by responsible issuers and responsible underwriters are by no means as redundant as they once were. It is true that they are probably seldom read with much care by the average investor, but they afford a source of information to experts in the business which is in one way or another passed on to the public.

Under the English Act, as pointed out in the Note, the prospectus appears not to be subject to preliminary scrutiny by any public body. On the other hand, all registration statements and prospectuses are reviewed by the staff of the S.E.C.,

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Under the English Act, as pointed out in the Note, the prospectus appears not to be subject to preliminary scrutiny by any public body. On the other hand, all registration statements and prospectuses are reviewed by the staff of the S.E.C.,

which, although it takes no responsibility for the accuracy of the final document, usually raises questions in so-called "deficiency letters" and asks for amplification or construction, and sometimes refuses to allow a registration and prospectus to become "effective" if it believes that it is not in proper form. Whether or not the S.E.C. should utilise this preventive technique is a question that has been often discussed. Some members of the industry and the Bar have from time to time expressed the opinion that it would be better if the S.E.C. accepted the papers as filed and then cracked down afterwards if errors or inadequacies were discovered. However, we believe that again the great majority of issuing companies and investment bankers, as well as their lawyers, would, if polled, express a preference for the present system. They would doubtless at the same time go on record as being anxious for more expeditious review, and would point out examples where the S.E.C.'s criticism of the documents is trivial or inappropriate. It is admittedly true that today the staff of the S.E.C. is not large enough to take care promptly of all of the business that it has to handle, and concern on this score has been expressed by the Chairman of the S.E.C. himself.

Since we first wrote the above paragraph there was published in December last a Report on Regulatory Agencies to the President Elect, prepared at the request of Senator Kennedy by James M. Landis, a former chairman of the S.E.C. and of the Civil Aeronautics Board. Mr. Landis's comments on the S.E.C. are much less critical than those he makes of some of the other commissions, but the following paragraph is pertinent and, in our opinion, well stated:

"The deficiency letter, a most valuable extra-legal development, has a real place with regard to the more promotional and speculative securities. There has grown up over the years a considerable tendency to indulge in lint-picking in these letters, resulting in delays and unnecessary costs. Another tendency has become noticeable due to the attitude of certain Commissioners shortly following World War II. This is to move away from the legislative standards of full disclosure to a judgment on the quality of the securities being registered. The history of state security regulation in this respect gives ample evidence of the undesirability of establishing a bureaucracy with powers of this nature. True, there is every temptation to move in this direction as one views as a whole the rapacity of promoters and underwriters and the unwillingness of a greedy and speculative public to try to understand the simplest facts of corporate finance. But control and supervision over the activities of the selling group and the marginal fringe of brokers and dealers making markets in these issues, can do more to dampen this type of financial piracy than the use of the registration powers for purposes for which it was not intended."

The Note suggests in paragraph 7 (d) several criticisms that might be made of present British techniques in connection with the offering of new issues. We have the following comments on these points:

- (i) the accounting requirements of the S.E.C. have done a great deal to produce a uniform presentation of financial data that is of real value to securities analysts and therefore to the public at large. Sometimes it is felt that the required financial statements are too voluminous, but the over-all results have been beneficial;
- (ii) the specific inclusion in the Securities Act of penalties for "omissions" as well as for mis-statements may well go no farther in the last analysis than the British case law, but the provision in the statute itself probably has had a good deal to do with stimulating the presentation of information of the type referred to in paragraph 7 (d) (i) of the Note. In addition, the penalties to which underwriters and directors (in addition to the issuing company) may become subject undoubtedly leads them to insist on disclosures which management might otherwise overlook;

- (iii) this same comment applies to the observations in the Note set forth in paragraph 7 (d) (iii) criticising English prospectuses for failing to disclose certain important facts;
- (iv) the 1933 Act includes not only sales for cash but also sales where the buyer pays his purchase price by surrendering other securities, and it seems to us that this should be so in most cases. However, we point out that under the Securities Act an exemption is given to any security of the issuer exchanged by it with its existing security holders exclusively "where no commission or other remuneration is paid or given directly or indirectly for soliciting such an exchange". There are certain other important exemptions, most notably perhaps the exemption afforded to railroad and municipal securities, and in many instances to securities issued as a result of mergers and other types of consolidations. However, many of these latter exempted transactions require stockholder action, and, where the stock involved is listed, are covered by the S.E.C.'s proxy rules (discussed below). These rules often operate to give to shareholders a good deal of the information that would be contained in a prospectus;
- (v) while there are perhaps some people who feel that a 20-day waiting period under the Securities Act is too long, we believe that the majority would be quite willing to let it stand and would certainly be of the opinion that, in the United States at least, a three-day waiting period would be too short. Techniques have been developed as a result of experience, and co-operation by the S.E.C., which avoid any difficulty that the United States underwriter must take too long a "carry". For example, the Commission has realised from the earliest days of the Act that it is unnecessary to the investor, and disadvantageous to the issuer, for the offering price of a security that has to be registered to be filed 20 days before the public offering is made. It therefore has always allowed the actual offering price, and items closely related to it (such as the "spread" to the underwriters, conversion terms and redemption prices), to be filed shortly before the effective date of the registration statement, which usually fixes the time of the public offering. While there are plausible reasons for giving the public a 20-day cooling period in which to consider the statements describing the issuing company and the basic characteristics of the security to be sold, there is no such need for any period for study of the offering price and related financial terms; and
- (vi) the Note observes that the scrutiny of the British Stock Exchanges is less likely to lead to the detection of inaccurate information than that of the S.E.C. We are not sufficiently familiar with the British practice to comment on this comparison. It is interesting to note, however, that during the 27 years since the 1933 Act was passed, there have been only a negligible number of cases where security purchasers have been successful in legal actions based on either erroneous or misleading prospectuses in registered issues.

Professor Gower has asked us to comment on difficulties encountered by any S.E.C. requirement for the disclosure of "turnover figures"—i.e., figures relating to sales. While the registration forms do not specifically call for analysis of such figures appearing normally in profit and loss statements (which must be furnished), more detailed data may sometimes be required by the general disclosure provisions of the law in order to make the prospectus properly informative. For example, it may well be material to disclose that a high percentage of a company's sales is made to one or a few very large purchasers. There is no requirement that a breakdown of sales into all the different categories be given, or that data be furnished showing the relative profitability of various lines (which would doubtless be very harmful competitively) but the form does call for "the relative importance of each product or service or class of similar products or services which contributed 15 per cent. or more to the gross volume of business during the last fiscal year" and in cases where there is a sufficient

variance between the amount a particular product contributes to sales and its contributions to profits sufficient disclosure must be made so as not to mislead the public.

We have heard that it is not usual in England for companies to publish in the profit and loss statement gross sales and costs of goods sold. Publication of these figures is generally made in the United States, and they are called for by certain of the S.E.C. rules. Back in 1939 a company asked the S.E.C. to treat such information confidentially, alleging that the disclosure would harm its business. The S.E.C. refused to do so, and was supported in its action by the Court of Appeals for the District of Columbia. The Court said, however, that disclosure of the items in controversy would not be required if the result would be to wreck the company's business. The Court also said (and this may be of interest in indicating the weight given by our Courts to action by the S.E.C.) that it would have no difficulty in understanding petitioner's reasons for apprehension that the disclosure would be harmful, "and if the question were before us as an original proposition we could easily see our way to sustaining the objections to general publication. But the question is primarily not for us but for the Commission, and Congress undoubtedly intended that the Commission should bring to bear upon the decision of this and like questions . . . the knowledge and experience of experts. This does not by any means set up an inquisition destructive of the rights of the individual. The delegated power is not to be exercised arbitrarily or to be considered an unfettered discretion over the property of the citizen. Its exercise is subject to review. But so long as the Commission's decision rests on substantial evidence and on inferences which are not arbitrary and capricious, it should be sustained. In the discharge by Congress of a dominant trust for the benefit of the public, the possibility of incidental loss to the individual is sometimes unavoidable." (*American Sumatra T. Corp. v. S.E.C.*, 110 F.2d 117, 120).

The Securities Exchange Act of 1934

The 1934 Act was enacted a year after the Securities Act, and in some respects it would be simpler if the two Acts had been incorporated into one. As the Note implies, the 1934 Act not only applies to trading in securities already issued but also includes a number of sections which might more logically have been incorporated in the corporation laws of the states. However, it would as a practical matter be impossible to obtain uniform treatment in all of the state corporation laws, and the subjects covered have been regarded as of sufficient importance to warrant a federal statute with uniform application throughout the country.

(a) *Registration of brokers.* The Note observes that an informed American critic would probably argue that whereas exclusion from control of members of the London Stock Exchange may be justified, the same can hardly be said of all the provincial exchanges or of the Association of Stock and Share Dealers. Whether or not this is true in England, we believe that in the United States the New York Stock Exchange undoubtedly does a better job of supervision than the smaller exchanges located throughout the country. Nevertheless, there is no question that the supervisory provisions of the 1934 Act were responsible for tightening up of standards on the New York Stock Exchange, as well as on the regional exchanges.

(b) *Anti-Fraud provisions.* The Note comments that under the 1934 Act civil remedies are made available to injured purchasers of securities, and that under the British law it is doubtful that such civil remedies could be used in private actions. The existence of remedies that can be directly enforced by the injured party is of great importance in carrying out the provisions of the Act, and we should think that it is one of the things that the Committee might well consider in any amendment of the English law.

While the Securities Act of 1933, applicable primarily to new issues of securities, was designed to fill a deficiency in United States law which had for some previous years been dealt with in the English Companies Act, many of the provisions of the 1934 Securities Exchange Act were recognised as going well beyond British precedents.

Quite certainly, so far as the 1934 Act applies to the activities of brokers and traders in dealings in previously-issued securities, it has worked quite effectively, and it would be hard to find any reputable broker or dealer, or any informed member of the public, who would advocate curtailment of its basic provisions.

(c) *Reporting.* The reporting requirements under the 1934 Act apply, as stated in the Note, to all the listed companies and to others who have made public issues above a certain stated minimum. Additional reports are required under certain Stock Exchange rules. These requirements have not proved to be unduly burdensome, and have caused no difficulties that reputable companies have not been willing to assume. If, as in England, there were in the United States for all practical purposes only one Stock Exchange, and if practically all new public issues were listed on that Stock Exchange, the entire subject might have been handled by Stock Exchange rules. However, in the United States it is doubtless desirable for uniform reporting rules to be made for all listed securities and for large new public issues, whether or not listed. Of course, under the 1934 Act, and the rules issued thereunder, remedies are made available to injured individuals in addition to the power of both the Stock Exchanges and the Securities and Exchange Commission to discipline, and these sanctions, taken together, may ensure accurate compliance to a greater extent than regulations issued by a Stock Exchange alone.

(d) The Proxy Regulations under the 1934 Act are another big subject. They constitute a type of provision that really belongs in corporation or company laws rather than in a law dealing primarily with dealings in securities and Stock Exchanges. The language of the statute itself is very brief, and consists only of the statement that it shall be unlawful for any person to solicit a proxy or consent or authorisation in respect of any security (other than an exempted security) registered on an exchange "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors". When the law was first passed it was not anticipated by anyone, including (we think) members of the Congress, that the rules and regulations would be expanded to the extent that they have been. However, the general purpose of the proxy rules has met with general approval, even though many individual stockholders may pay scant attention to much of the material that is sent to them. The disclosure requirements (relating, for example, to compensation and benefits to officers and directors, amount of stock held by them in the company and their financial interest in matters to be voted on) have a salutary effect on management and involve no great burden on reputable companies. There has in recent years been considerable feeling in some quarters that unlisted companies should be brought within the scope of the rules.

(e) *The Stockholder-Proposal Rule.* Although nothing appears on the subject in the 1934 Act, some years ago the S.E.C. inserted in the proxy rules a provision that any stockholder might require a listed company to include in its material soliciting proxies any question (subject, of course, to certain restrictions) which he wishes to submit to a vote of the stockholders. A part of this provision requires the form of the proxy to permit a "yes" or "no" vote on such question.

This rule has been often availed of by individuals with special interests, or even by publicity seekers. The great bulk of the proposals which shareholders force managements to incorporate in proxy statements are on subjects where the proponents have little or no chance of obtaining approval and often involve questions which are not really proper for stockholder action at all.

(f) *Insider trading.* Section 16 of the Securities and Exchange Act contain provisions relating to transactions by owners of more than ten per cent. of any class of equity security registered on a stock exchange, or by directors or officers of the issuer of such stock. The provisions do not apply to unlisted stocks. Each such person is required by section 16 (a) to file with the S.E.C. statements regarding his holdings of such stock and any changes in such holdings. In paragraph (b) of section 16 it is provided that if any such owner, director or officer realises a profit from any purchase

and sale, or any sale and purchase, of any such stock within a period of less than six months (with certain exceptions), he must account to his Company for any profit resulting from such transactions. Finally, paragraph (c) makes it unlawful for any such person to make short sales of any such stock.

The disclosure requirements of section 16 (a) have doubtless had a salutary effect on insider trading, and they are generally accepted as appropriate. We believe that they have been lived up to, and that the kind of men who act as directors of listed companies do not seek to avoid them by putting their stock in street names or other similar devices. The short sale provisions in section 16(c) are extensions of provisions in some of our corporation laws prohibiting short sales by directors, and are understandable.

Section 16(b), however, is obviously and admittedly an arbitrary limitation on insider profits. There would seem to be little difference between an insider profit realised within a five-months' period and one realised with a seven-months' period. The clause and the relevant regulations of the S.E.C. have given rise to considerable litigation growing out of uncertainty as to its application to various types of transactions, but it cannot be said that such disputes have been burdensome to the companies involved. Furthermore, crude as the prohibition is, and in spite of criticism in various quarters, we have no doubt that it will remain on the books until a better one is devised. We believe that it also has been generally complied with, although we know of cases where ignorance or oversight, or uncertainty as to the applicability of section 16(b), have brought about non-compliance—and considerable embarrassment when the non-compliance was discovered.

The Note also refers under the caption "Insider Trading" to Rule X—10—(b)—(5) issued by the Securities and Exchange Commission under the Securities Exchange Act, and correctly notes that this rule has a very broad scope. It is not limited to dealings in listed securities, it includes purchases as well as sales, and by no means relates only to transactions by insiders. Under the rule it is made unlawful for any person, directly or indirectly in connection with the purchase or sale of any security subject to Federal jurisdiction (i) to employ any device, scheme or artifice to defraud, (ii) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (iii) to engage in any practice or course of business which operates or would operate as a fraud or deceit on any person. So far we do not have the benefit of much case law to help us determine just how far these very broad provisions go. Because of certain suggestions made in the Note as to the possible effect of the rule on insiders, we point out that the "omission to state" provision applies only when some affirmative statement of a material fact is made. However, a failure to disclose material facts even in the absence of some affirmative representation could, under certain circumstances, be brought within the prohibitions of clauses (ii) and (iii) referred to above.

The Investment Advisers Act of 1940

The purpose of this Act, summarised in the Note, is commendable. It had, until its amendment in 1960, shortcomings which may have prevented full realisation of its objectives. The S.E.C. has brought very few cases under the Act (only one in 1957, two in 1958 and three in 1959). There was no provision similar to that in the Securities Exchange Act which gives the S.E.C. authority to inspect the books and records of brokers and dealers, to prescribe what books and records shall be kept, and to require the filing of reports. However, the Act has recently been amended to remedy this and other deficiencies and may become an effective regulatory weapon.

The Trust Indenture Act of 1939

Little need be added at this time to the comments in the Note about this Act, which on the whole has operated satisfactorily. However, the restriction on the powers of bondholders to amend indentures (section 316) seem to us unnecessary, and

10th February, 1961]

MEMORANDUM BY
DAVIS POLK WARDWELL SUNDERLAND AND KIENDL

[Continued

certainly would be completely contrary to the English practice as we understand it. In addition, it can well be argued that many provisions of the Act are too detailed and complicated and merely add "jargon" to the terms of an otherwise satisfactory indenture.

The Investment Company Act of 1940

This very complicated Act was originally worked out with the co-operation of representatives of the investment companies industry who realised that certain controls were desirable from their point of view as well as from that of the public. In general it appears to have operated reasonably well. Our own contacts with this Act have been limited, and we defer specific comment until specific questions are raised by your Committee.

Section X of the Bankruptcy Act

This Act authorises the S.E.C. to act as adviser to the Courts on corporate reorganisations. It gives the Commission no administrative duties, and the Courts are under no obligation to follow its suggestions or recommendations. We believe that on occasion the assistance of the S.E.C. has been important.

The Public Utility Holding Company Act of 1935

This was an Act designed to meet a special situation in the United States which we believe does not exist in the United Kingdom. The principal duties imposed on the S.E.C. by the Act in connection with the breaking up of large utility holding companies has been substantially completed, and it is the general feeling, which we share, that the remaining duties should be transferred from the S.E.C. to the Federal Power Commission.

The foregoing observations are obviously of a very informal and preliminary nature. We imagine that in due course your Committee will raise more specific inquiries, which we will be glad to try to answer either in a supplemental memorandum or in informal discussion if occasion permits.

GEORGE A. BROWNELL

LEIGHTON H. COLEMAN

6th January, 1961.

APPENDIX XLI

Memorandum by Morgan Stanley & Co.

The Company Law Committee has requested our views and comments on certain questions contained in a letter dated 19th July, 1960, from the Secretary of the Committee and on Professor L. C. B. Gower's Note on "Corporate Law and Practice in the U.S.A."*

The Committee may find helpful the brief review set forth below of the development in the United States of independent regulatory commissions of the type represented by the Securities and Exchange Commission (S.E.C.) and their function in the government structure.

The regulatory commissions, which are independent agencies in the executive branch of the Government, are charged with the administration of appropriate acts of the Congress. The original commission of this type, the Interstate Commerce Commission, was created in 1887 with limited regulatory powers over railroads. In 1913 the Federal Reserve Board was created to regulate money and credit. The Federal Trade Commission, organised in 1914, was given responsibility for enforcing the Clayton Act and for preventing unfair competition. Supervision of the merchant marine was entrusted in 1916 to the United States Shipping Board, which was succeeded in 1936 by the United States Maritime Commission. The Federal Radio Commission, now the Federal Communications Commission, was created in 1927 to regulate wire and radio communications. The Federal Power Commission, created in 1930 to take over a Governmental committee originally set up in 1920, supervises interstate transmission of electric power, interstate gas pipe lines and certain hydro-electric power projects.

In the 1930's, three new independent commissions were created. The Securities and Exchange Commission was organised in 1934 to take over from the Federal Trade Commission the administration of the Securities Act of 1933, and to administer the Securities Exchange Act of 1934. In 1935 the National Labor Relations Board was established to administer the Labor Relations Act, and in 1938 the Civil Aeronautics Authority was established by the Civil Aeronautics Act. The work originally performed by this latter commission is now done by the Civil Aeronautics Board and by the Federal Aviation Agency.

Our principal concern in this memorandum is with the Securities and Exchange Commission, a five-member commission which administers the following statutes:

- (a) *Securities Act of 1933*, as amended, which, among other things, requires the filing of a registration statement with the S.E.C. It prescribes the information to be included therein with respect to issues of securities publicly offered for sale in interstate commerce or by use of the mails. In general, U.S. Government, state and municipal issues and the issues of banks, railroads and co-operatives are exempted from the registration provisions of the Act. This Act is primarily concerned with the process of distributing new issues of securities.
- (b) *Securities Exchange Act of 1934*, which is concerned primarily with trading markets in securities, is designed to regulate stock exchanges, securities markets and transactions in securities and brokers and dealers and to enforce the restrictions on and extension of credit in securities markets. This Act and the rules and regulations thereunder are specifically concerned with, among other things, market activity of listed securities, solicitation of proxies, listing requirements, reporting by listed companies, and registration of over-the-counter brokers and dealers. The enforcement of equitable principles of

* Appendix XXXIX.

trade is left largely to the exchanges in the case of listed securities and to the National Association of Securities Dealers, a voluntary broker-dealer organisation, in the case of over-the-counter securities.

The S.E.C. has little authority under this Act over companies whose securities are not listed on a national securities exchange, although it has supported certain proposed legislation to bring such companies under its supervision.

- (c) *Trust Indenture Act of 1939*, which relates to the independence, powers and duties of trustees of debt securities.
- (d) *The Investment Company Act of 1940*, which requires the registration of, and regulates many of the activities of, investment companies to insure compliance with certain standards of management and to protect investors against certain abuses.
- (e) *Investment Advisers Act of 1940*, which requires registration with the S.E.C. of investment advisers and provides certain safeguards against abuses in the conduct of their business.
- (f) *Public Utility Holding Company Act of 1935*, which regulates registered public utility holding companies and their subsidiaries.
- (g) *Chapter X of the Bankruptcy Act*, which gives to the S.E.C. a function as impartial representative of investors and as expert adviser to the Federal district courts in judicial reorganisation proceedings.

Set forth in Annex A are summaries of the Acts administered by the Securities and Exchange Commission and the Commission's function under each such Act, all as described in the Annual Report of the Commission for the year ended 30th June, 1960.

It is probably unnecessary to point out that, while we have a reasonable familiarity with securities legislation and regulation in the United States as it affects the conduct of the investment banking business of our firm, it is outside our province to give an opinion as to what features of American law and practice are appropriate or suited to British law and practice. We have, therefore, confined our remarks to comments on how the United States legislation and regulation have worked in practice with the thought that this approach might be of some help to the Committee in determining which features, if any, might be suited to British requirements.

Specific Questions contained in the Letter from the Secretary of the Committee dated 19th July, 1960

- (a) *The organisation and functions of the Securities and Exchange Commission: in particular, whether its status and powers have proved satisfactory.*

We understand that among those scheduled to testify before this Committee is an official of the Securities and Exchange Commission who is better qualified than we to describe the internal organisation of the S.E.C. and to enumerate its functions. We think we can be helpful, however, in expressing our views as to the manner in which the S.E.C. has performed its functions.

The administration of the S.E.C. has on the whole been substantially above the standard of the other United States regulatory commissions, which have come under increasingly sharp criticism by the Hoover Commission, by Committees of Congress, and by the more recent report by James M. Landis to President John F. Kennedy (an excerpt from which is attached as Annex B) which calls attention to some of the weaknesses of the various commissions and of their administration.

Few members of the investment banking profession would argue that we should do away with the Securities and Exchange Commission. In fact our firm, as well as most in the profession, is a strong believer in disclosure of all relevant information relating to issues of securities and we feel that investors and issuers as well as the investment banking profession have benefited from the existence of the S.E.C. and, more particularly, from the securities acts which it administers. Passage and implementation

of the Securities Act of 1933 and the Securities and Exchange Act of 1934 did much to restore public confidence in the profession, in the securities it offers and in the nation's securities markets.

In this connection, it is worth noting that, while the Landis report is critical of several of the independent commissions, it is not particularly critical of the organisation and operation of the S.E.C. The Landis report's recommendations concerning the S.E.C. are directed principally towards easing registration requirements for high-grade securities, extending control over the activities of marginal brokers, dealers and investment advisers, and extending full disclosure requirements to certain over-the-counter securities.

One of the more difficult aspects of the relationship between the S.E.C. and issuers and investment bankers is caused by the troublesome delays experienced during recent years in obtaining clearance of registration statements filed with the S.E.C. The "normal" (and statutory) period between the filing of a registration statement and the "effective" date (after which sales are legally permissible) is 20 days to which must be added the length of time (often a month or more) required to prepare the registration statement and related documents for filing. Of the 1,275 registration statements that became effective during the year ended 30th June, 1960, the median registration statement took 43 days to be processed and become effective. This contrasts with 28 days for 925 registration statements in fiscal 1959. For the month of June 1960 the number of days required was 59 even though the S.E.C. (by amendment to the original Act) has been empowered to permit effectiveness of a registration statement in substantially less than 20 days. As a result, the capital-raising process has been hampered, particularly in the case of smaller companies. In fairness to the S.E.C. it must be noted that this delay is often a result of the burden placed on its staff by the submission of inadequately prepared registration statements by small companies going through the procedure for the first time using inexperienced lawyers and accountants. Large, top-quality companies which have securities listed on the New York Stock Exchange and which have had some experience with the registration procedure seldom encounter substantial delays as a result of shortcomings in their own registration statements. However, such companies do encounter delays as a result of the burden placed on the examining staff of the S.E.C. by the large volume of smaller companies' registration statements. In this connection, it should be noted that the total appropriation for the S.E.C. for fiscal 1961 was approximately \$9,500,000 with expected average employment of 1,041 as contrasted with \$8,100,000 and average employment of 954 in fiscal 1960 and with \$5,878,250 and average employment of 1,060 in fiscal 1950.

Of course, putting the interpretation and administration of a legislative act in the hands of an administrative agency and its staff is bound to lead to problems in certain areas. One of the most vexatious areas is that of unilateral interpretations of the intent of Congress by the S.E.C. with resulting rules (or unwritten procedural requirements) and administrative decisions which in the opinion of many were not originally encompassed by the Act. An example is the Note to Rule 460 under the Securities Act of 1933. This Note denies acceleration of the effective date of the registration statement (a prerequisite to a public offering in the United States) to a company which fails or refuses to undertake to submit to a Court the question of whether or not indemnification by it of its officers and directors against successful claims against them based on the Securities Act is against public policy. Denial of such indemnity often is in direct contravention of provisions of the company's own by-laws and may well be in conflict with provisions for such indemnification in the laws of the state in which the company is incorporated. Along somewhat similar lines, the S.E.C. has been rather arbitrary, in the view of issuers and underwriters, in its attitude toward factual publicity concerning an issue prior to actual registration of that issue. The S.E.C. claims that any such pre-filing publicity is really part of the selling effort which may only be done by means of a prospectus even though such publicity may in the opinion of many, be required by stock exchange requirement or the issuer's judgment as to its obligations to its stockholders and the public.

There is general agreement in the investment banking profession that the burden on the S.E.C., as well as on issuers, their lawyers, accountants and underwriters would be substantially lightened if companies which have outstanding securities listed on a national securities exchange such as the New York Stock Exchange were allowed to use an abbreviated, simplified form of registration statement (certain such companies which meet prescribed earnings tests are even now permitted to use a shortened form (Form S.9) for debt issues). These companies are bound by law and by stock exchange rule and agreement to make reasonably complete and periodic reports which are available to the public and are regularly published. The New York Stock Exchange requires that companies having securities listed with it solicit proxies. The resulting proxy statements, as well as annual reports to stockholders, insider trading reports and periodic financial reports to the Exchange and the S.E.C. all combine to make detailed information on such a company's operations available to the public and, more particularly, to that company's shareholders. Under these circumstances it seems unnecessary to require such a company to repeat much of the same information in a registration statement and prospectus. When the expense and time required to produce a full registration statement in these cases is weighed against the negligible amount of additional protection afforded to the investor, the simplified form is seen to have important advantages. An ancillary benefit resulting from the use of a simplified registration statement is the wider distribution such a document can be given and its greater utility to investors. Furthermore, more companies which now hesitate to spend the time and incur the expense necessary to prepare a full registration statement would turn from private placements of their debt securities with a few large institutions to public offerings which would be available to the general public including institutions of all sizes.

In this connection it is interesting to note that nine years ago at a hearing before a subcommittee of the House of Representatives, C. Keith Funston, the President of the New York Stock Exchange, advocated amending the Securities Act of 1933 to exempt from the registration requirements of that Act all securities already registered under the Securities Exchange Act of 1934 and admitted to dealings for more than three years on a national securities exchange. An excerpt from Mr. Funston's statement is included in Annex C.

Finally, there may be considerable merit in asserting that public utility companies which have securities listed on a national securities exchange should be exempted from the registration provisions of the Securities Act of 1933. Such companies are regulated by both Federal and State agencies and it is difficult to see why they must also comply with the registration provisions of the Securities Act of 1933.

In the case of companies that qualify for registration under the simplified procedure described above, we believe that the formal review of the registration statement by the S.E.C. might be eliminated entirely, thus freeing the staff to devote a larger proportion of its time to more speculative offerings in which the risks to investors are much greater.

We also believe that the full 20-day statutory waiting period (between the filing of the registration statement and its effective date) is unnecessary in the case of companies which qualify for the simplified registration procedure. Surely in the case of a rights offering by such a company its shareholders do not need 20 days superimposed on a two to four week subscription period to study the information necessary for a considered investment decision. In fact, particularly in cases where a warning letter is circulated some weeks in advance, we see no real justification for more than a short waiting period in connection with securities being offered initially to such a company's own shareholders and no justification for more than ten days to two weeks in cases where the securities of such a company are being offered to the general public.

Any discussion of waiting periods brings up the question of the administrative advantage the S.E.C. holds, under the present system of review of all registration statements, over companies registering issues of securities under the Securities Act of 1933. If a company and those working on an issue for that company fail to agree with the interpretation the S.E.C. makes of the law or its own rules of procedure

with respect to such an issue, as a practical matter they must submit to the S.E.C.'s interpretation because the alternative would result in an extended delay in the offering date which might well mean missing an advantageous market for the company's securities.

(b) The conditions in which it was originally decided to introduce a public supervisory body with far reaching powers and responsibilities in this field: and the extent to which any of the Commission's existing powers and responsibilities might today be discharged effectively by private organisations, e.g., the Stock Exchange and the National Association of Security Dealers.

It might be worthwhile to recall that the United States securities legislation of the 1930-1940 period, while prompted in part by the collapse of stock market values of stocks and bonds, represented to a large extent a delayed reaction to various abuses and malpractices in all types of finance including local real estate investments and securities of small companies as well as securities traded on stock exchanges and in certain elements of the securities business. Prior to 1933 corrective legislation was in the form of state "Blue Sky" laws, which were generally ineffective because of the interstate nature of the securities business, or legislation directed at abuses in specific public utility industries.

The years 1933-1935 produced a complex of federal securities legislation having more general application, including the Securities Act of 1933, the Banking Act of 1933 and the Securities Exchange Act of 1934, as well as the Public Utility Holding Company Act of 1935, aimed at specific aspects of a particular industry. These laws were followed by the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940 and Section X of the Bankruptcy Act.

The abuses which the legislation of the 1930's was designed to correct have been detailed many times in Congressional hearings. In the case of the 1933 Act, for example, the abuses included the dissemination of misleading or inadequate information about new issues of securities, high-pressure salesmanship, artificial market support without public disclosure, generation of new issues to feed the public appetite for securities rather than to meet a genuine corporate need for funds and an abdication of legal and moral responsibility on the part of a relatively small segment of the securities business.

The Securities Exchange Act of 1934 was the result of a variety of malpractices, including a number of devices to stimulate the public's speculative fever. There was excessive use of credit for security speculation; markets in certain securities were manipulated by the use of pools and other deceptive mechanisms and high-pressure sales efforts were exerted through customers' men.

The Public Utility Holding Company Act of 1935 was designed to combat abuses on the part of utility holding companies. These included issuance of securities against unsound values, heavily leveraged capital structures, and control of subsidiaries through disproportionately small investment.

No sensible person would argue that securities legislation conceived under, and presumably appropriate to, conditions as they existed in the United States would also be a suitable model to follow in another country under quite a different set of circumstances a quarter of a century later. Furthermore, certain portions of the legislation that was passed in the United States had to do with correcting situations that no longer exist and their retention as part of the law is of doubtful value when it is highly unlikely that the conditions which brought on the legislation will ever reappear.

Some of the S.E.C.'s powers and responsibilities are now discharged effectively by the various national stock exchanges and by the National Association of Securities Dealers. The financial responsibility requirements of Rule X-15C3-1 under the Securities Exchange Act of 1934 which imposes minimum capital limitations on brokers and dealers are included in more rigorous form in the rules of the New York Stock Exchange governing members of that Exchange.

We do not believe that there is in existence in the United States any "private organisation", such as the New York Stock Exchange, the National Association of Securities Dealers or the Investment Bankers Association, with a sufficiently broad purpose, membership and authority to take over the S.E.C.'s more important duties, such as the examination of registration statements.

(c) *The practical value of the various legal safeguards for investors which exist in the United States but, as Professor Gower's memorandum indicates, not in Great Britain.*

As outlined in Professor Gower's Note, there are various types of legal safeguards in the United States which are not provided to British investors or which are more extensive than those provided in British law. These include the more detailed disclosure requirements of the Securities Act of 1933, the waiting period and the S.E.C. review; the civil liability provisions in both the Securities Act of 1933 and the Securities Exchange Act of 1934; the proxy requirements; the control over professional dealers in securities and investment advisers; the controls to insure the independence of accountants and trustees; the reporting requirements of listed companies and companies which have registered under the Securities Act of 1933; accounting requirements; and the regulation of investment companies.

While no one will contend that a complete prospectus is read by every individual investor before he agrees to commit his funds to the purchase of the securities being offered by such a prospectus, nevertheless, institutional investors and banks and others advising individual investors do read prospectuses and, indeed, have come to rely on such documents as a source of information which would be more difficult or impossible to derive from other sources. Unfortunately, while the greatest part of securities offered by prospectuses are sold either directly to institutional investors or to others with the benefit of informed advice, the unsophisticated, uninformed individual who is either unwilling or unable to read and comprehend a prospectus is most apt to be the target for unscrupulous promoters of speculative securities. It is difficult to see how any full disclosure requirement, no matter how comprehensive, can protect the unwary individual who does not read the document. One important benefit of the full disclosure approach that should be considered, however, is the deterrent effect it has on arrangements or practices that could not stand public scrutiny. It should also be noted that the investor can assert a claim under the civil liabilities provisions of the Securities Act of 1933 even though he cannot prove reliance on the offering document.

The provision for a 20-day waiting period, during which the S.E.C. reviews the registration statement, affords additional safeguards to investors particularly in the case of speculative securities. The 20-day period appears to be excessive in many cases, but the principle of providing some interval prior to the offering for the widespread dissemination of information is sound. As in the case of the disclosure requirements, the statutory provision for review by the S.E.C. undoubtedly discourages many fraudulent schemes from being attempted. Although the registration provisions of the Securities Acts of 1933 are primarily designed only to insure appropriate disclosure, it is apparent that in the case of some speculative issues the S.E.C. review from the disclosure standpoint may be tantamount to an examination of investment merit.

Although the subject is alluded to only briefly in Professor Gower's Note in connection with anti-fraud provisions in the Securities Exchange Act of 1934, it is important to note that there are civil liability provisions in sections 11, 12 and 15 of the Securities Act of 1933 and in sections 18 and 20 of the Securities Exchange Act of 1934. Some of these are apparently not provided to the same extent in British law. The practical value of these provisions has been that they have made officers, directors, underwriters and experts extremely careful in the preparation of registration statements and have helped to curb the exuberance of securities salesmen. The civil liability provisions of the Securities Exchange Act of 1934 appear to have been active deterrents to insiders taking advantage of information available to them to the detriment of other shareholders.

The law contains various other provisions designed to prevent manipulative practices in the securities markets through continuous surveillance of market activities by the S.E.C. which investigates unusual fluctuations in price or volume and regulates stabilisation activities and short selling. The S.E.C. also enforces regulations adopted by the Board of Governors of the Federal Reserve System relating to margins. Under section 10 (b) of the Securities Exchange Act of 1934, the S.E.C. has adopted Rule X—10B—5, a rigorous general anti-fraud provision relating to manipulative and deceptive devices and practices in connection with the purchase or sale of securities. These activities have had a salutary effect in helping to discourage improper market and sales activities.

Section 14 (a) of the Securities Exchange Act of 1934 and the rules adopted thereunder relating to proxy solicitation comprise another important safeguard. A basic purpose of these rules is to require accurate and adequate disclosure of information to each person being solicited in order to enable him to vote intelligently on matters to be brought before a meeting of stockholders. As in the case of the disclosure requirements of the Securities Act of 1933, these rules have provided useful data to investors.

As Professor Gower's Note indicates, the degree of control over professional security dealers provided in the Securities Exchange Act of 1934 is considerably greater than that provided in British law. In our opinion, the registration requirements for stock exchanges and the S.E.C.'s supervision of stock exchange operations have helped to restore public confidence in this vital segment of the securities business. Similarly, the self-regulation of over-the-counter broker-dealers exercised by the National Association of Securities Dealers, under the supervision of the S.E.C., has helped to raise industry standards of conduct and improve its standing with the investing public. Dealers not members of the N.A.S.D. are regulated directly by the S.E.C.

Another area in which United States law and practice appear to provide legal safeguards more extensive than in Britain is in the volume and content of annual and periodic reports required to be filed by many companies with the S.E.C., the New York Stock Exchange, and the other national stock exchanges. The practical value of these requirements is that they provide a library of financial information which is available to the public both directly and through the financial reporting agencies.

Professor Gower's Note

Professor Gower's Note is devoted primarily to matters of law and we have reviewed the Memorandum for the Company Law Committee of the Board of Trade that has been submitted to your Committee by Davis Polk Wardwell Sunderland & Kiendl.* In general, in areas within our province, we concur in the expressions of opinion and the conclusions reached by Davis Polk. We would like to make a few observations from a business point of view about certain of Professor Gower's comments.

Company Law

(c) *Purchase of Own Shares*

In addition to the advantages listed in the Davis Polk memorandum we would like to point out that a company and its shareholders can often benefit if the company is permitted to deal in its own shares at least to the extent necessary to take care of fractional shares arising from stock dividends or rights offerings. Also, very often a preferred stock issue can be sold at a somewhat lower dividend cost if a sinking fund is provided.

(d) *No par shares*

From the business point of view we know of no argument that would support the view that no par shares should be compulsory rather than optional. On the contrary,

* Appendix XL.

in the case of preferred stock, a specific par value can be most useful in making clear that stock's prior claim. Perhaps it should be mentioned that, contrary to the situation obtaining when this question was considered by the Gedge Committee, there is no longer a transfer tax penalty which for a time made no par shares less attractive in the United States than shares of a low par value.

(e) Non-voting Shares

While we agree that there may be circumstances where non-voting shares might be desirable (such as in the case of closely-held non-public companies) we believe strongly that all common shares of a publicly-held domestic company should have the same voting privileges.

(g) Cumulative voting for directors

We are most strongly of the opinion that cumulative voting for directors should not be made compulsory on grounds similar to those put forth by Davis Polk. Directors should represent all shareholders and should not be put in the position of being divided into factions by feelings of responsibility to the particular groups which elected them.

(h) Quorums at annual meetings

We suspect that, because of the international character of the London securities market, there may be a larger percentage of foreign ownership of shares of British companies than of shares of American companies. In the case of a company with a substantial percentage of its shares held abroad, a large quorum requirement might be difficult to attain.

(j) Pre-emptive rights

We believe that, with suitable exceptions for employee stock purchase and stock option plans, offerings for cash of common stock or securities convertible into common stock, absent controlling reasons to the contrary, should be made to existing shareholders. With this in mind as a general principle we feel that company law should be sufficiently flexible so that neither the granting nor the denying of pre-emptive rights is fixed without possibility of change by stockholder action.

MORGAN STANLEY & CO.

2nd February, 1961.

ANNEX A

Excerpts from the 26th Annual Report of the Securities and Exchange Commission

The Securities Act of 1933

"The Securities Act of 1933 is primarily a disclosure statute designed to provide investors with material facts concerning securities publicly offered for sale by use of the mails or instrumentalities of interstate commerce, and to prevent misrepresentation, deceit or other fraudulent practices in the sale of securities. The issuer of such securities is required to file with the Commission a registration statement and related prospectus containing significant information about the issuer and the offering. These documents are available for public inspection as soon as they are filed. The registration statement must become "effective" before the securities may be sold to the public. In addition, the prospectus must be furnished to the purchaser at or before the making of any written offering or before the sale or delivery of the security. The registrant and the underwriter are responsible for the contents of the registration statement. The Commission has no authority to control the nature or quality of a security to be offered for public sale or to pass upon its merits or the terms of its distribution. Its action in permitting a registration statement to become effective does not constitute approval

of the securities, and any representation to a prospective purchaser of securities to the contrary is made unlawful by section 23 of the Act."

The Securities Exchange Act of 1934

"The Securities Exchange Act of 1934 provides for the registration and regulation of securities exchanges, and the registration of securities listed on such exchanges and it establishes, for issuers of securities so registered, financial and other reporting requirements, regulation of proxy solicitations and requirements with respect to trading by directors, officers and principal security holders. The Act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter market, contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets and authorises the Federal Reserve Board to regulate the use of credit in securities transactions. The purpose of these statutory requirements is to ensure the maintenance of fair and honest markets in securities."

The Public Utility Holding Company Act of 1935

"Under the Public Utility Holding Company Act of 1935 the Commission is charged with the regulation of interstate public-utility holding company systems engaged in the electric utility business or in the retail distribution of gas. The Commission's jurisdiction extends to natural gas pipeline companies and other non-utility companies which are subsidiaries of registered holding companies. Although the matters dealt with embrace a variety of intricate and complex questions of law and fact, there are three principal areas of regulation. The first of such areas covers those provisions of the Act contained principally in section 11 (b), which require the physical integration of public-utility companies and functionally related properties of holding company systems and the simplification of inter-corporate relationships and financial structures of holding company systems. The second area of regulation covers the financing operations of registered holding companies and their subsidiaries, the acquisition and disposition of securities and properties, and certain accounting practices, servicing arrangements and intercompany transactions. The third area of regulation includes the exemptive provisions of the Act, the provisions covering the status under the Act of persons and companies, and those regulating the right of a person affiliated with a public-utility company to acquire securities resulting in a second such affiliation. Matters embraced within this area of regulation require periodic examination by the Commission and its staff. Many such examinations do not result in formal proceedings and others are reflected in such proceedings only in an indirect manner when they are related to issues principally under one or the other areas of regulation."

Participation of The Commission in Corporate Reorganisations under Chapter X of the Bankruptcy Act, as amended

"The role of the Commission under Chapter X of the Bankruptcy Act, which provides a procedure for reorganising corporations in the United States District Courts, differs from that under the various other statutes which it administers in that the Commission does not initiate Chapter X proceedings or hold its own hearings. It has no authority to determine any of the issues in these proceedings. However, at the request of the judge or on the Commission's own motion, if approved by the judge, the Commission may participate in such proceedings in order to provide independent, expert assistance to the court, the participants, and investors on matters arising in such proceedings and, where the Commission considers such action appropriate, it may file advisory reports on reorganisation plans. Thus, the facilities of the Commission's technical staff and its disinterested recommendations are placed at the service of the judge and the parties, affording them the views of impartial experts in a highly complex area of corporate law and finance. The Commission pays special attention to the interests of public security holders, who may not otherwise be effectively represented."

"In any case where the scheduled indebtedness of a debtor corporation does not exceed \$3 million, the judge under section 172 of Chapter X may, before approving any plan of reorganisation, submit it to the Commission for its examination and report. If the indebtedness exceeds \$3 million, the judge must submit the plan to the Commission before he may approve it. Where the Commission files a report, copies of it, or a summary thereof, must be sent to all security holders and creditors when they are asked to vote on the plan. The Commission has no authority to veto or require the adoption of a plan of reorganisation and is not obligated to file a formal advisory report on a plan."

The Trust Indenture Act of 1939

"The Trust Indenture Act of 1939 requires that bonds, notes, debentures and similar securities publicly offered for sale, except as specifically exempted by the Act, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission. The Act requires that indentures to be qualified include specified provisions which provide means by which the rights of holders of securities issued under such indentures may be protected and enforced. These provisions relate to designated standards of eligibility and qualification of the corporate trustee to provide reasonable financial responsibility and to minimise conflicting interests. The Act outlaws exculpatory provisions formerly used to eliminate all liability of the indenture trustee and imposes on the trustee, after default, the duty to use the same degree of care and skill 'in the exercise of the rights and powers invested in it by the indenture' as a prudent man would use in the conduct of his own affairs.

"The provisions of the Trust Indenture Act are closely integrated with the requirements of the Securities Act. Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become effective unless the indenture conforms to the requirements of the latter Act, and necessary information as to the trustee and the indenture must be contained in the registration statement. In the case of securities issued in exchange for other securities of the same issuer and securities issued under a plan approved by a court or other proper authority which, although exempted from the registration requirements of the Securities Act, are not exempted from the requirements of the Trust Indenture Act, the obligor must file an application for the qualification of the indenture, including a statement of the required information concerning the eligibility and qualification of the trustee."

The Investment Company Act of 1940

"The Investment Company Act of 1940 provides for the registration and regulation of companies engaged primarily in the business of investing, reinvesting, holding and trading in securities. The Act requires, among other things, disclosure of the finances and investment policies of these companies, prohibits such companies from changing the nature of their business or certain of their investment policies without the approval of their stockholders, regulates the means of custody of the companies' securities, prohibits underwriters, investment bankers and brokers from constituting more than a minority of the directors of such companies, requires new management contracts to be submitted to security holders for their approval, prohibits transactions between such companies and their officers, directors and affiliates except with the approval of the Commission and regulates the issuance of senior securities. The Act requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon their certificates.

"The securities of investment companies which are offered to the public are also required to be registered under the Securities Act, and the companies must file periodic reports. Such companies are also subject to the Commission's 'proxy rules' and closed-end companies are subject to 'insider' trading rules. The Division of Corporation Finance and the Division of Corporate Regulation both assist the Commission in the administration of the statute, the former being concerned with the disclosure provisions and the latter with the regulatory provisions."

The Investment Advisers Act of 1940

"The Investment Advisers Act of 1940 requires the registration of persons who are engaged for compensation in the business of advising others with respect to securities. There are, however, certain limited exemptions from the requirement of registration.

"One type of exemption applies to persons in certain occupations when their advice regarding securities is merely an incidental part of the performance of their normal business or profession. These include broker-dealers when they are not separately compensated for the investment advisory aspects of their work, lawyers, accountants, engineers and teachers. Magazines and financial publications of general and regular circulation are similarly exempt.

"Certain of the exemptions contained in the Act depend for their applicability on the type of clientele of the adviser. One who advises only investment or insurance companies need not register. An exemption is also afforded the adviser who in the last 12 months had fewer than 15 clients and does not hold himself out generally to the public as an investment adviser.

"Furthermore, the registration requirement does not apply to one whose investment advice extends only to persons resident in the state in which the adviser maintains his principal place of business as long as the advice proffered does not concern securities listed on a national securities exchange or admitted to unlisted trading privileges on such an exchange.

"The Act makes it unlawful for registered investment advisers to engage in practices which constitute fraud or deceit upon clients. If an adviser is also a broker or dealer, he must disclose his interest in any transaction in which he acts as an investment adviser. The Act also prohibits an investment adviser from basing his compensation upon a share of the capital gains realised or the capital appreciation of his client's funds. Furthermore, a client's consent is required before an assignment of his investment advisory contract can be effected.

"The Act does not grant the Commission power to inspect the books and records of a registered investment adviser, but proceedings by the Commission to revoke or deny the registration of an investment adviser may be instituted under specific circumstances. The filing of a false application for registration constitutes sufficient grounds for administrative proceedings on the question of whether registration should be denied or revoked. Other than this, action by the Commission must be preceded by either an injunction against the adviser by a court of competent jurisdiction from activities in connection with his conduct as an investment adviser or certain other activities or the conviction of the adviser within the previous ten years of a crime involving securities, the securities business, or certain related activities."*

* A footnote to this paragraph refers to the following excerpt from Part I of the Report:

Investment Advisers

"The enactment subsequent to the close of the fiscal year of substantial amendments to the Investment Advisers Act of 1940 vested in the Commission additional responsibilities which will require the devotion of considerable time and energy by the Commission and its staff in the development of revised forms for registration and reporting, special rules as to record-keeping by investment advisers, rules specifically designed to obviate to the extent possible fraudulent practices in this heretofore largely unregulated field, and new procedures for the periodic inspection of the affairs and operations of all registered investment advisers."

ANNEX B

The following excerpt is taken from the Report on Regulatory Agencies to the President-Elect by James M. Landis, December, 1960

3. The Securities and Exchange Commission

"The problems of the Securities and Exchange Commission are relatively simple. Much of the delays that characterise its operation stem from the fact that it, more than

any other agency, has been starved for appropriations. Even the recent increases have not restored the amounts formerly available. What has been responsible for this attitude other than pure ignorance as to the significance of its functions is difficult to fathom. But more than increasing its appropriations is necessary.

"Much of the delay that attends the registration of securities could be eliminated by providing for simpler forms of registration and a simplified supervision of the process of registration with respect to seasoned securities, bonds and debentures with an A or B rating and preferred stocks that for a past period have shown an appropriate ratio of earnings to dividends payable on such stocks. In the case of seasoned securities of this nature, the issuer and underwriter should be relied on to furnish full and accurate statements of fact and deficiency letters could be substantially abolished. It could also relieve from registration requirements certain admittedly technical public offerings for which registration is now technically necessary. The necessity for maintaining a currently effective registration statement on convertible securities, options and warrants, when an adequate market exists for the basic securities and adequate information is available in annual financial reports or proxy statements, is an example of a situation where registration is unnecessary. The issuance of restricted options to groups of employees not too excessive in number is another such example. More of them can be found. Relieving the Commission and the industry of the necessity for acting on registration statements in such situations would clear the Commission's docket to some degree and relieve the industry of unnecessary costs.

"The deficiency letter, a most valuable extra-legal development, has a real place with regard to the more promotional and speculative securities. There has grown up over the years a considerable tendency to indulge in lint-picking in these letters, resulting in delays and unnecessary costs. Another tendency has become noticeable due to the attitude of certain Commissioners shortly following World War II. This is to move away from the legislative standards of full disclosure to a judgment on the quality of the securities being registered. The history of state security regulation in this respect gives ample evidence of the undesirability of establishing a bureaucracy with powers of this nature. True, there is every temptation to move in this direction as one views as a whole the rapacity of promoters and underwriters and the unwillingness of a greedy and speculative public to try to understand the simplest facts of corporate finance. But control and supervision over the activities of the selling group and the marginal fringe of brokers and dealers making markets in these issues, can do more to dampen this type of financial piracy than the use of the registration powers for purposes for which it was not intended.

"Similarly controls should be extended more widely as against so-called investment advisers, many of whom have morals not exceeding those of tipsters at the race track. Even our conservative newspapers carry horrendous advertisements as to the prowess of particular advisers and the aura that these advisers have engendered has led to imitation of their tactics by large and respectable brokerage houses. Here is a field that the Securities and Exchange Commission is beginning to plough and money made available for such a purpose will pay ample dividends in turning savings away from rank speculation to reasonable investment.

"One serious feature of delay on the part of the Securities and Exchange Commission lies in the issuance of regulations and forms. Important regulations have been delayed for years. Some reason for this delay lies in the inherent complexities of the problems and the commendable practice of the Securities and Exchange Commission, so different from that of the Federal Aviation Agency, of affording opportunities to the industry to comment on proposed regulations. But an element of delay arises from the incapacity of the Commissioners themselves to grasp the essence of these problems and the significance of their resolution to the financial community. Because of the excellence of its staff and the inherent complexities of the problems, the Commission in a sense is the captive of its staff. It appears to be incapable at times of resolving differences within the staff and the resultant inaction makes for delay. The recent confirmed appointment of a career employee as a

Commissioner may provide some remedy for this situation. But it points up the absolute necessity for having qualified individuals as members of the Commission.

"Rapidity of decision in many matters is more important in the Securities and Exchange Commission than in most of the other regulatory agencies. The failure to get a decision or delay in making a decision is in itself defeat in many cases. Delegation thus becomes essential. Too little of this characterises the work of the Commission and, when it does exist, the line of delegation is not clear. Decisions, important decisions, are made by subordinates at fairly low levels and, because of time pressures of such importance to the business of financing, their decisions have to be accepted. On the other hand, in such simple matters as the acceleration of the effective date of registration statements, decision is not delegated and unnecessary time is consumed by the Commission in dealing with a problem that in nine out of ten cases is simple of solution.

"The Securities and Exchange Commission has an opinion writing section whose quality is high, if not the highest among the agencies. Nevertheless, it should be abolished and individual Commissioners held individually responsible for the enunciation of the grounds upon which conclusions of the Commission are stated to rest. If the numerous speeches and articles of the various Commissioners are a test of their capacity for articulation, this should not be an impossible task.

"The extension of the Commission's power of forcing appropriate disclosures with respect to securities in the over-the-counter market—an extension long urged by the Commission—is a matter for legislative action. As an ideal it has basic merit, particularly with respect to categories of securities, such as bank and insurance stocks, which have traditionally refrained from listing on the stock exchanges. As a practical matter, certain restraining lines have to be drawn, perhaps tighter than those presently suggested by the Commission.

"From the standpoint of the formal Presidential action needed with respect to the Securities and Exchange Commission, the only thing required is further strengthening the powers granted to the Chairman in 1950 to the full extent heretofore suggested for the Interstate Commerce Commission and the implementation of its powers to delegate adjudicatory matters to hearing examiners and employees."

ANNEX C

Extract from statement of C. Keith Funston, President, New York Stock Exchange, New York, N.Y., at hearings before a subcommittee of the committee on Interstate and Foreign Commerce, House of Representatives Eighty-Second Congress, Second Session on Powers, Duties and Functions of Securities and Exchange Commission.

PART I

24th March, 1952

I. Proposed Amendments Affecting the Registration of Securities and the Prospectus Requirements of the 1933 Act.

"1. The Securities Act of 1933 should be amended to exempt from registration under the Securities Act of 1933 all securities which have been registered under the Securities Exchange Act of 1934 and admitted to dealings for more than three years on a registered national securities exchange and exempt additional issues of such securities.

"This proposal would exempt from the registration requirements of the Securities Act of 1933, securities registered under the Securities Exchange Act of 1934, and admitted to dealings on a registered national securities exchange for more than three years, and would permit the issuer to offer additional amounts of such securities without registration under the Securities Act of 1933.

"One of the stated purposes of the 1933 Act is to provide full and fair disclosure of the character of the securities sold through interstate commerce and through

the mails. When this act was passed there was no Federal law compelling the disclosure of essential facts concerning securities traded on our national securities exchanges. The question of disclosure was left to the several exchanges. While the New York Stock Exchange had for many years prior to the passage of the Securities Act of 1933, been a leader in requiring companies whose securities were listed on the exchange to make public more and more information about the companies and their operations, the requirements of some of the other exchanges were much less exacting.

" Since the passage of the Securities Exchange Act of 1934, a security cannot be listed on a national securities exchange unless the security is registered with the Securities and Exchange Commission under the 1934 Act. Section 12 (b) (1) of the act requires the public filing of the following information by the issuer of the securities:

- (a) The organisation, financial structure, and nature of the business;
- (b) The terms, position, rights, and privileges of the different classes of securities outstanding;
- (c) The terms on which their securities are to be, and during the preceding three years have been, offered to the public or otherwise;
- (d) The directors, officers, and underwriters, and each security holder of record holding more than 10 per cent. of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;
- (e) Remuneration to other than directors and officers exceeding \$20,000 per annum;
- (f) Bonus and profit-sharing arrangements;
- (g) Management and service contracts;
- (h) Options existing or to be created in respect of their securities;
- (i) Balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants;
- (j) Profit and loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants; and
- (k) Any further financial statements which the Commission may deem necessary or appropriate for the protection of investors.

" Section 12 (b) (2) of the 1934 Act requires the filing of:

such copies of articles of incorporation, by-laws, trust indentures, or corresponding documents by whatever name known, underwriting arrangements, and other similar documents of, and voting trust agreements with respect to, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer as the Commission may require as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.

" Section 13 of the 1934 Act, and the rules and regulations of the Commission issued thereunder, require companies having securities listed on the exchange to file annual and interim financial reports and other interim reports necessary to keep the information contained in the registration statement up to date. The purpose of the disclosure requirements of the 1933 Act is to make available information from which a prospective investor can reach an intelligent decision as to whether or not to purchase the security at the price at which it is offered. Prices of securities traded on an exchange are widely publicised and reflect the opinion of buyers and sellers throughout the country. It seems to us that prices so established in an auction market on the basis of information filed and kept current under the 1934 Act are far more helpful to the public investor than is his own opinion of value based on his analysis of the information

contained in a 1933 Act prospectus. Full information concerning the additional issue will be filed with the Securities and Exchange Commission in the application for registration of these shares under the 1934 Act and this information is available to the public. The present costly—both to the issuer and the Government—duplication of registration on additional issues of listed securities is unnecessary. The penalties of sections 12 (2) and 17 of the Securities Act will be applicable to any sales literature used in connection with the distribution of the additional shares.

"This proposed amendment would, we believe, greatly facilitate the raising of capital by established companies by reducing costly delays and duplication, and would not lessen essential protection to the public."

Section 12 (2) and Section 17 of the Securities Act of 1933 are as follows:

Section 12 (2) of the Securities Act of 1933

"Section 12. Any person who:

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 17 of the Securities Act of 1933

FRAUDULENT INTERSTATE TRANSACTIONS

"Section 17 (a). It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly:

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section."

APPENDIX XLII

Memorandum by Mr. C. D. McDaniel

The Securities and Exchange Commission in the U.S.A.

I have read the memorandum on "Corporate Law and Practice in the U.S.A."* that was submitted to the Company Law Committee by Professor Gower. In my opinion this memorandum is an excellent summary of and commentary on the laws administered by the Securities and Exchange Commission in the United States.

In another country, in different times or under different conditions, a legislative body might not see fit to follow exactly the same course that has been followed in the States. To understand why the Congress of the United States thought these laws to be necessary and why it created a Federal Commission to administer them, it is helpful to consider the conditions that existed in the United States for a few years prior to that time.

As Professor Gower stated, this legislation followed the stock market decline of 1929-32. The crash in the market triggered the reaction which resulted in this legislation. The real causes lie in the conditions which had been brought about by the exercise of an excessive amount of human greed. These in turn had resulted in a lowering of ethical standards and an acceptance of questionable practices as normal business conduct.

For some years prior to the market crash there had been a period of more or less steady expansion of business. This had made its customary demands for additional capital. Many sound issues were sold during this period. Other issues of a much more speculative character were also sold to the public, without the public being informed as to the true nature of these securities. Particularly in the public utility field, many highly leveraged situations developed in the holding company systems.

There was no Federal legislation, nor does any yet exist, comparable to the Companies Act, so that there is no requirement for the annual audit of the accounts of every company.

The basic accounting by which corporate profits were determined left a great deal to be desired and the standards of disclosure in corporate reporting were not high. In attempts to maintain reported earnings and thus support the market price of outstanding securities so as to be able to sell additional issues, some managements were too optimistic in deferring charges to future periods.

In many of the holding company groups there was a rather general disregard for the rights of certain classes of security holders. There were many inter-group transactions which were entered into on bases that would not have been acceptable between independent parties. The disclosure of these conditions was practically non-existent and where any disclosure was made it was sometimes so incomplete as to be misleading. Such actions fed the flames of speculative excesses that were already present in the market.

When the market went down in 1929 it was not an adjustment of isolated overvalued securities of a few shaky companies. It was a major movement carrying down with it the securities of all companies regardless of the intrinsic worth of some of the individual enterprises. Many investors lost money and most of them felt that it could not possibly have been their own fault. Since the stock market crash occurred first and with so much publicity, it received more than its share of the blame for the business depression which followed.

As so often happens in times of economic disaster, the next national election brought another party into office. This party campaigned on promises, among

* Appendix XXXIX.

others, of correcting the abuses that had taken place in the financial community during the previous administration, and of preventing their recurrence. Once in office they attacked these problems with a crusader's zeal.

The individual states had had Blue Sky Laws before but these had not enforced a full disclosure of all relevant facts in connection with the sale of securities many of which subsequently became worthless with an attendant loss to investors. The New York Stock Exchange had been in existence for many years prior to this time but it had prevented neither the speculative excesses nor their unfortunate aftermath. There may be a serious question as to whether this is a proper function for an Exchange to perform, but because of some of the practices that had taken place the Exchange itself was somewhat in disrepute and there was a more or less general feeling that its operation had been conducted for the benefit of the members rather than as a free and open market for buyers and sellers.

It was against this background that Congress decided to centralise the function of screening new issues to require adequate disclosure of the terms of the issue and certain basic information on the issuing company and to place the administration of this function and the supervision of the exchanges in a Federal Commission.

In considering the course which comparable legislation might take in another country one should keep in mind the objectives as well as some of the differences that seem to exist in the conditions. It is difficult for me to imagine the functions now performed by the Securities and Exchange Commission (S.E.C.) being successfully administered in the United States by a private organisation. On the other hand, in a country where some of the underlying conditions did not exist or where it was thought to be unnecessary or undesirable to have these functions in the hands of a government body, it might be feasible to have the remaining functions lodged in some private organisation. Once again, I would like to point out that a large portion of the law administered by S.E.C. is composed of after the fact remedial legislation designed to correct excesses and abuses, that, if not universal, were all too frequent prior to the enactment of those laws. In its effort to correct for these things Congress may have gone further than was necessary or may have taken action which would not be required in another country.

I would not presume to suggest what should be done in this country but instead will set forth some of the reasons for placing and retaining these powers and responsibilities in a public body in the States.

An investigation of the practices indicated that many of the members of stock exchanges had participated in questionable procedures which, if not actually illegal, had not been for the benefit of their customers, particularly the small investor. The same was true of many over-the-counter brokers and dealers. It was the feeling of Congress that even though many individual firms conducted their business in a highly ethical manner the Stock Exchanges and dealer organisations had not demonstrated sufficient self-policing action on their members and that it would be in the public interest to subject the exchanges and their members to outside supervision.

As Professor Gower has pointed out there are many issues of securities in the States which are not listed on any exchange. While the trading in many of these issues may not be particularly active, the initial sales represent large amounts of capital and it was thought desirable for these, as well as those actively traded on exchanges, to be covered by the requirements of the Securities Act of 1933.

The disposition of and or realignment of ownership of electric and gas operating utilities that was contemplated by the Public Utility Holding Company Act of 1935 has been for all practical purposes accomplished. This law however does not prohibit holding companies. Basically it limits their holdings to one integrated system and subjects them and all of their subsidiaries to the jurisdiction of S.E.C. There are still very large operating utility companies owned by holding company systems. S.E.C. has regulatory jurisdiction over many of the transactions of these companies.

In addition to the requirements of the 1933 Act relating to the sales of securities, the 1935 Act requires the prior approval of S.E.C. of the nature, terms and amounts of securities to be issued by any company that is subject to the jurisdiction of that act.

Because rate regulation holds down the income of utility operating companies, very little growth can be financed from earnings. This means frequent public financing and S.E.C. is very vigilant to see that, in their opinion, the capital structures of these companies do not take a form that would encourage a repetition of past mistakes.

The problems arising from and work incident to the Holding Company Act may not be present in this country but the need for the co-ordination of the administration of this Act with the other functions performed by S.E.C. in the States is one reason for lodging these powers in a public body.

The amount of information and disclosures required upon the sale of securities is far greater in the States than is customary in this country at the present time. This is not just a large mass of information which finds its way into the files. S.E.C. makes a very thorough review and analysis of all parts of it. While the responsibility for disclosure and accuracy rests with the registrant on any issue, S.E.C. is extremely vigilant, and, in my opinion, does an excellent job of pointing out the places which might be considered misleading or where further disclosure would be desirable.

Assuming that the filing of the present amount of information is desirable and that it should be critically reviewed, any organisation undertaking the task would require a large number of highly qualified personnel. A private organisation could assemble and maintain such personnel, but would presumably be motivated by the same reason that keeps other private organisations going, i.e., profit. As Professor Gower has pointed out, S.E.C. is not self-supporting and with the vagaries that exist in governmental accounting may be even less so than appears on the surface.

If the powers and responsibilities are to be placed in a private organisation what should that organisation be? In the United States there are a number of stock exchanges as well as the National Association of Security Dealers. Would any one of these be willing to undertake the task for all and would the others be willing to submit to the jurisdiction of any one?

As far as the situation in the States is concerned I think there is a general recognition that the members of the Stock Exchanges make their living acting as brokers. If they are not trading for their own accounts, the determinant of profit is volume of business handled. It makes no difference whether the seller realises a profit or suffers a loss or whether the buyer gets a bargain or not the broker profits by the transaction. All other things being equal, the more securities available for trading the higher the trading volume is likely to be. The Securities and Exchange Commission was created to serve a watch dog function. It was the intention of Congress that S.E.C. would be an impartial referee over the issuance and trading in securities rather than to assign this task to one of the participants in the game.

The Securities and Exchange Commission has been performing its function for approximately 25 years. It would be impossible for it to operate for that length of time entirely free of complaints. The consensus of opinion in the States is that the Commission has done a very good job of administering the laws with which it has been charged.

In the administration of the Securities Act of 1933, S.E.C. has done an excellent job in bringing about truth in securities. The law gives S.E.C. the right to prescribe the type of information which must be filed and to require a full disclosure of the facts that it feels are relevant. The nature and extent of the prescribed information is much more extensive than it was previously customary to publish in the States or than is done currently in this country.

S.E.C. does not approve or disapprove any security issue. It is not an investment advisory service or even a security rating bureau. It does not make independent field investigations of underlying facts at the time of an issue. The approach consists

primarily of a review, analysis and cross check of the information furnished by the registrant. This review is extensive and thorough but even so S.E.C. does not in any way guarantee the accuracy or adequacy of any prospectus. The staff who make these reviews and analyses are experienced and in general extremely competent. Many of the changes that they suggest are merely the correction of items that were overlooked in the initial preparation of the documents. On important items they can be very persuasive in getting a prospectus amended to their satisfaction.

The issuance of new securities being an appeal to the capital market is a competitive venture. Companies seek to sell their securities when they can get the best price for them. This results in periods of peak activity for S.E.C. When at these times the staff of S.E.C. raise questions as to the disclosure in the text of a prospectus or in the accompanying financial statements, a company will often agree to a change merely in the interests of saving time even though they do not wholeheartedly agree that the change is necessary. On more important items they may attempt by further explanations to persuade the staff to withdraw their objections. Failing this they are entitled to a hearing before the Commission itself. The time allotted for these hearings is quite short and the procedures leave much to be desired. If the Commission upholds the position taken by the staff the company can amend the prospectus or S.E.C. will issue a "Stop" order. Such an order will of course not only cause the company to miss its market but would likely cast such a cloud upon the securities in question that any subsequent sale might be difficult. The company usually amend the prospectus and there is no public knowledge that S.E.C. has exerted its powers.

On the other hand, if a company realises in advance that it may have a problem upon its next attempt to sell securities, the staff of S.E.C. is generally very co-operative in meeting with the representatives of the company to try to work out a solution that will be acceptable to both. A high proportion of the problems arising in this manner have their origin in or relate to the accounting followed by the company. The staff of S.E.C. does not attempt to promulgate its own accounting principles but requires that the principles followed by a company have authoritative support. As a result, S.E.C. is sometimes slow to adopt new accounting ideas. S.E.C. strongly favours accounting text books for citations of authority and inasmuch as many of the problems which business faces currently have not yet been reduced to examples in text books it is difficult to win over the staff on some points. Logic by itself without precedents does not seem to be persuasive enough.

The Commission and its staff have been a powerful influence in improving the standards of accounting and reporting followed by companies coming under their jurisdiction. Even those who are sometimes critical recognise the contribution that has been made and are critical only because they feel still further progress could be accomplished.

The assistance which S.E.C. has given in the cause of better and more informative reporting to investors can be appreciated when it is contrasted with the record of another Federal Commission, the Interstate Commerce Commission.

At the time of S.E.C.'s creation the jurisdiction over security issues of railroad companies was left where previous legislation had lodged it, with the Interstate Commerce Commission. In contrast to the improvement in the reporting of companies subject to S.E.C.'s jurisdiction, the reporting of railroad companies, which was of questionable validity at the time has, if anything, deteriorated. The accounting and reporting followed by the railroads in the United States is so poor currently as to make their financial statements practically meaningless and even misleading when viewed by the same standards that S.E.C. insists be followed by companies subject to its jurisdiction.

The Public Utility Holding Company Act of 1935 places the regulation of companies subject to the Act in the hands of S.E.C. This in substance requires the advance approval of certain transactions rather than mere disclosure of them. Under such circumstances there is room for substantial differences of opinion and there is sometimes a feeling that S.E.C. is substituting its judgment for that of management without

having to face the consequences of the decision. Such a situation can occur under any type of regulation and while if the matter is of sufficient importance recourse can be had to the Courts, such a procedure is too expensive and time consuming to be followed unless the issue at stake is really vital.

In my opinion, the safeguards that have been effected by the laws which are administered by the Securities and Exchange Commission have done a great deal to protect the investor in the United States from the questionable practices of unscrupulous financial operators. They do not protect an investor from himself. I do not believe that you can legislate profitability into investing.

The laws in question require and their administration has enforced a disclosure of information such as was almost unheard of prior to their passage. The fact that this information is available does not of course mean that an investor will read and study it before he makes up his mind to buy. Even if he does read it, there is no assurance that he will properly evaluate it. The mere fact that the information must be presented to him, however, undoubtedly has prevented many questionable speculative issues from being offered in the first place, and has been a deterrent to overly optimistic appraisals of future operations of those that have been sold.

The amount of disclosure required in the financial statements both for an initial issue and also subsequent reporting, together with the review that these statements received from S.E.C. and the insistence of the Commission that the accounting principles followed by a company must have authoritative support or that statement would be considered misleading, has done a great deal to spotlight the questionable practices and to aid in their correction. This has resulted in improved reporting of income thus giving investors more reliable information upon which to base their investment decisions.

The rules relating to "Insider Trading" are generally considered to have eliminated a substantial amount of speculative trading together with the related adverse effect upon an orderly market. These transactions did not benefit the large number of small investors and frequently worked to their disadvantage.

In my opinion, the laws in question have in general given the investor in the United States much more protection than he was previously afforded; the Securities and Exchange Commission has done a creditable job of administering these laws; and, as a consequence this has encouraged the market for capital and has helped to improve the general level of ethics in finance and business.

London.

21st September, 1960.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee

FIFTEENTH DAY

Friday, 17th February, 1961

Present

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MRS. M. NAYLOR

MR. C. H. SCOTT

MR. R. SMITH (*Questions 5185 to 5436
only*)

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

THE LORD RITCHIE, MR. J. A. HUNTER, MR. R. C. QUIRK, MR. W. D. WALKER,
MR. C. D. MORLEY and MR. W. S. WAREHAM *called and examined*

5185. *Chairman*: I need hardly say that we are very much obliged to you for coming here this morning in full force, and we hope the activities of the Stock Exchange are not at a standstill! For the purposes of the record, may I just read out your names and who you are: Lord Ritchie, you are the Chairman of the Stock Exchange, and Mr. J. A. Hunter, Mr. R. C. Quirk and Mr. W. D. Walker are members of the Council of the Stock Exchange; then Mr. C. D. Morley is Secretary to the Council, and Mr. Wareham is Secretary to the Share and Loan Department?—*Lord Ritchie*: Yes, Sir, that is correct. I wonder if I might say one word in advance of your questions? First of all, Sir, you were good enough to say we have come in force—I was going to apologise for it, but we think there is good reason for quite a number of us coming. What I had in mind was that most of the questions dealing with company law and quotation procedure would probably be dealt with by Mr. Hunter and Mr. Quirk, who are the joint chairmen of the committee on quotations, and they have with them Mr. Wareham,

who is their chief executive and is Secretary of the Share and Loan Department. So far as I am concerned, I thought it would be proper that I should endeavour to answer questions on the special memorandum which we have put in with regard to item 18 (Control over the Business of Dealing in Securities), and of course on any other general matters. Mr. Walker is chairman of our committee which deals with our relationship with the Country Exchanges and all matters connected with the granting of licences by the Board of Trade. Finally we have Mr. Morley, who is chief executive of the Stock Exchange and who also will deal with any general questions, but perhaps in particular, Sir, with our relationship with the Board of Trade.

5186. Thank you. I do not propose to trouble you with the intricacies of the *ultra vires* rule, which has been exercising everyone on this Committee for some time, but I think we might conveniently begin with an allied topic which I think is of some public interest, and that is the position which now exists owing to the

very wide form of the objects clause and the very wide delegation of the company's powers to directors. I understand from your memorandum that you have no objection to wide objects clauses, indeed you favour them as giving companies opportunities to diversify their business as and when occasion requires?—*Mr. Hunter*: That is right, Sir.

5187. But that does carry with it, does it not, the corollary that the directors may in exercise of their delegated powers completely alter the character of a business, possibly without reference to shareholders: in fact I think more often than not, as memoranda and articles now stand, the directors could do it without referring to the shareholders at all? I gather your view to be that fundamental changes or sales of the entire undertaking and assets of a company should be submitted to the shareholders for approval before the directors embark on the transaction; is that your view?—Yes, Sir.

5188. Do you see any difficulty in deciding what is a fundamental change for that purpose?—Not really, Sir. It sounds very difficult, but in fact if a board of directors sat down and started thinking about it I do not think they would have any doubts as to whether a change was fundamental or not.

5189. Then you say I think "where there is disposal of the whole of the undertaking and assets"; of course, you might get disposal of substantially the whole, all but some part of less importance?—We would be against anything of that sort, Sir. We have been against it for some time. There was a condition some years ago when a considerable number of Malayan companies were winding up, and there were a lot of companies whose main business was being sold with a view to providing a shell; and that was largely stopped because we suspend quotation as soon as anything like that happens, and I think the fear of the Stock Exchange suspending the quotation of a company is a very big disincentive to a company to sell its assets without going to the shareholders first. It does remove from a company the value it might have in being able to go and do something else and still maintain its quotation. The directors know that if

they go and sell a large part of the business, and reduce the company largely to cash, the quotation will be suspended. It will not be reintroduced without going through the full prospectus issuing procedure, and therefore they will not do it lightly, I think, because the unquoted shares are of very little value.

5190. So one might put it that from the Stock Exchange point of view a fundamental change is one which radically alters the business and changes it to something different from the business on the strength of which the official quotation was granted?—Yes, Sir. I think I should go further than that. I think if you had a company like Guest Keen, where a minority of the business is now making steel, if the directors sold the steel-making part I think we would regard that as a fundamental change in the business. If there is a business which really depends in the opinion of the public on some main part, and the other parts which may be in the majority depend on this one, I think if they sold that one we would regard that as a fundamental change.

5191. And for this purpose as I understand it it matters not to you whether the fundamental change was quite regularly carried out according to the constitution of the company?—No, Sir, it does not matter to us at all.

5192. What you are concerned with is to see that a quotation has not been obtained on the strength of a business of one character, and then sought to be applied to a business of a different character?—I think I would go further than that. I think what we are interested in is that people who are using the Stock Exchange as a market—and we are fundamentally as an institution only a market, we are nothing more nor less—know what they are buying and selling. It is essential to a free market that information as to what somebody is buying and selling is readily available. If therefore a company sells its steelmaking interest, to take the example I have already instanced, until such time as it comes back to the public and says what it is going to do, we say there cannot be a free market.

5193. I appreciate that that would probably be a valuable protection to a

man who had not as yet invested in the company in question, but what of the existing shareholders in such a company?

—I think it is still a protection to them, because I think the sanction is a very severe one, and it is certainly our experience that the directors think two or three times before they do something of that sort.

5194. But the position is that if the sanction is laid on, an existing shareholder may not only be in rubber in the evening and in gold mines the next morning, but he may also be deprived of an opportunity of realising his shares on the Stock Exchange?—He could be, Sir, but there is no great advantage to the directors in doing that.

5195. But how about the man?—The man himself is deprived, I do not argue that point at all, but unless there is some advantage to the directors in doing this they will not embark on that adventure, I think.

5196. I can see that the situation within the company might very rapidly hot up. You might have a meeting which was better attended than any meeting of that company had been for years, and pressure would no doubt be put on the directors in that kind of way, but the existing shareholder, except insofar as he could get redress inside the company, must be prejudiced by the withdrawal of the official quotation?—Yes, Sir, I entirely agree with that, but I think the fear of withdrawal would prevent the directors from doing it. I think as a Stock Exchange we would welcome any addition to the law which said a company could not sell a fundamental part of its business without reference to the shareholders; in fact that would strengthen our hand. I think all we are trying to say is that in our experience in recent years it is not a common practice. I cannot think of any occasion in the last two years in a quoted company where it has happened.

5197. So far as quoted companies are concerned the probability is that if they were going to embark on a new business then, in addition to getting any shareholder consents that might be required, they would declare the new business to the appropriate committee of the Stock

Exchange before the thing was finalised?

—Yes. They have to send out a circular letter to their shareholders, which has to be approved by us under their general undertaking with us, for any change which is in excess of 10 per cent., that is roughly our rule.

5198. *Sir George Erskine*: This change might also take place gradually over a period?—Yes, Sir.

5199. Does that face you with the difficulty as to when you decide a fundamental change has taken place?—No, I think it is up to the directors to keep the shareholders informed in their annual report each year as to what is happening. I think it brings out really a point which probably disturbs many of us more than anything else, and that is the lack of information which some boards of directors give in their annual reports.

5200. I was thinking rather of the withdrawal of the quotation; I could see it would be brought home to you if a fundamental change took place at one time, but if the company is gradually changing its actual business over a period is there some point of time when you consider that a fundamental change has taken place?—Not if they have kept their shareholders informed annually. It is only a sudden change.

5201. *Mr. Brown*: The procedure of suspending a quotation when there is a fundamental change is a very proper one, but I take it that the Stock Exchange would take the same action whether the shareholders had previously agreed the change or not?—Yes, Sir, unless the public in general were by that time fully aware of what the company then did.

5202. *Chairman*: There is one other small point on this topic: in paragraph 5 you say, with regard to fundamental changes in activity or the sale of the whole of the undertaking and assets of the company, the approval of shareholders should be obtained. When you say "should be obtained", do you mean it would be a right thing for a prudent and circumspect board to do, or do you mean it is a matter which ought to be made compulsory?—We feel it is a matter which ought to be made compulsory, Sir.

5203. Of course, one would have a sort of halfway house if one put it in the articles; articles can always be altered. —Yes, I think so, but if the Act required that it had to be in the articles and could not be altered, I think that would be better.

5204. Do you think there is any future in the notion that provisions such as this, provisions requiring consent in certain cases by way of restricting the absolute delegation to directors, might be put compulsorily in the articles, and provision might be made that the articles were not to be changed so far as those provisions were concerned within a period of x months from the company's formation? —I do not think the directors at any time should be allowed to sell anything which is fundamental to the business, or to sell the whole assets, without reference to the shareholders first. That is a delegation of power which should not be made.

5205. My suggestion is that possibly if these provisions were put in the articles with a restriction on changing them, on the lines that these articles could not be changed for three months or four months, the directors who sought to have those articles taken out of the company's constitution would attract to themselves a good deal of attention from the financial press, and so forth, and they would think twice before they did it. —Yes, I think they would think twice now, but I would hate to think that directors who had got control of a company could in fact change the articles, and could in fact at some subsequent time carry out the sale of the undertaking.

5206. *Mr. Watson:* How does the Stock Exchange deal with the modern diversified holding company in this context? Is it not possible that such a company can fundamentally change its activities or add to them in a new fundamental way, and does that cause any action by the Stock Exchange? —I do not think so, Sir. If it is a diversified holding company it means it has got to sell a good many of its subsidiaries at once to come within the scope of our regulations for a suspension of quotation, and we have not come across anything like that yet and I think it is very unlikely that we should.

5207. Where a company already has holdings in, shall we say, engineering, and

then acquires a textile business, would that be regarded as a fundamental change? —Not unless having been 90 per cent. engineering it became 65 per cent. textile. But we would regard that as a holding company; we would consider that when people buy shares of such companies it is part of the risk which they take that they can buy all kinds of things. It is usually fully understood that they do that.

5208. So you put these companies as it were in a special category? —Yes.

5209. *Chairman:* Passing then to quite a different topic, what about shares of no par value? In your memorandum you endorse the conclusions of the Gedge Report, which excepted preference shares. What is your view about no par value preference shares? —We do not see any reason against them. It is fairly common practice in the United States to have them. The chief reason against them in this country is our currency. It is easy in the United States; if you have a no par value preference share paying 85-50 it is 5½ per cent. preference, and it is redeemable at \$100 or \$105 in the case of winding up as the case may be. But in this country if you had a 5½ per cent. preference share you would be paying 1s. 1-2d., and 6½ per cent. would be 1s. 3-6d., it would be a very difficult thing to carry out. As long as we have a currency such as we have, no par value preference shares lose a great deal of their attraction—and you meet the same difficulty with ordinary shares in stating the dividend in terms of fractions of pennies.

5210. But there would be no harm in people adopting such a system if they chose, in your view? —None at all, Sir.

Mr. Quirk: Provided of course that there was a stated redemption figure in the event of liquidation of the company.

Mr. Hunter: I think it would have to be stated that in the event of the company being wound up or the preference being paid off they would get so much.

5211. Yes, it would have to be quantified, but you would also have to have provisions preventing an under-cover return of capital? —Yes, Sir.

5212. You see no objection, with proper safeguards, subject to this currency difficulty?—No, I just think that makes it difficult to do.

5213. The next matter I want to ask you about is whether when there is an issue of shares for cash the shares ought to be offered in the first instance to the shareholders *pro rata* to their existing holdings, and I gather that as a matter of general principle you approve that, but I am not sure whether you go so far as to say it ought to be made compulsory?—Yes, I think we would be very pleased if it was made compulsory.

5214. You insist on the *pro rata* offer being made?—Yes, Sir, we allow no issue for cash to other than the shareholders without the shareholders' specific approval.

5215. Curiously enough—you probably know this—a provision about offering cash issues *pro rata* to members was contained in all versions of Table A from 1862 down to and including 1929, I think, then it was omitted from the 1948 Table A.—We definitely do not allow it, we do not allow the issue of convertible debentures or any other kind of security which can be converted into equity capital unless it is offered to the shareholders *pro rata*, or unless the shareholders approve it.

5216. *Mrs. Naylor*: Is that not in conflict with the position which actually occurred in a number of quoted hire purchase finance companies?—It was following that that we changed our policy.

5217. *Mr. Scott*: Is it your view that it should be made compulsory that any new issue of equity capital for cash should be made to shareholders even if, at the time of the creation of that capital which is subsequently issued, the shareholders specifically authorised it to be at the disposal of the directors to issue as they thought fit?—Yes, Sir, unless the shareholders specifically authorised the issue for cash to somebody else. We do not allow shareholders to authorise the directors to issue shares as they see fit and then issue them for cash to other than the shareholders, without going back to the shareholders.

5218. And you would recommend that that should be made compulsory?—Yes, Sir—as far as we are concerned, it is.

5219. For quoted companies, of course?—Yes.

5220. *Mr. Bingen*: Does that apply without any qualifications, even if it is only a small issue?—*Mr. Wareham*: There are some small exceptions, we are prepared to consider some very small amounts. It may be for instance that a company which has an issued capital of £99,000 just wants to round off the figure to £100,000 and make an issue of £1,000. We should raise no objection to that, or to some small issues to staff pension schemes, for example.

5221. *Chairman*: Directors' qualifications as required by the articles, that sort of thing?—Yes, and small amounts.

Mr. Hunter: I think we would look twice at directors' qualification shares.

5222. Suppose the articles said he should have them?—I think we would look twice if they were offered at a discount. I think if they were offered at the current market price and you could not buy them from somebody else, we would not object at all.

5223. He ought not to get the benefit of any premium?—No, Sir.

5224. I was not thinking of it from that angle, but as an exception to the general rule it would be reasonable to say that small issues for purposes such as these could well be excepted?—Yes, Sir. I think we have hardly any rules that we do not make exceptions to at times, if the reason is good enough and if the effect on the shareholders is in our opinion to their benefit and not adverse. We try to be flexible, but we are only flexible if in fact it is a very good reason, if it is a very small amount and if it is not going adversely to affect the shareholders.

Mr. Quirk: We always want to know the price that a small issue is being issued at, Sir.

5225. *Mr. Scott*: But there is a difference between your having the flexibility and power to grant exceptions, and a compulsory provision of law which says that all issues must be for cash?—Yes.

5226. Are you suggesting that if it is made compulsory there should be power to any authority to exempt a company in such cases as you have mentioned?—

Mr. Hunter: I think it would be quite reasonable if the Board of Trade were given that power. The exceptions are small, they do not come up very often. I think it is a pity to tie anything down which makes no provision for exceptions which do come up. There are extraordinary circumstances which one cannot foresee, and I think it is a pity if there is no flexibility.

5227. And your recommendation would apply only to public companies?—That is all we are interested in, Sir, yes. We are not interested in private companies.

5228. *Sir George Erskine:* If the company is making an offer for the shares of another company and giving its own shares in exchange, its own shares having already been authorised, you do not then insist, do you, that there should be shareholders' approval?—No, Sir.

5229. Would you be in favour of a provision that that should be so?—It is one of the things we have been turning over in our minds. We are very keen that shareholders should be responsible, and we are very keen that nothing should be done to remove from shareholders their sense of responsibility. We are keen for that reason really that they have a vote, and I think if you say to shareholders: "You can go and authorise a lot of shares for the company to issue for other than cash", and then say they must come back and authorise them all over again, that really would not be reasonable. I think very often these deals have to be done reasonably quickly, and I think it would be a pity to take that power away from the directors if the shareholders fully realise when they give that power to directors that it may be used.

5230. *Chairman:* Do you think it would be reasonable to provide in the articles that directors should whenever practicable make a cash issue to shareholders *pro rata*, and that the directors are to consider the matter, and if they decide that it is not practicable they have got to record a proper resolution saying why they considered it was not practicable, and the

shareholders should be informed as soon as reasonably possible?—I do not think we would like that, Sir, not for cash issues.

5231. It might be of some value in requiring the directors to apply their minds to the question?—I think our experience would be that it would be better that they were not allowed to issue shares for cash other than to shareholders, without permission.

5232. Would you welcome an addition to Table A expressing these obligations?—I think it would be better effected by legislation rather than by an addition to Table A.

5233. What about shares issued for consideration other than cash, in a general way?—I think in a general way there is no way out of it. We have thought about this a great deal, but if a company is expanding, if a company is a go-ahead company, it must be put in a position to expand, and very often the only way in which it can expand is by issuing its own shares in payment for an acquisition. The delay of three weeks or more which would take place if the directors had to go to their shareholders in order to do that could bring other people into the field. It could be serious, it could prevent a company making an acquisition which it wanted to make, and we would be sorry I think to see that power taken away from the directors, once the shareholders had authorised the issue of those shares knowing full well the directors might use it.

5234. *Mr. Mackinnon:* If that is the case of course it would enable the company to effect a fundamental change in its activities in a broad way, not by ceasing to carry on an activity but by adding a new, fundamentally different activity without the shareholders being consulted. Would you therefore say in that sort of case that, for the reason there is going to be a fundamental change in activities, they should go to the shareholders?—I think if there was going to be a fundamental change, yes, they should.

5235. But on the grounds that there was a fundamental change, not on the grounds that the shares were being issued?—Yes.

5236. *Mr. Brown*: Would your views be just the same if a proposition of this kind in effect, say, doubles the capital of the company?—I would think it was unusual for a company to have authorised capital that enabled it to be done. I think if the shareholders leave that much power with the directors they get what is coming to them. I think it is terribly important that shareholders should in fact take up their responsibilities far more than they do.

Mr. Quirk: Again I think it depends on whether or not a fundamental change is being made. If a brewery takes over another brewery almost the same size it is not a fundamental change.

5237. *Chairman*: This does mean, does it not, that there may be a quite different result according to the size of the initial authorised capital of the company? If a company was incorporated with a capital from the stamp duty point of view extravagantly large, it would then have a reserve of shares which it could issue without reference to the shareholders. But if they budgeted their capital a bit more closely there might be no shares in reserve. They would then have by statute to get the shareholders' consent, a shareholders' resolution for the increase of capital. Does it not strike you as odd that the matter should depend on that quite fortuitous distinction?—Yes, Sir, I think it is a bit odd. Of course, we are really very flexible, and when anything like that does happen, if they come for a quotation for the new shares which they have issued—they will want a quotation for them—then we do require at once, if they have not already done so, that a circular is sent out and the shareholders told what has happened. It may be a little late, but at any rate they are told what has happened before we give a quotation for the new shares.

5238. Yes. I think the only other point I have to raise on this topic is this: one of our more ingenious contributors suggested that any provision requiring the offer to shareholders *pro rata* of any shares issued for cash could be defeated in most cases by expressing the transaction in a rather different way. You can dress up an issue of shares for cash as an issue for consideration other than cash in many cases.—I think it can be done, Sir, but

I do not think it is often done. I do not think the companies with big wads of cash exist today, not a lot of them in any case. I do not think we are very worried about that.

Mr. Wareham: Our restriction is imposed on the issue of shares, the offering of shares for subscription. We are not attempting to impose any restriction on the means or methods of raising cash. A company might elect, if it did not want to offer shares for subscription, to issue debentures or raise cash in some other way; equally it might issue shares for consideration of a business which had a large amount of cash. But the control which we have been trying to exercise is over the offering of equity shares for subscription. We have not attempted to extend our restrictions beyond that, and we do not believe that the issue of shares for consideration other than cash coupled with the acquisition of cash in that business would be used at any time as an avoidance of that restriction. It would not be generally practicable.

Mr. Hunter: I think you were really saying that if Company A takes over Company B, and all the assets of Company B are cash and that is all, that is the point, is it? I think that sort of case arises so seldom that it does not really need dealing with.

5239. That is one point, but there is the other that the transaction of sale and purchase may be carried out *either* by the issue of shares for £x to be satisfied by the transfer of the other shares, if those are the goods that are being bought; *or* it can be done by an offer of shares for subscription to the shareholders and an application of the cash so obtained in buying the shares of the other company.—If the shares are offered to the shareholders for subscription, I do not see any objection at all to the use of the cash in buying another company.

5240. *Professor Gower*: I think it is the other way round. As I understood, if the company wanted to acquire another business, it could issue some more shares for cash, then use the cash to acquire the business; and in those circumstances you would require that the issue should be offered to the shareholders *pro rata*, so

that the existing shareholders would end up still with the same proportion of the equity?—Yes.

5241. If on the other hand instead of doing that the company issued its shares direct to the vendors of the business, although the net result from its point of view may be the same, the position is very different for the shareholders who are thereby denied their rights. It seems rather illogical.—*Mr. Quirk*: I think, Sir, it is not all that illogical really, because the shareholders can provide the cash but they cannot provide the assets that the company is obtaining by the exchange of the shares.

5242. But it might be argued that they should be given an opportunity of saying whether they prefer to provide the cash and remain in control of the company, or whether they prefer not to provide the cash and let some outsiders come in with a substantial stake.—That could cause a delay in the take-over. Someone else might come into the picture and it might thereby damage the company.

Mr. Brown: The point is more illogical in cases where the vendor company in fact requires cash but is allotted shares with a concurrent arrangement with some third party to acquire those shares. The Stock Exchange proposals would not in fact touch that.

5243. *Chairman*: Next there is the matter of directors' duties, with particular reference to the register of directors' dealings in shares under section 195. You suggest that it should be extended so as to apply to officers of the company as well as to directors?—Yes, Sir.

5244. I am not sure whether the term "officers" has been the subject of any very precise definition. I was wondering how you would meet that point?—We rather think, Sir, that the definition of an officer for this purpose should include any officer of the company who has access to confidential information which might affect the price of the shares. We feel that it is a very difficult thing to tie down, and the chairman or the board of the company would have to name its officers in this connection. I admit we have not very much to suggest on it, but we do feel

that officers of a company are as important as directors in some of the share dealings, or could be, and therefore it is up to the board or the chairman at some stage to designate who are officers in the meaning of this suggestion.

Mr. Hunter: I think we feel, Sir, that this provision would probably tighten up the security of information; it would bring to the attention of the board, some of whom are good and some are bad, that this information is in fact confidential and should not be allowed to leak out in any way. I think if a board had to nominate which officers came under this provision, and the names of those officers were put on the register which is available to shareholders, it puts the responsibility where it should be with the chairman and the board, and I think generally speaking they would fulfil it. I think it might also make boards more careful about what they say themselves.

5245. Of course, people in positions of no great responsibility in other respects may have access to secret information in the course of their duties as typists or whatever it may be. How does one deal with that?—I think if they have such access, their names should go on the register. There should be very few.

5246. That might make the register rather voluminous?—It should not, really. In the case of information coming out of the boardroom about dividends, free issues, rights, anything of that sort, there cannot be very many officers of the company who are in possession of that information prior to its publication. Once the information is published there will be many employees who have dealt with it but the number of employees of a company who have confidential information while it is still confidential cannot be very many.

5247. *Mr. Bingen*: I would doubt whether that is true in the case of a large company, because quite a substantial number of people must know what is going on and be concerned in the preparation of documents.—The final documents?

5248. Yes.—I would not have thought there would be many.

Professor Gower: They would only go on the register if in fact they bought or

sold shares, so in point of fact the managing director's typist might be an officer for this purpose, but it is highly unlikely that in fact she would have the money to speculate in the company's shares.

5249. *Mr. Lawson*: Is this whole matter not one for internal discipline? The directors can discipline the staff; is that not the essential difference between directors and officers?—Yes, that is our point, that this is a matter of internal discipline and it is brought to the attention of directors in this way. We believe the security would be very much greater. It is very interesting how the security in a deal like the Ford take-over was complete, and no information came out until the day it was announced. It caught everybody by surprise, but there are other things which have happened where the information was banded about for almost weeks ahead. The security between companies varies enormously, but if it can be done with a company the size of Ford it seems to us there is no reason why it should not be done in every company.

5250. *Mr. Brown*: But you surely are thinking solely of the new issue, take-over bid type of operation? Information about the value of shares can come from all sorts of quarters.—That is the sort of information which is available to a very large number of people, but I would not have thought it confidential and it can be very misleading. I think it is really the people who know whether the profits are going to go up and dividends are going to go up that we are interested in. I think we have got to take the rough with the smooth in the broader sense. There is one other point, and that is I think that not only share dealings but options should be included. I think it is most important. We did not put it in our memorandum, but we would like that to be included. We think directors' dealings in options very much should be included.

5251. *Chairman*: I think it already includes options one way, options to buy, but it does not include options the other way. I think that is the present position, and it is suggested that both should be included?—We think both should be included. The present law does not include options at all, does it?

Mr. Wareham: Our understanding is that most people at any rate take the view that option business does not come within the operation of the present Act, and that they are quite open to do option business without declaring it in any way.

5252. Section 195 (1) covers "any shares which are held by or in trust for him or of which he has any right to become owner, whether on payment or not"; I should have thought if one had an option to buy shares, one would have a right to become the owner.—*Mr. Hunter*: We would feel that that is not the generally accepted view, though I must say it reads that way.

Chairman: I think the word "option" on the Stock Exchange has perhaps a rather special implication, but I think everyone would agree in principle that options either way should be included in section 195, and if there is any doubt about that there is nothing simpler than to put it in express language.

5253. *Mr. Bingen*: But would you go further and prohibit directors and officers from dealing in options, on the theory that you should not be a bear of shares in your own company, if you have got shares and want to sell them you can do so but you should not sell shares you have not got with the idea of buying them back cheaper?—We had not thought about that one. It makes sense, off the cuff, but it is entirely a personal view.

5254. *Chairman*: But might it not be that the best solution here is to leave the directors, who are of course in a special position by virtue of their fiduciary capacity, bound to disclose their shareholdings and dealings under section 195, but limit it to directors and let the case of employees subordinate to the board to be dealt with as a matter of discipline?—I do not think we would feel that it would be dealt with, Sir, unless attention was called to it in the Act. This Committee's proceedings when published could perhaps call attention to the fact that boards of directors are responsible for the information which may go to their confidential officers and should see that security is enforced.

5255. Perhaps not as a matter of legislation but as a matter of education

really?—Yes, Sir, that is really why we put in our suggestion that this matter of the register should be put in the notice calling the annual general meeting. The thought behind that is that we are forcibly calling to the attention of the board something which I think some of them probably try to forget, and which many of their shareholders are unaware of. If it is put in black and white to all the shareholders, "You may come and see what your directors have done", first of all you would have more shareholders going and looking at the register, and secondly I think it would bring it very much more to the attention of boards what their duty is.

5256. This topic is rather complicated by the fact that in some companies at all events directors are required to hold certain shares, and no doubt there are some companies where the employees are encouraged themselves to invest in shares of the company?—We would encourage that, we see no reason why they should not. All we say is every now and again cases arise in which directors have taken advantage of their own shareholders, and we think that ought to be stamped out as strongly as possible.

5257. But there is a certain illogicality about it, because one might prohibit directors from holding shares at all, I suppose?—No, Sir, we do not want to do that.

5258. It would be possible to do that?—Yes. We would be against that.

5259. But those companies which require a qualification of directors must have taken the view when the article was framed that it was a good thing for a director to have a stake in the business, and if he has a stake in the business and he sees it going up from £500 to £1,000 it is rather difficult to prevent him from selling and making a profit?—*Mr. Quirk*: In paragraph 6(c) we do say: "The Council does not object to directors and officers dealing in their own company's shares provided that adequate information of the transactions is made available and that the transactions have not taken place as a result of the receipt of privileged information".

5260. Yes, I am much obliged, I think that states your position very clearly. It has been suggested to us by a number of our witnesses that the register under section 195 ought to be open to the same extent as the register of members. At present it is only open for inspection 14 days before the annual general meeting and three days thereafter, and it is suggested there is no good reason why it should not always be open during usual working hours.—*Mr. Hunter*: We would not object, Sir, if it was open all the year. We do not believe it would have as much value as calling attention to it in the notice convening the annual meeting.

5261. As to that, it has been suggested that particulars should be sent out, with the documents for consideration at the annual general meeting, of any transactions its directors have had during the year under review. Do you think that would be an unnecessary additional burden, or do you think it would be a good idea?—I think it is unnecessary, Sir.

5262. Then there is a point under paragraph 6(d) of your memorandum, where you give a reference to "Appendix 34, Schedule II, Part A of the Rules of the Stock Exchange in respect of new companies seeking quotation for the first time and Schedule II, Part B in respect of quoted companies seeking quotation for further issues require directors to disclose their interests"; then you refer to a number of requirements, some of which are I think required at some stage or other to be the subject of disclosure under the Act. You set those out, and then recommend "that the law should be strengthened in the case of all public companies by the inclusion of similar requirements". This provision as it stands is linked to an application for an official quotation, is it not?—Yes.

5263. I was wondering to what point of time or event you would link the corresponding general obligations you think should be made statutory?—*Mr. Wareham*: We had visualised, Sir, that there would be either references in a prospectus or a circular giving information to shareholders of these acquisitions or disposals of assets as the case may be,

and that in those documents there should be full disclosure of the directors' interests, whether they were direct or indirect. It is at that point of time, the issue of the circulars, prospectuses or whatever the documents are, giving information to the shareholders.

5264. But you say these should be included in any prospectus or offer for sale so far as they are not already covered by statutory provisions?—Certainly, while the existing statutory provisions cover this to some extent in the case of prospectuses and offers for sale, there is no provision in the case of other documents, circulars giving information to shareholders. We have had experience of a number of cases where there have been very important interests of directors in these further acquisitions of which our requirements has compelled disclosure.

5265. Then you are suggesting that these subjects of disclosure, so far as they are not already included in the statutory requirements, should be added to the particulars required in prospectuses and offers for sale?—And in circulars. In fact if there were such an interest possibly the legislation should go so far as to say that a circular should be issued to shareholders notifying them of that interest, even if no circular were being issued generally with regard to the acquisition.

5266. I wanted to verify that this is a prospectus point, and not for example intended to introduce new matter under section 200, the register of directors?—No, it is not on that, but it goes wider than the prospectus.

5267. Yes, I follow. Then a point which has attracted a great deal of discussion I think is the question of shares with restricted or no voting rights. That really resolves itself I think into ordinary shares with no voting rights, because no objection I think has been raised by anybody to the customary limitation of the rights of preference shareholders to vote. You say that the Stock Exchange does not favour voteless shares. On the other hand you make no recommendations as to abolishing them, owing to the great difficulty of doing so, but you do not elaborate your reasons really why you think they are a bad thing.—*Lord Ritchie*: I think, Mr.

Chairman, it is really based on the fundamental thought that it is right that a shareholder should have a say in the conduct of the company in which he has got shares. But we find ourselves I think in a great difficulty over this because our fundamental function is to provide a market, provided that the shares are of a company which is a reputable concern and that the shareholders know what they are buying. That is we feel the most important thing. I think quite frankly, the Stock Exchange Council have been a little bit divided in their opinions on this subject as to whether non-voting shares should be prohibited by law; because there are people who prefer perhaps to buy a share a little bit cheaper, and say: "I am not interested in the vote". Just one further point: I think there is very great difficulty over the question of restricted voting powers; it so happens that I am on the board of a quite large public company where all the ordinary shareholders have a vote, but there are in existence 100,000 "A" shares which have a controlling vote, so that all the ordinary shareholders who go to that meeting and vote can be nullified by the "A" shareholders.

5268. You produce the same result by a different means?—Yes.

Mr. Quirk: It does produce the same result, if I could add to that, although it does mean that all shareholders in that sort of company can attend the meeting and can vote. The non-voting share of course does mean that the shareholder has no right to attend the meeting.

5269. And I suppose if some keen shareholders chose somehow to convene a meeting in August, when all the shareholders carrying the heavy voting rights were away, then it might give them their opportunity?—*Lord Ritchie*: I think in this case, Sir, it would only require one secretary to attend and cast his 100,000 votes. But in fact I think in any reputable company those "A" votes would never be used against the overwhelming majority vote of the ordinary shareholders.

5270. So your position really is this, that these non-voting shares ought to be clearly identified for what they are?—Yes, that is all we feel.

5271. And one might suggest that a statement that they do not carry any votes ought to be endorsed or somehow attached to the certificate?—*Mr. Morley*: Yes.

Lord Ritchie: We insist on it in the case of any new quotations.

5272. So although you do not like them you see really insuperable difficulties in abolishing them by statute?—Yes.

5273. *Professor Gower*: Do you? I thought you said in your original memorandum that you thought the matter should be dealt with by statute?—*Mr. Hunter*: I do not think we see any difficulty in dealing with it by statute. I think we see difficulty in not dealing with it by statute.

5274. I do not quite follow that. So far as preference shares are concerned you have always provided that a quotation will not be granted unless there are adequate voting rights?—Yes, Sir.

5275. If it works with preference shares why should it not work with ordinary shares, which *prima facie* one would have thought were more entitled to adequate voting rights?—*Mr. Quirk*: Voting rights for preference shares in certain circumstances, Sir. Usually only when they are in arrears of dividend.

5276. Yes, but you can and have assessed whether you think the voting rights are adequate in that case, and you require to be satisfied. Is there insuperable difficulty in assessing whether you think the voting rights of ordinary shares are adequate?—*Mr. Hunter*: No, Sir, and I think we would not mind a hit seeing the complete abolition of non-voting shares. Many of us feel very strongly that the shareholders should run the company and should have a vote.

5277. But why do you want it done by legislation instead of by alteration of your rules? In New York, it is dealt with in that way, yet you take the view that you cannot deal with it, it has got to be done by legislation.—I think the reason is that this country has got a very large number of private businesses which have been family businesses for many years. It has been the practice of

those family businesses over the last 20 years, in an increasing number, to come to the Stock Exchange for a quotation. They come for a quotation, and those that have come have had the facility of a quotation without giving up control of their business, because they have been enabled to issue non-voting shares. It has become built into our business life that this is possible. There would be a fundamental change, if the Stock Exchange at this point stepped in and said: "No longer will a family business be able to retain its control and at the same time get some quoted shares". We should be striking very much at the root of a whole series of practices which have been built up, and we think this is something about which the country is by no means unanimous, there are quite a lot of people who feel that it is essential that these family businesses do retain control, and I do not think we feel in a case like that, which is quite fundamental, the Stock Exchange should take upon itself to say this will not be done. Because, unlike New York, here almost everything becomes quoted, and we are in fact shutting off completely something which has been accepted, which is part of our life, and we feel that a change of that sort should be changed by Parliament after the thought of everybody concerned. We are against voteless shares, and we think the vote of the shareholders is one of the props on which the whole thing stands. If you do away with *ultra vires*, I think it is important that shareholders have a vote. We are keen that shareholders shoulder their responsibility, but we do not think it is our job to change this completely fundamental practice.

Lord Ritchie: Furthermore, I think we tried to indicate it in our memorandum, it is not practicable for us to do it with the existing company which already has non-voting shares. If one may give an example of Marks & Spencer, for instance, who have very large issues of non-voting shares, if they proposed a further issue of one million shares and we said we would not quote them, it would be perfectly open to the board to issue those shares without a quotation. They are all unnumbered, and they would become quite unidentifiable, and we should have battered our heads against a brick wall to no purpose.

5278. *Professor Gower*: Surely no responsible board of directors would deliberately proceed in a way which would deprive all the shareholders of a market, and surely what would happen in fact would be that Marks & Spencer would either not issue the shares or enfranchise the existing shares, which I understand is what you would like them to have to do? —We should.

5279. Is it fair to suggest in these circumstances that a reputable public company would deliberately proceed to finance itself in a way which would cause all their shares to become unquoted? —I think that is probably perfectly true of a reputable public company.

5280. *Mr. Lawson*: Do you think if the law were altered in this respect it would have the effect of greatly reducing the number of family businesses which expand by coming to the Stock Exchange? —*Mr. Hunter*: I think some of them would think twice before they came, but the pressure of death duties and other things would probably bring them in the end. I think it would stop some which might expand.

5281. From that point of view it might stop the expansion of some businesses which really should expand in the national interest? —I think that is one of the reasons that we have not banned voteless shares. That is the sort of argument which is brought forward, and there are a lot of people who feel that. It is a very broad subject, there is no black and white solution, I think, and unless it is completely black or completely white we do not think we should take this very big step on our own.

Mr. Quirk: I think another point in this question which makes it difficult is that we do insist now in any quotation for a non-voting share that it is quite clearly labelled a non-voting share. If those were not allowed, but you could have "A" shares with one vote and "B" shares with 20 votes, then none of those shares could be labelled as non-voting, although in fact one man owning a handful of "B" shares might easily still have complete control of the company. There is some difficulty I can see in removing the non-voting

share which is clearly marked as non-voting, and then getting the differential voting between "A" and "B" shares which are so popular nowadays. I do not know whether you see my point, whether I have made it very clear?

Chairman: Yes.

5282. *Mr. Lawson*: Do you think the accounts should disclose the voting rights of particular classes of shares? —*Mr. Hunter*: We had not thought of that, Sir —but there is no harm in doing it. I think it would be a good idea.

5283. *Sir George Erskine*: Is one of your difficulties the question of compensation? —No, Sir. I have heard it said that compensation is illegal, that one part of the equity cannot compensate itself at the expense of another part of the equity, but it is quite commonly practised.

5284. *Mr. Mackinnon*: When you say you would like to see something done by legislation to introduce voting power, do you envisage the legislature introducing this rule, but allowing multiple votes, still preserving the idea of an "A" share which has 20 votes and a "B" share which has one, or do you contemplate absolute parity, one vote for every £1 of nominal capital held? —We feel that responsibility goes with the share of the equity which you put up in cash, and that only.

5285. *Mr. Brown*: If there were legislation like this, one of the points put up is the difficulty of finding appropriate votes for different types of share. Would it not be fair to assume that if the legislature laid down this as a principle the Stock Exchange would have no difficulty in dealing with the freak share which was devised to get round it? —If the legislature approved the general principle I think we could cope with the details.

5286. *Mr. Bingen*: I gather the Stock Exchange are against non-voting shares in principle, for the reasons which you have expressed. You said the Stock Exchange themselves could not deal with this matter, but you would not object to legislation. What I would like to know is whether the Stock Exchange have experience of abuse of non-voting shares, or whether this is only one of these matters where there is a sort of feeling against

them. Have you found any real mischief to non-voting shareholders arising from the fact that in reputable companies there are non-voting and voting shares?—*Lord Ritchie*: I am not aware of any.

Mr. Wareham: I do not think we could really say we have any experience of that kind.

Mr. Hunter: I think one could think of companies which people feel perhaps are not as well run as they ought to be.

5287. The only case which has been mentioned at previous meetings is Carreras, but I have heard no other case quoted where there has been any problem.—I think it is indefinable. I think there are companies controlled by families which people on the Stock Exchange would say were sleeping. Nothing can be done about it. One wonders whether if in fact they were not controlled by families they would be quite so sleepy. It is a matter of opinion.

Lord Ritchie: Perhaps I should add that we do not consider Marks & Spencer sleepy.

Mr. Hunter: Then there is the case of control of a company by its own pension fund. In those circumstances there are no death duties and no sales, so that if a company is controlled by its own pension fund and the directors are the trustees of the fund, they elect the trustees and the trustees elect the directors, and so it goes round and round.

5288. *Chairman*: With reference to the question of the public knowing that they are buying voteless shares, on any prospectus special voting rights would have to be disclosed, would they not, so the difficulty of telling the public what they are getting arises with shares bought in the market?—*Lord Ritchie*: Yes.

5289. Supposing I was attracted by "A" shares in the X Company Ltd., and I knew nothing about their voting rights; I rang up my broker and asked him what he thought and whether he could get me some of these shares; would it be reasonable for me to expect that he would tell me that these shares were subject to special voting restrictions, or do you think he would have no duty in that matter at

all?—I think he would certainly have a duty in it, Mr. Chairman. In fact we once had a case rather on those lines. We feel however that it should be something rather more than that, that the shares should be described—I am speaking off the cuff here—on the share certificate, should be quoted in our own official list and elsewhere as "A" non-voting shares, not just as "A" shares.

5290. I appreciate that, but I was carrying it there rather further into the case of differential voting.—That is much more difficult, of course.

5291. Which you could not possibly explain in some cases, it is far too elaborate to explain on a share certificate?—That is quite true.

Mr. Quirk: I think if instead of ringing up your broker you were to write him a letter saying "Please buy 500 of these for me", I imagine the broker would have to deal immediately on receipt of your letter.

5292. *Mr. Watson*: Mr. Chairman, I have been listening to these answers, and it seems that the Stock Exchange view is that they are against non-voting shares in principle but they recognise that they have some use in practice?—*Lord Ritchie*: Yes.

5293. One wonders, Lord Ritchie, if that is your view, are they a type of security that the community should live with, and if so should they be controlled by proportion in relation to the total issued capital, as a means of preventing control falling into the hands of a very small minority of voting shareholders? Have you considered that possibility?—I do not know that we have.

Mr. Hunter: I think our real problem is that the whole business community depends on the directors running the business, and that they are capable of being chucked out if they do not run it well. The directors are responsible for looking after the workpeople, for providing the jobs, for seeing that the business is profitable and run well, and they are responsible to the shareholders. If in fact you remove the responsibility from the shareholders you are striking completely at the roots of the whole thing. Then I think if one really saw a multiplicity of

non-voting shares, then one should have very much stricter memoranda; and if there were going to be an increase in non-voting shares, if in fact you had directors responsible to nobody except themselves, then you would have a very difficult situation and I think in due course it would be very bad for the country and for industry as a whole. It is terribly important that the shareholders should have that responsibility, and that the directors should be capable of removal for inefficiency as well as for malfeasance.

5294. What I had in mind was laying it down by statute that the non-voting shares in a company initially should never exceed a certain proportion, be it 30 or 40 per cent. of the total shares of that class in issue.—I think that would be better than having no limitation. I think we are against non-voting shares and in due course would like to see them done away with.

5295. But I gather you recognise that they have a purpose?—They have a purpose.

5296. *Professor Gower*: But their purpose surely is to enable people to maintain control? They will not have a purpose if they do not maintain control.—It is a purpose we recognise but do not really approve of.

5297. *Chairman*: If we could pass now to another topic, there is one item under protection of special classes of shares, and that concerns the position of preference shares in a winding up or a reduction of capital by returning it to the members. Your suggestion there as I understand it is that any resolution for winding up or for reduction of capital in that way should be subject to separate consent by the preference shareholders?—I think from a practical stockbroking point of view the decisions by the House of Lords to which we have referred in our memorandum struck at the roots of preference shares; preference shares which were not specifically redeemable had been regarded by investors as in fact irredeemable shares, and they thought they would only be paid off if the company went into liquidation. The result was that people were prepared to purchase 7 per cent. preference shares for, say, 34s. 6d. in 1947. There were very

big premiums. Since those decisions by the House of Lords there are many investors who will not buy preference shares at a premium in excess of 10 per cent. or some very small amount. It has in fact deprived the preference shares of a great deal of their value. It has taken away many of the buyers who otherwise would be prepared to buy them. I think what we feel is that it should be made abundantly clear that a company cannot, if it comes into good times and has a bit of surplus cash, go to Court and pay off its preference shareholders who have lent money at 6 per cent. or 7 per cent. when times were not so good, although there is nothing in the articles which says they can do it. Unless a company specifically keeps to itself the power of redeeming preference shares, we believe they should not be redeemable.

5298. So far as winding up is concerned, the articles usually contain a provision saying that in winding up, preference shareholders shall be entitled to the payment of all arrears and accruals of dividend and furthermore the return of their capital, but to no other participation in profits or assets. That is the ordinary preference shareholder's bargain, and insofar as the winding up is concerned it is clear enough, is it not?—Yes.

5299. But difficulty has arisen because the Court has regarded a reduction of capital involving the return of capital in excess to the members as an operation to be conducted in accordance with the rights in a winding up, and on that footing of course the preference shareholders, as in a winding up, are only entitled to their capital and arrears and accruals of dividend. It is the latter part of the bargain that you consider wrong?—From a practical point of view, preference shares which have a high coupon might go to a considerable premium at times of low interest rates, and they would become attractive to institutional buyers if they were irredeemable.

5300. In some circumstances it might be advantageous to the preference shareholders, might it not?—I find it difficult to think of an occasion when it might be advantageous, Sir.

5301. Supposing the preference shares had a fixed cumulative preference dividend of 2½ per cent., a bargain made when the value of money was very different, it would be in their interests to be paid off as soon as possible and go into something better, would it not?—Yes, Sir, if the company wants to make an *ex gratia* payment to pay them off.

Mr. Quirk: I think we can go a little beyond that. Thomeycrofts announced the other day that they had received some money and that they proposed to pay off the preference; the preference was standing at about 13s. and they are offering to pay off the preference at par.

Mr. Hunter: In those cases the preference shareholders would undoubtedly give consent.

5302. Sir George Erskine: Is it not going a little far to provide that the preference shareholders, by giving them a class meeting in a winding up, can stop a winding up if it is in the interests of the ordinary shareholders and the ordinary shareholders want to see the company wound up?—I think it may be going too far, Sir, but it is part of a bargain, you see. The ordinary shareholders go to the preference shareholders, they raise capital from the preference shareholders at a certain rate, and I think if they want to terminate that bargain it is up to them to come to an agreement with the preference shareholders that the bargain should be terminated.

5303. Mr. Mackinnon: I am not quite clear whether you want to make this retrospective to preference shares now in issue, or whether you are contemplating that it should only apply to future preference shares? I ask that question for this reason, that so far as past preference shares are concerned there is a bargain which has been made, it has been statutorily interpreted, and it might be said that the legislature should not interfere with that bargain. So far as future shares are concerned, this point is now, as I venture to think, well understood in the market and well dealt with with the aid of the Association of Investment Trusts and other bodies and yourselves. For that reason I am suggesting that this, which might have been a good point some

years ago, has no practical application today.—It only has a practical application in that it penalises a very large number of preference shareholders who have bought shares prior to this decision, very often at a very high premium, thinking there was no possibility of their being paid off unless the company went out of business, and who now find themselves with shares unlikely to rise to those same premiums in the future because of this decision.

5304. So your recommendation is really directed to retrospective legislation?—Yes.

5305. Sir George Erskine: If I could come back to my question, what you are really saying is that the ordinary shareholders made a bargain with the preference shareholders that they would never wind up the company unless the preference shareholders agreed; surely it is very unusual for a bargain of that kind to be made?—I do not think when a company starts they are thinking about winding up. That is really the trouble of this thing, that nobody really thinks of it. What one would want to prevent is ordinary shareholders winding up a company which is a perfectly good company, which is quite capable of continuing, just to obtain some immediate advantage to them to the disadvantage of the preference shareholders. I think preference shareholders should have some say.

5306. Surely if the ordinary shareholders represented the majority of the interest in the business it is going a long way to say you cannot wind up a business unless you get the preference shareholders to agree?—Yes, I think the point is a good one, Sir George, and I think from a practical point of view it would have very little effect. A complete winding up could be done without a vote of the preference shareholders because I do not think ordinary day-to-day business people would worry about that. I think I would suggest that.

Mr. Quirk: I think what worries me is really that a preference share when it is issued, unless it is called a redeemable preference share in which there would possibly be dates mentioned—years in which it could be redeemed—is assumed to be a perpetual preference share until

the company is liquidated. A company which pays off preference shares at par normally only does so on a "Tails you lose, heads I win" basis. If the preference shares were above par it might pay off; it would not be likely to do so the other way. Therefore the shareholder will be left with the shares as long as it suits the company.

5307. *Mr. Scott:* Is your remedy for that state of affairs that the preference shareholders should have the right to veto a winding up?—No, it has never been my thought at all. It was simply that we all felt that the decisions were—I must not say they were wrong—but we were surprised when that company was allowed to pay off its preference shares at par when they had stood considerably higher. It was never thought that was possible.

5308. Your recommendation is that they should have a right of veto?—*Mr. Hunter:* I think so in a partial winding up, not a complete winding up.

5309. *Mr. Watson:* Are you concerned with the situation where a company finds itself with a large amount of cash for which it has no use and it wishes for a capital reduction to divest itself of this cash? And in these circumstances the first approach is to the preference shareholders and the directors say: "You are going to be paid off"?—Yes.

5310. How would you deal with this situation: how is a company to divest itself of the cash otherwise? Are the preference shareholders to be approached and told you may be paid off if you wish but if you decline to be paid off then this cash is going to be paid to the equity holders? Is that a situation you would view with equanimity?—*Mr. Quirk:* An offer has often been made to preference shareholders to pay them something to get them to agree.

Mr. Brown: It has also been put to the preference shareholders that they should not be disturbed and that the money should be used to reduce the ordinary capital.

5311. *Mr. Watson:* Your point is preference shareholders should have the right to decline repayment?—Exactly.

5312. In these circumstances they should either be bargained with or they should be prepared to see the cash being paid to the ordinary shareholders, is that right?—Yes.

5313. And if the law was set up in that way you would be satisfied?—I would, Sir.

5314. *Chairman:* Then from that I should like to pass to general considerations about the protection of investors. I do not know if you agree that your essential function is to provide an organisation through which shares can be freely marketed. That is your basic function?—*Lord Ritchie:* Yes.

5315. And as an instance of that and if your organisation is to continue in existence and maintain its credit, it is essential that you should impose some regulations as to the shares and securities which can be dealt in on that exchange?—Yes.

5316. And that involves suitable regulations designed to protect primarily, I take it, the prospective investors so as to enable them to form a fair assessment of the proposition in which they are thinking of investing their money?—Yes, Sir, as regards these particular regulations.

5317. And you have indeed set up an elaborate code of rules which in a number of respects goes beyond the statutory protection required in the case of a prospectus, offers for sale, and so forth?—Yes.

5318. These are your domestic rules?—Yes.

5319. And the sanction, the mode of securing compliance, apart from disciplinary action against your members, consists of the withholding or cancellation of the official quotation attached to the shares in question?—Yes.

5320. And that is a severe penalty because it means that the shares in question cannot be dealt with on your exchange except in special transactions requiring special sanction?—Yes.

5321. That is the basic position. Now, as regards the protection you provide it is designed, is it not, primarily for intending investors and not for existing shareholders, would that be right?—Yes, I

think so, Sir. I think we come back in a way to something which you were asking about earlier and that is the question of withdrawing a quotation. That is a very powerful weapon which is in our hands and we sometimes have been criticised for not using it more often but the reason why we only exercise that power with reluctance is because of the damage that we are doing to the existing shareholders by withholding the power to deal in the shares.

5322. Yes. I do not think we need go in detail into the precautions you take in your rules to ensure that the investor gets a square deal, but I would like to ask you this general question. In deciding to grant or withhold quotation for a new issue how far do you investigate the underlying facts? For example, suppose a company is formed to hold and turn to account some specific real property somewhere in the country and that is described in the document submitted to you as of a certain character, size, condition and so forth. What steps do you take to verify the truth of such statements?—I think perhaps I would ask Mr. Wareham to answer that question. If I might just say generally we have been taking a number of fresh steps along those very lines just lately particularly in relation to property companies.

Mr. Wareham: I think I should say in the first instance that the verification of the information published in prospectuses has by the general practice in this country been left largely to the issuing houses and the sponsoring brokers, the reporting accountants, the solicitors and others who are engaged in the processing of the documents. I think the practice has been founded on the fact that there is a very high standard of investigation carried out by the members of these various bodies in this country.

Our object in the examination of the prospectus is to ensure that all the relevant information is there to enable the shareholder or potential investor to assess the facts. We do not necessarily go behind the statements of the issuing house or the reporting accountants to verify those statements. We may ask for a great deal of supporting information to justify claims that are made and, as my

Chairman indicated, in the case of property companies we were very exercised about claims and statements that were being made and we did take expert advice from the Royal Institution of Chartered Surveyors and other bodies as to the sort of information we should seek in regard to properties. We have in addition power to call for a report upon the investigations that have been carried out by the sponsors where we think such report is necessary. If, for example, we have a case before us where as a result of our enquiries we feel that the sponsors are not fully informed of the proposition, then we have the power to ask for a full report on the nature and extent of the enquiries by the sponsors, even down to such details as the internal accounting requirements that may have been carried out or adopted in a particular business.

5323. Yes. In the property company case I suppose the sponsors would produce statements by surveyors, valuers and so on giving all the relevant particulars about the property and the opinion of the experts as to its investment value and so forth?—Yes. I think perhaps I should have added that the great majority of the claims in the prospectus have got to be supported by the opinions of experts. The profits and assets are supported by the reporting accountants, the valuations and details of properties are supported by the opinions of independent valuers and the document contains their report and so on.

Lord Ritchie: We do pay a retainer to Messrs. Debenham, Tewson & Chinnocks to advise us on these matters on property valuation.

5324. They are retained as independent experts?—Yes.

Mr. Hunter: We have three independent experts who are our standing experts. We have Peat, Marwick, Mitchell & Co., accountants; Debenham, Tewson & Chinnocks on property and we have Linklater & Paines as solicitors. They are the three standing experts we have to whom the share and loan department can refer at any time and ask anything. The Royal Institution of Chartered Surveyors, in fact, drew up for us the draft questionnaire on which the department asks for

the information which they require on property issues. We spent a lot of time last year on property because we were rather worried about some which had been admitted previously, and within the last 18 months the whole procedure of property issues has been very, very greatly tightened up.

5325. Yes. So that you do not accept the mere statement of these sponsors, you require supporting evidence from experts and you have three independent experts to advise you on the different departments of the proposition, so to speak?—Yes. I think I may put it this way. We may or may not require supporting evidence. If we have any reason whatsoever for suspicion when Mr. Wareham and his men see the brokers who come round, then they ask questions. If the broker is at all vague and does not appear to know the answers to the questions pretty well and if they are then suspicious that perhaps this issue has not been investigated in the way in which it ought to be, we will then ask questions which we would not otherwise do. We have taken the right to ask very, very wide questions about internal accounting procedures, about managerial procedures and everything else about the company.

5326. You cannot really give a figure but how many of the prospectuses, offers for sale, and so on issued during recent years have come home to roost?—Very few, Sir.

5327. So far as you know have there been many of the old fashioned actions on the prospectus alleging misrepresentation and that kind of thing?—I cannot think of any action, except one shortly after the war about Miles Aircraft. That went to the Courts. I can think of a couple of companies where the preference shares defaulted within the year. One certainly should never have got through and I do not think would now. But there are really surprisingly few cases of this sort. It is very much a matter of comment—and the Press are a great help in this way—if a prospectus estimate is not lived up to.

5328. *Professor Gower*: Have you carried out investigations to see how often the estimate of future profits and dividends

is lived up to? There is a great contrast here. American practice is to refuse these estimates to be made on the ground that investigation shows they are too often unrelated to reality. Here some value seems to be attached to such estimates. I wondered if you had checked up?—They are very seldom high. I do not think we have ever checked up. From experience I would say they quite often err on the low side.

Mr. Wareham: I think I would add we did make some attempt within the last 18 months to ascertain how many cases there were where the profits were considerably below estimates and there were only one or two cases.

5329. *Mr. Brown*: Would they have been explained by some event occurring afterwards?—I think in both cases there were economic factors which had arisen which at least partially explained it.

5330. *Chairman*: Then my next question is this: when you have taken all the precautions you have described to ensure the factual accuracy of the material before you, do you go on to consider the merits of the proposition?—No, we do not consider the merits of the proposition. We feel that this is the field of the potential investor; that our task is simply to ensure that he is in a position to assess those merits.

5331. There is a passage in your memorandum to which I would like to refer in connection with that. It is paragraph 15, where you say:

"In a small number of cases the examination may result in some alteration in the proposed organisation or even the abandonment of the proposition. In certain cases the proposition may be considered wholly unsuitable for quotation or not sufficiently developed to justify quotation; in these cases it is discussed with the panel which may indicate that it would not be prepared to grant a quotation or that quotation would only be considered after, say, the publication of the first accounts to show a full year's operation of the proposition."

That suggested to my mind that you do go into the merits to the extent of seeing whether the proposition is what one might

call in a business sense viable.—*Mr. Hunter:* We had a case of a company which came for quotation where the managing director was twice convicted of fraud and bankruptcy, in one case a very long time ago. He was obviously the chap who was the guiding spirit of the company and we said that we were very unhappy about this and unless he was either removed or the board was very much strengthened to our satisfaction we did not feel we could give a quotation. That is the sort of case which happens, or it may be that it is a new company which is seeking risk capital. We cannot say that we will not give a quotation unless we have five or ten years' figures, as the case may be, otherwise no new venture would ever see the light of day. Therefore there are times when we allow quotations without a record which the companies can put in front of the public, but in those cases there is sufficient backing by reputable accountants and reputable experts of all sorts so that the investor knows enough to make up his mind, certainly the sophisticated investor. But if a company comes which is starting off a new manufacturing process where really it is impossible to say whether it is going to be profitable or not then we do not feel that it is the sort of thing which should go in front of the public without some kind of a record to back up what the prospectus states.

5332. It would be possible that all your regulations could have been complied with to the letter, the fullest possible information and perfectly true information given but the conclusion might emerge, for instance, that the concern would be greatly over-capitalised; you would not concern yourself with that?—If we once do that we are lost. I think the Americans tried it. I think I am right in saying they had a red stamp across their prospectus—"This security is speculative". The corollary being that if it was not there it was not speculative. If we once say this is a good investment or a properly capitalised investment, if we once say this is not a good investment, in due course the public will expect the Stock Exchange to make judgments which properly should be made by the investor. We must not ever be in a position of judging the value of investment.

5333. What do you mean by "wholly unsuitable for quotation"?—Usually I think it is a case of not having a long enough record in order for anybody to judge.

Mr. Wareham: I think we have had one or two cases in the past where the company was extremely small or the purpose of the company was something about which we were not happy. If, for example, a football pools promoter came there might be some reluctance to accept that type of business as suitable for quotation.

5334. How about a Spanish galleon sunk somewhere in the West Indies crammed full with bullion, what would you do about that?—This is simply a question of degree and we are in the fortunate position of being able to be very flexible in the application of our rules, and if the committee were not happy that that was a suitable proposition we should then not consider it.

Mr. Hunter: I think if there was any case where there were really no facts on which somebody could make up their mind but plenty of fancy, therefore the thing was open to fairly wide speculative movement, in those circumstances we certainly would not grant a quotation.

5335. It must be a question of degree?—Yes.

5336. Obviously you could not substitute your own judgment for that of the sponsors on the question whether a business was likely to prosper or to what extent. I quite appreciate that would be impossible, but you must, I take it, draw the line somewhere?—We must, I think, exercise our judgment to make quite sure that the public have sufficient information on which they can make up a reasonable investment judgment.

5337. Yes. To sum up the position, generally speaking you regard your function as being to ensure that the prospective investor is fully informed on all matters necessary to enable him, with the help of any advisory system employed, to assess for himself the merits of the proposition on which he is invited to subscribe?—Yes.

5338. That broadly is your function. Now, so far as issues for which a quotation

is sought are concerned the combination of statutory and Stock Exchange requirements seems to have worked very well in practice, if I may say so with respect. Would you claim that at all events in the conditions existing in this country it is preferable to the system in force in the United States of America where the issue of all listed stocks is subject to control by statutory body in the shape of the Securities & Exchange Commission? Could you give us your views about that?—*Lord Ritchie*: The advantages and disadvantages of establishing the equivalent of a Securities and Exchange Commission in this country have been, as we all know, the subject of a great deal of debate recently. We think it proper that attention should be drawn to the circumstances in which the S.E.C. came into being in America. The Government of the United States was in the hands of a recently formed administration which was charged with a policy of national recovery for a country which had just experienced the most serious financial crisis in its history.

The administration of the London Stock Market is in the hands of a Council of men who are experienced in their business as compared with officials who, no matter how well trained, do not have an understanding or the experience of the daily impact of carrying on business. If the Council fails to perform its functions satisfactorily, London will lose its business. A similar result would occur if it were regulated with an inflexible or ponderous hand.

In considering all the relevant factors we believe that it is necessary to remember that London is and must surely aim to remain an international market. Our policy is directed to the attainment of these objects and our rules contain much which is in advance of the requirements of the law at present. Our requirements are based on experience after trial and error and we are continually seeking ways in which we can further progress.

We believe that the flexibility with which we can administer our regulations is invaluable when compared with the necessarily rigid application of rules by a Government department. In this connection it has already transpired in some of what has been said today that from time

to time applications come forward for quotation which conform in every respect with the regulations but about which information is available which makes the appropriate committee decide that the application is an undesirable one. There are also applications on the other side of the picture received from time to time which for technical reasons cannot strictly conform to all the regulations but which are clearly of a class as to make the waiving of certain of these regulations proper and desirable. The value of this flexibility has been recognised both frequently and in the highest quarters.

We also consider that the speed with which decisions on matters of principle or detail are obtained is of the greatest value to the business community. In recent years there has grown up an increasing practice for the City Institutions to collaborate. A recent example is the proposals for the new method of transfer procedure. This machinery exists for bringing this collaboration into operation at the shortest notice. We believe that the principle is an admirable one and one where all parties are ready and willing to co-operate. We know that much remains and will always remain to be done in order to keep pace with changing conditions but we think that this is the type of system not only best suited to this country but fundamentally better than the rigidity and formality which exists elsewhere.

It may be added, of course, that no system has yet been devised which can guard against deliberate fraud. We naturally receive criticism from time to time much of which is informed and helpful and from which we obtain considerable benefit. But looking back over the past 30 years we think it can be said that the confidence which has been put in us has not been misplaced.

These comments, Mr. Chairman, have been made with reference to dealing in securities and to the policing of the security markets so far as concerns the Stock Exchange. As regards the raising of capital where no application for quotation on the Stock Exchange is to be sought, the Stock Exchange, of course, has no jurisdiction.

Chairman: Would anyone like to supplement that?

5339. *Mr. Scott*: You did not comment on one quite important difference I imagine that applies in the United States as compared with this country. You really as the London Stock Exchange represent by far the greatest number of quoted securities. The situation in the United States is very different where, as we were told last week, they have 51 different jurisdictions, 50 States and the District of Columbia, and differing laws in the various States. A nation-wide offering here of a security in a newspaper is practicable and frequently done, whereas in the United States, of course, that is not so.—Yes, and I think in addition it should not be forgotten that the whole way of life financially as regards investments is utterly different in the United States. For one example, the definition of the word "underwriting" is an entirely different thing in this country from what it is out there. I believe that there are in existence a number of stock salesmen or whatever they are called, running into something over six figures, going round the country and their job is to try to sell stock to the public, literally hawking it at the door. If the Committee wanted to have details my colleague, Mr. Hunter, actually acted as one of these salesmen for a period in the United States. But I think possibly the attitude of the public relations of the two countries, the two Stock Exchanges, is relevant in this context. As the Committee will know for the past ten years or so we have come into the public relations field a certain amount. In the United States the whole atmosphere of their public relations is selling stock to the public. That is what the Stock Exchange aims to do. They have "Own your share of American business" printed on their official letters. In a much smaller way the Stock Exchange public relations attitude in this country has been merely to try to explain to the public that we believe the Stock Exchange is a good thing and not a bad thing, and that a Stock Exchange is necessary. But never to sell stock to the public. I think that reflects the difference in the needs of the two countries.

5340. *Mrs. Naylor*: Do you think that the existence of the S.E.C. prevents Wall Street from being an international stock market?—I would say it does have a considerable brake on it because we have

experienced that when there are new issues by companies like Shell and so forth there is the most awful rignarole before they can get a quotation there and we have mutual trouble with them over it.

5341. Is it the S.E.C. rules or the New York Stock Exchange?—S.E.C. almost entirely.

Mr. Wareham: It is the rules of S.E.C. and the fact that they are inflexible. We had considerable discussions over the Shell issue some three or four years ago. The basic trouble was that the S.E.C. could not go to Congress and ask for amendment of the legislation because Congress would never be prepared to amend legislation which might give some advantage to a shareholder who was resident outside the United States.

5342. *Chairman*: Perhaps one could pass on to the question of unquoted securities, that is to say securities for which no official quotation on the Stock Exchange is sought and as you, I think, Lord Ritchie, said just now, the Stock Exchange has no jurisdiction in those cases?—*Lord Ritchie*: No jurisdiction.

5343. As I have no doubt you are well aware prospectuses do come out from time to time which do not seek an official quotation and which, therefore, do not get the advantage of the Stock Exchange scrutiny which is such a vital factor in the case of quoted securities. You make certain proposals under heading 17. Perhaps we might look at them. Paragraph 4 says:

"It is the practice of the Stock Exchange to require companies to furnish a statement as to the financial and trading prospects of the company together with material information which may be relevant thereto and in certain circumstances to ask for the profits' estimates to be accompanied by evidence supporting the basis on which they have been determined. The Council would welcome legislation which included such information in the prospectus requirements of the Companies Act."

That, of course, if your recommendation was adopted would go into the Act and would apply as part of the prospectus law?—Yes.

5344. Then paragraph 6:

"Having regard to the necessity to provide adequate safeguards in cases where no application is being made to a recognised Stock Exchange, the Council considers that the following written requirements of the Stock Exchange should be incorporated in the requirements of a revised Companies Act."

Then various information is listed. That again would involve a tightening up of the prospectus law which would affect cases where no official quotation was sought. Then there is paragraph 12 under this heading, which sets out certain Stock Exchange requirements and goes on at paragraph 13:

"The Council's experience in regard to quoted companies leads it to suggest that some similar extensions to the provisions of the Companies Act would be advantageous in regard to such issues generally." So in these respects you advocate tightening up the law as to what a prospectus offering non-quoted shares is to contain. No doubt these suggestions so far as they are not already incorporated in any of the existing prospectus law would be an improvement but what troubles me is that that is no substitute for the very valuable and close scrutiny which the documents offering quoted investments receive. Can you, in your wisdom, make any suggestions as to how scrutiny of such prospectuses could be provided?—I think our thought really on that is that it would have to be handled by some department of the Board of Trade. I think it would be a task which would be quite beyond us.

5345. *Professor Gower*: You do it for a quotation on a provincial exchange by informal arrangements. As I understand it, Mr. Wareham does help with the scrutiny in those cases. There must be much more of those than completely unquoted flotations.—*Mr. Wareham*: I would not go so far as to say we do help with scrutiny in such cases. We do get a certain number of enquiries from members of the associated exchanges when they are in doubt about certain points and in one or two cases where they have great difficulties they have submitted to us the documents and asked for further views.

5346. They told us when they were here they had not got the staff to carry out any

real screening but that fortunately an arrangement had been made with you whereby you did it for them, that is what I understood?—We are always very happy and we have indicated to them that we are very ready and willing to give them any help and advice which they may seek but I do not think I would like to subscribe to the fact that in all issues with which they are engaged they submit the documents to us or even ask questions on all of them.

5347. *Chairman*: Might I refer to the material question in the 8th day of our evidence, question no. 2524 to the representatives of the Council of Associated Stock Exchanges: "It is not just a question of having regulations but of scrutinising statements to make sure they comply with the regulations not only to the letter but in the spirit. Have your smaller provincial exchanges really got the staff to do this adequately? Answer: I do not think they have. We get quite a lot of encouragement from the Share and Loan Department in London. I cannot be sure of this but I think a number of the secretaries do communicate with London and also some of the smaller ones get in touch with the secretaries of the larger exchanges."—Yes, I notice he says in his answer that he cannot be sure of the extent.

5348. Perhaps I had better read the next question. "2525. I can quite see if the shares were also going to be quoted in London they would come under the umbrella of that Stock Exchange but is there really adequate scrutiny in the other cases always? Answer: I should have thought so. I do not think they have very many issues on these smaller exchanges. One or two of the smaller exchanges, for example, practically always come to Liverpool." Presumably they would get advice from the Stock Exchange there.—I think that is very likely that they may go to one of their member exchanges; they may go to the exchange acting for the time being as the secretary of the Council of Associated Stock Exchanges.

5349. They have on occasion come to you?—They have on occasion come to us. They do from time to time ring us up on particular points and discuss matters.

5350. Various suggestions have been made to fill this need for scrutiny in the cases of non-quoted stocks. The first is the Board of Trade might be required to carry out a similar scrutiny of unquoted prospectuses. Given manpower and so forth do you think that might be a reasonable solution?—*Lord Ritchie*: I think so, Sir. I think that we could undertake the task if we were given the funds to do it and we could get the manpower.

5351. You might be able to undertake it yourselves if the cost was provided for?—Yes.

Mr. Wareham: I think we should have to envisage the possibility that if we were carrying out some form of scrutiny in respect of companies which were not making an application for quotation that we would need some protection from the possibility of having to be answerable to Parliament for our actions. If, for example, we were insisting on certain information being disclosed before the issue saw the light of day there might be very considerable objections, so considerable that they would result in questions being asked in Parliament and the Stock Exchange might find itself in the invidious position of having to answer to Parliament for its actions. I think it would be very essential to have some protection from such a situation if any such provision were made.

5352. Supposing the Board of Trade was given power after consultation with the Stock Exchange?—Yes.

5353. The Stock Exchange might be brought in in some way like that, and that might get over that difficulty?—Yes. We should be very happy to exchange views and assist on that basis.

5354. It would be going too far to say roundly that it should be unlawful to offer to the public any stock in respect of which a quotation was not going to be provided?—*Lord Ritchie*: Yes.

5355. That would be too much of a restriction, would you agree?—Yes.

5356. So that so far it seems to be the Board of Trade, or the Board of Trade in consultation with the Stock Exchange as a possible runner?—I think so, yes.

Mr. Hunter: I think there is an alternative one—to put up penalties. I think if the penalties for omission as well as commission were high enough it would make people think twice before they put up some prospectuses without being gone into.

5357. Yes. Your statement of profits might require the sponsor to say that the facts he has stated are true and there are no further facts which if disclosed would make the facts stated misleading, that kind of undertaking?—Yes. I think if the aggrieved investor could sue the promoters for double the amount of money lost, if he could prove he had bought shares on a false statement or lack of statement which might be known to the promoters at the time it would be a very great sanction against people putting up prospectuses which lacked information.

5358. I would not much like allowing him more damages than he had suffered.—This is only in respect of securities which are not quoted. I think it requires a strong sanction or else somebody looking after it.

5359. It would rather stick in my throat to see a man who had lost £5 being able to recover £500.—He might recover £10.

5360. *Professor Gower*: In an answer you gave to the Chairman you said it would be going much too far to provide that public issues should not be made unless the shares were to be quoted on the Stock Exchange. Why do you say that? In a country where there is no over-the-counter market—there hardly is in this country—is it unreasonable for legislation to ban public issues of shares which virtually are unsaleable?—*Lord Ritchie*: I think it is rather unreasonable in the case of a very small company where they would not come for or want a quotation.

5361. The definition of "public" is a difficult one but when, as happened in two recent cases, shares are kept on tap for the public generally would it be going too far to ban them? People were induced to buy shares which they virtually had no means of selling except through the company?—*Mr. Quirk*: I think, Sir, we should dislike it very much because it would

completely cut across our freedom and our flexibility on whether we granted a quotation or not.

Professor Gower: I see that.—We are rather jealous of our good name and the class of stocks we try to quote and not quote and I think we would be forced in a position which would be rather uncomfortable.

5362. Under section 51 of the Act as it is worded at the moment if the prospectus announces that a quotation is to be applied for and then the Stock Exchange instead of refusing it defers consideration, the unfortunate subscribers do not get their money back. It is expressly put in this way as a result of the recommendation of the Cohen Committee. It always seems to me that that is a bit unhappy. Have there been any cases where you have deferred?—*Mr. Wareham:* There have been one or two cases where we have deferred consideration of the application for quotation to such time as the first accounts showing a full year's operations had been published. We had some slight doubts and the committee were in favour of deferring consideration until they had seen accounts showing a full year's operations.

5363. *Mr. Scott:* Did the issue then take place?—*Yes.*

5364. *Professor Gower:* As long as you refuse all is well because the subscriber gets his money back. It is the case where you defer. I can see you might well say at an early stage: "Look, we will defer this", and then the issue would not be made. But section 51 envisages cases where the issue is made, the prospectus announces that quotation is being applied for and you at the moment have power to defer consideration of this and the unfortunate subscribers cannot get their money back, although you may never grant a quotation; is this right and should it be allowed?—*I think I should correct my statement. I think the case of deferment after the lists had opened which I was thinking of was probably some years ago; not since the 1948 Act.*

5365. Would you agree that section might simply read that if a quotation had not been granted within 28 days then the investors should be entitled to their money back?—*Lord Ritchie:* Yes.

Mr. Hunter: I think it is fair to say from the time of publication of the prospectus it is very, very unlikely. All the detail is done, a quotation would really only be deferred for a technical reason.

5366. *Chairman:* There are one or two other points on this aspect of the matter and the first, I think, is in part covered by discussions we have already had. That is the institution as a matter of practice of regular liaison between the Board of Trade and the Stock Exchange covering the whole field of investor protection. That is a suggestion really for unofficial contact and consultation so it falls short of the earlier suggestion which we have discussed. I take it there would be no objection to that from your point of view?—*Lord Ritchie:* No.

5367. Then the second point reverts to the provincial Stock Exchanges and the question is whether the machinery for examining new issues by provincial Stock Exchanges, or some of them, is as effective as that of the London Stock Exchange having regard to their small size and more limited resources.—*It cannot be.*

5368. If one looks through the list of Stock Exchanges there are some very small ones.—*Yes.*

5369. It has been suggested, I think, that it would be desirable perhaps if they were asked about the possibility of combination and reorganisation so as to have a more limited number of Exchanges which could provide the services necessary to verify these prospectuses and so forth.—*Mr. Walker:* I think that is beginning to happen. The Newport Exchange recently amalgamated by joining up with Cardiff and I am the Chairman of the Committee that deals with country affairs and I think the Council of the Associated Exchanges are very well aware that the small Exchanges are perhaps not as efficient as they might be.

5370. So the need for something in the way of reorganisation is recognised?—*I think it is, Sir.*

5371. And there are signs that steps are being taken to carry it out?—*Yes.* The first step was taken about a month ago with regard to Newport.

5372. Then reverting to the contents of prospectuses I think this has already been touched upon: your practice is to require companies to furnish statements as to their financial and trading prospects whereas the S.E.C. puts what seems to amount to an absolute ban on including in the prospectus any such statement. They confine themselves to the facts with no inferences or estimates as to the future. Have you any comment to make on that? —*Mr. Hunter*: It seems to us absolutely cardinal to the whole thing. If the company has come to the end of a long period of prosperity and they know it you may get an offer for sale coming out almost immediately following the end of a very good year. If it is not necessary in that prospectus to say that they do not expect the next year to be as good, people can get away with quite a lot of other people's money. We think it is very important that companies should not be judged on the past but be judged on the future. The future is far more important than the past.

5373. I think the S.E.C. make an exception in the case of really bad news? —*Even trends*, Sir.

5374. But there is nothing in the way of the familiar forecasts which set out profits in larger and larger letters, finally huge black letters, with the inference that if the profits go on running at the same rate as they have for the last fortnight then the dividend should be covered 102 times, that kind of thing. But seriously, is it desirable that the sponsors should be required to say what their opinion is of the future, whether it be good or whether it be bad?—I do think it absolutely essential.

5375. *Mr. Bingen*: How far ahead do you expect directors to prophecy?—Next financial year unless there is one still to report. If they are only coming out in February and there is a financial year ending in April we would expect the one following.

5376. Really only 12 months' forecast? —*Yes*.

5377. *Chairman*: Thank you. A third point on a different topic. Section 50 (1) allows an interval of three days between the issue of a prospectus and the opening

of the lists. It has been suggested to us that the period of three days which is designed to enable a prospective investor to inform himself as to the proposition is too short and that some longer period should be substituted. Have you any view on that?—Three days is absolutely ample.

5378. In the United States 20 days is their standard period.—*Sir*, they have no national advertising. They are a big country. They have a great many securities which are not quoted. They have these salesmen who go out and they have not got our form of underwriting. I think that explains why it is practicable there but would not be here.

5379. That perhaps might make 20 days reasonable in the United States. In your view it would be grossly excessive here?—I think it would be a very great handicap to industry. The pricing of issues cannot be done during that period. You already have to go through a very long period: i.e., the production of the prospectus which takes six weeks upwards, sometimes very much longer. At the end of that period if you add another three weeks I think it is a great hardship. Markets may be moving one way or the other. I think the sooner you get on with it the better.

5380. *Mr. Althaus*: Would it be right to say that in this country these issues in general are underwritten by institutional investors and that they themselves are highly critical and highly competent investors and find no difficulty in deciding whether they will undertake underwriting or not?—I think that is fair.

5381. *Professor Gower*: They get prior information. They do not have to make up their minds in three days, do they? —*They have to make up their minds in 24 hours*.

5382. Surely they have seen the prospectus. You say it will be in draft for at least six weeks. During those six weeks surely quite a lot of people see it in draft form, including official underwriters?—*No, Sir*. I do not say never. Undoubtedly on a very big issue one or two people might be consulted but generally speaking underwriters are given less than 24 hours.

The letter will go out for answer at 3 p.m. next day. They get from first post to 3 p.m.

Mr. Brown: That is absolutely correct.

5383. *Professor Gower:* Is there any real objection to a longer period? I can quite see there is difficulty in fixing the price but they get round that in the United States by circulating a provisional prospectus which leaves out the price and other things necessarily dependent on the price. Would it be impracticable for that to occur here? Why would there be anything wrong in Mrs. Naylor having a provisional prospectus which has been the second draft agreed with the Stock Exchange so that she can comment on it prior to or at the same time as it is published; as the *Investors' Chronicle* only comes out weekly she may not be able to comment on it at all until it is too late? —Too dangerous and the prospectus may be changed.

5384. Assuming there is no change?

—*Mr. Quirk:* It simply delays the whole operation.

5385. It would if there was a substantial change. Obviously brokers would have to make sure they did not start circulating it until it was finalised and I should have thought in 99 cases out of 100 it would not be a difficult decision to make.—*Mr. Hunter:* In the United States underwriting is entirely different.

5386. I can see all that, but the fact does remain that in the United States most stockbrokers will have had 20 days whereas over here the average stockbroker will have only three.—I do not think any stockbroker should need 20 days.

5387. It may be too much. Could I put another point which has been brought to my attention by someone who has always banked in the Post Office Savings Bank. He says he can never subscribe for a new issue because he cannot get money out under three days, therefore it is impossible for him to subscribe to a new issue. Here is a small investor, I gather you want to encourage, who is precluded by the present rule?—I think if he went to any reasonable broker they would do

it for him. Any client who had been properly introduced to the broker, whom the broker knew kept his money in the Post Office and whom the broker got to trust, I think under those circumstances most reasonable brokers would, in fact, advance the cash on a statement that it would be paid for through the Post Office.

Sir George Erskine: There is more than three days because normal practice is to give the information to the Press at the same time as the underwriter so the Press are commenting on the issue some days before the prospectus has actually been advertised and the potential investor has in fact got more than three days to make up his mind.

Chairman: Yes, I see.

Mrs. Naylor: The information given to the Press is not as detailed as the underwriters get in most cases, surely?

Sir George Erskine: Usually the Press get the underwriter's copy of the prospectus.

Mr. Mackinnon: Presumably the Press would have the proofs of the advertisement anyhow several days in advance in time for the editor to make comments, would that be the case?

5388. *Mrs. Naylor:* I did make some enquiries yesterday. The prospectus is only sent in on the afternoon of the day before it is going to be published and I also understood that it was quite rare—as the result of some special personal contact—that the information given to the underwriters was available to any paper.—I think the fundamental difference in this country is this difference which Lord Ritchie mentioned about selling. It is terribly important to the S.E.C. to see that salesmen deal with issues properly. No issues are done by subscription. There is no form of subscription on the advertisement. There is no full advertisement published. There is only an advertisement published saying a prospectus is available. They are all Box advertisements in the United States. There is no detail published in any newspaper of any kind. Therefore it would be possible out there if there was only a short period of time for a salesman—I was one for 11 years and know most of their practices—to ring

up a client and say you had better subscribe to this, I cannot get the prospectus quickly, I know it is going out of the window, put your name down. Subsequently you push the prospectus along and the chap may not like it but he is committed by then. That is very much the practice the S.E.C. is trying to prevent. An issue was advertised and if it was liked out it went, very quickly. I think it was because of the special high pressure salesmanship which is the way that securities are sold there, that the time element was brought in so that nobody could say "you had better hurry up and let me know". You have, in fact, got three weeks. The buyer of a security of new issue in the United States really can only get it if he knows a salesman of one of the underwriting broking firms. There is no form of application. You cannot put your form in and take a chance with the ballot. You have to know the right person in the right firm and be one of his clients. That being the case it was all too easy for someone to high-pressure people. Over here that is not the case. The full prospectus is published in the newspapers, people can see it and the name of the firm at the moment organising it; they can get hold of a broker who can go on the floor of the Exchange and try and get it for them.

5389. *Chairman*: I think we have that point. We will have to consider it. I can well see there are important differences between the United States and this country. Could we pass to another matter which is the control of the business of dealing in securities. The effect of your proposals on this matter would restrict somewhat severely the categories of persons who are allowed to deal. The proposals are to be found under heading 18 of your memorandum and I think the effect of what is proposed is to exclude from the category of people who can act as recognised dealers in securities and recognised Stock Exchanges all except those actually named in the memorandum and to abolish the licensed dealer altogether. If your recommendations were adopted the position would be, as it were, frozen once and for all so that no new association could be allowed to come into the field. Do you think it would be reasonable to freeze the position

once and for all by any new Act of Parliament? At present, you see, it depends on the Board of Trade. They can add people or subtract them.—*Lord Ritchie*: I think perhaps we had not fully visualised the point of your question that it would freeze out any new association. We were dealing with the existing position as it is today and making a recommendation affecting that. I think the Committee is probably aware of the associations which would be excluded under our recommendations. They do consist, apart from the licensed dealers, of the Oldham Stock Exchange, Mincing Lane Stock Exchange and the Association of Stock and Share Dealers. Those are the important bodies which would be excluded if that recommendation went through. We believe that there is good reason for the exclusion of all those three bodies.

5390. There was one association which gave evidence before us which I understand was likely to be excluded or so they told us. That surely would be a matter between you and any other interested parties and the Board of Trade. Is it not essential to give some statutory body authority to say who is going to be permitted to deal and who is not, otherwise the thing is frozen once and for all?—It is.

Mr. Walker: We do not propose the exclusion of the exempted dealers. They could still be added to or reduced.

Lord Ritchie: We accept the exempted dealers as being a top class and many of them are on our registers of agents and that list under this recommendation could always be added to. But—I think I must mention details here—Mincing Lane Stock Exchange probably once performed an important function in rubber and tea shares but it now consists of four firms, two are in the City, one in the West End and one has an address in Dartford in Kent. It really should not continue to exist as a Stock Exchange and body dealing with stocks and shares. I think those individual firms would have the right to apply to the Board of Trade for an exemption order and become exempted dealers if they were accepted. In the case of Oldham we feel that they should join or endeavour to join some other association. They have not so far been accepted.

I think they have made application twice for membership of the Associated Stock Exchanges.

5391. Did you say that Mincing Lane was accepted or not?—No, as far as we know they have never applied.

5392. Oldham has applied and has not been accepted?—As I say, twice been refused.

5393. Could you give us some further details?—They consist of 26 firms of which 15 are one-man firms and they are spread all over Lancashire. They have no common floor and they have a chairman and a committee but they really are not a Stock Exchange. We think they should either become members of a Stock Exchange and there are two big Stock Exchanges in the area, Liverpool and Manchester, or they should apply for admission to the Provincial Brokers' Stock Exchange where they might or might not be accepted but they would be treated as individual firms. But we feel the fact is they are not a proper Stock Exchange; they are out on a limb by themselves. I am not suggesting their organisation is not adequate or they run anything but first class business but they are out on a limb by themselves and it seems to us to be wrong.

5394. There is a third one?—There is the Association of Stock and Share Dealers, that is a body you had in front of you not very long ago, I think, and quite frankly we think that that Association should not have been recognised in the Prevention of Fraud Act, because in the main their occupation is circularising the public with offers of shares. They have no doubt certain permanent clients but they do, many of the firms, send circulars, broadcast round the country, offering shares at a net price to people whom they do not know at all and we feel that this is not a desirable practice. We have got with us which we can, if you would like, Sir, hand in, a copy of a recent circular which came to us through a lady client of a firm of brokers. She wrote in a statement that she received these circulars regularly, she had never heard of the people, she finishes up: "It looks quite *bona fide* to me but I never do anything but tear them up". Those go all round the country.

5395. I think their stock in trade consists exclusively of quoted securities?—Yes, they buy a block of shares in the market. They add a perfectly reputable commission and they write round to the public offering up to so many thousand or so many hundred shares at a net price and we think it is open to abuse and we think they could, some of the firms, properly apply either to the Stock Exchange or become exempted dealers but as an Association broadcasting circulars round the country to the public we think it undesirable.

5396. I follow. I think it would be difficult for the Committee to carry this much further than to say it seems to be a matter for the Board of Trade in any new Act. No doubt the Board of Trade have regard to all relevant circumstances but I think it would be difficult for us to make any specific recommendation about a particular organisation.—Yes.

5397. It is highly improbable that the Board of Trade would remove the London Stock Exchange! We will bear all that in mind. Could we now just have a word about take-over bids. I gather that you are, broadly speaking, satisfied with the new Board of Trade Regulations?—Yes.

5398. I do not think there is any question I want to ask about your own observations. But there have been some other suggestions made about take-over bids and one was from Mr. Clore that all take-over bids should be for 100 per cent. and no less. Would you see any merit in that?—*Mr. Hunter*: No, Sir.

5399. His idea is to get rid of minorities.—Yes, Sir. We do not think that on the whole it would be a good thing. We think if somebody makes a bid for less than 100 per cent. that purchases should be *pro rata* if more than the required proportion offer their shares, but we do not want to take away from anybody the right to go on remaining there if he wants to. We think that people should make up their minds about their own shares and should not have them made up for them.

5400. *Mrs. Naylor*: A *pro rata* acceptance can leave people with a very tiresome shareholding, can it not?—It could do.

5401. You do not think that is a serious objection?—No, they do not have to offer their shares.

5402. *Mr. Lawson:* Is there not something to be said for the view that the bidder should offer to buy the lot in the sense that the shareholder is going to find himself in a minority with a new controlling shareholding?—Yes, I think that is perfectly true but I think if somebody makes an offer it is up to the shareholder to make up his own mind. I think if a shareholder can sit back and comfortably say "if he gets 51 per cent. I can make him take my shares", you are moving out of bargaining, which is a healthy and good thing to have, into an entirely new element. I can see cases where it would be useful but I think the balance is against it. I think it is terribly important that people who are shareholders realise they have responsibility to themselves and to their company. Generally speaking that is very true of the institutions, it is becoming increasingly true of private individuals. I think anything which tends to let people sit back and say "it does not matter, I am protected, I can come along afterwards and if he does get 51 per cent. of the stock I can force him to buy me out", I do not think that is responsible.

Mr. Quirk: I think it is very difficult for the bidder to know where he is if he gets 51 per cent., when people have been sitting back and waiting and then they come along afterwards. I think it is putting rather undue hardship on the bidder.

5403. If he takes 51 per cent. he should take it *pro rata*?—*Mr. Hunter:* I think it is easy to bid for 51 per cent. I think if he bids for 51 per cent. and 70 per cent. offer their shares he should take it *pro rata*.

5404. *Mr. Brown:* If, in fact, the bid is for 51 per cent. the shareholder has not very much option. He can sell or not but if he does not like the bidder he cannot get out of the remaining minority.—The bid may not succeed if they all think that way.

Mr. Quirk: It is often possible to acquire 51 per cent. of the shares through

the market. The shareholder would not then know he was a minority shareholder but in fact was. There is not much difference.

Mr. Hunter: I think the fact is if somebody is not attempting to get a complete shareholding it is easier to bid for the shares on the market and get what one wants and then drop it; I think that is less fair to the shareholder than to make a partial bid.

5405. *Chairman:* It has been suggested if as a result of a take-over bid the bidder acquires 51 per cent. of the shares then the 49 per cent. minority should have the right to compel him to acquire their shares also?—*Mr. Quirk:* We think that is quite wrong, Sir.

5406. *Mrs. Naylor:* But you do not object when it is 90 and 10 per cent.?—No, because of the small minority the present Act works very well.

5407. You would not reduce that 90 to 85, you think 90 is fair?—Yes.

5408. *Chairman:* There has been a suggestion put to us, and we have undertaken to consider it, that on any take-over bid some part at all events of the consideration should consist of cash?—*Mr. Hunter:* No, Sir, we would be very much against that.

5409. I am not quite clear myself as to what the object of that proposition is. Have any of you any views upon it?—I think it would tend to put the sluggish company with a lot of cash in a better position than the company without cash which is expanding fast; the go-ahead company, very often in the very nature of things, is short of cash; it may see another company which would round up its business, I think it would be wrong to penalise it.

5410. Another criticism made of the present take-over procedure is that the bargain is one-sided because the offer is conditional and the acceptance is unconditional and it is said that is wrong.—*Mr. Quirk:* We do not think that is wrong. At some stage a bargain has got to be reached. Someone makes a bid subject to obtaining a certain number of shares, and you offer those shares if you

are a shareholder to that person and until he knows he has got the percentage he has asked for he cannot say whether he wants them or not.

5411. *Professor Gower*: Should not an acceptor be entitled to withdraw prior to the offer being declared unconditional? The wise man makes it the last possible day. Stupid people like me, seeing the recommendation of my directors, immediately accept. A week later somebody else comes forward with a higher offer. Maybe the original bidder will choose to make it unconditional. If he chooses to make it unconditional I cannot get out. Is this fair?—I would imagine that people like that were very rare nowadays. I thought nearly everyone waited to the last day: they are told to by the Press and any official adviser they would go to would say wait until the last day. I would have thought a very small number of people do it early.

Mr. Hunter: I agree with that, and further than that, again, it is important for people to be responsible. I know that there are people—widows and people of that sort—who may be in a difficulty but it is terribly important if people sign a contract they stick to it.

5412. Should it be a contract until it becomes a firm offer?—I think it has to be firm on one side. We do not think, in fact, it is any great hardship. We think very few people accept in the early weeks. Certainly if they ask any advice most people would be told not to and we think the administrative chaos, which might result if withdrawals were possible, is to be avoided if possible.

Mr. Quirk: I think on all take-over bids we have had recently if anyone has accepted the first bid and another one has come out, usually the first bidder, even with acceptances, has released shareholders so far as I know.

Mr. Wareham: I know that it has happened in a number of cases but the normal time is three weeks for acceptance and all advisers say wait till the end of that three-week period.

5413. *Mr. Scott*: If the first offeror makes an offer of, say, 50s. and somebody else outbids him by offering, say, 60s. if he, in fact, puts in another offer of 70s.,

he extends that extra price to the people who have already accepted?—Yes.

5414. Otherwise the first offeror cannot invoke section 209?—Yes, it is necessary to do that to protect himself.

Mr. Hunter: We are keen that more is done to make people feel that they are responsible as shareholders. They are not bits and pieces which get dividends and profits. They have responsibility tied up with it. Anything which hits at that we would be against.

5415. *Professor Gower*: They are acting on the advice of their directors very often. As far as I know the directors do not say "we recommend this offer but we recommend you to postpone accepting it to the last day", do they?—No.

Chairman: I have put all the questions I have in mind to put. I do not know if other members of the Committee would like to put any questions.

5416. *Mr. Lawson*: Could I ask one on take-overs. Are you satisfied that the bidder should not have to give any more information than he gives now with regard to the shares which he is offering in exchange for those of the company for which he is bidding?—If the bidder is a quoted company and there are full particulars available we think that the information given now is sufficient. The information is all there available for anybody who wants to ask in the case of a quoted company. It is quite a separate point if the bidder makes misleading statements. If he makes statements he has to make full ones.

5417. But he is offering shares in effect to people living all over the country, many miles away, perhaps abroad, I suppose they must ask their broker or something of that kind?—I think that is the usual practice.

5418. *Mr. Brown*: Does the Stock Exchange not have to approve the circular sent out?—Yes. They are occasionally sent out without our approval but it is part of the agreement that we have to approve them.

5419. *Mr. Watson*: It becomes a little difficult where one take-over follows another in rapid succession?—Very.

5420. One wonders whether the intention behind this suggestion that a certain amount of cash should be put up does not relate to these very situations where perhaps the public imagination has been inspired to the point of valuing the shares of the acquiring company on a very high basis in relation to their real assets and these shares are offered at some price approaching their market price for the acquisition of other businesses?—I think if somebody has measles you do not cut off one of their fingers. I think there is a rash of take-overs on at the moment and there is a tendency to feel that this is a plague which is going to be with us always; I do not think it is likely to be with us always. I think under normal circumstances the thing works and I think it would be a pity to prevent a go-ahead company from expanding and maintaining its position in a trade to the benefit of everybody concerned—its workers, itself, its shareholders—simply because for the time being it is short of cash. It might have to move very fast to protect its position and I think it would be a great pity because there is a rash of take-overs on at the moment to put any block in the way of go-ahead companies, and generally speaking it is they who are short of cash.

5421. You see no potential danger in this ability to offer shares and shares only for acquisition of other business?—No, Sir.

5422. *Professor Gower*: Section 39 dealing with the Stock Exchange power to grant certificates of exemption—I appreciate this is a very convenient power but on the face of it is a startling one, a dispensing power of this magnitude given to the Stock Exchange, and the remarkable thing is that it was not recommended by the Cohen Committee. It was put in at a late stage in the House of Lords and it is quite clear from the debates that it was envisaged that it would only be used in certain placings. In fact you have used it to a considerably greater extent than that?—Yes.

5423. When it is coupled with a waiver of your normal advertising requirement the investor may get virtually no information at all?—*Mr. Wareham*: The only cases in which it is coupled with a waiver of our normal advertising requirement are

the placings of those fixed income securities of existing quoted companies which are attractive to a very limited class of investors; and a large supply of the relevant statistical cards giving details of that particular security are always available to investors and to anyone who wants them.

5424. When you grant exemption it does mean the Fourth Schedule is excluded completely?—The Fourth Schedule is excluded completely and it remains incumbent upon the Stock Exchange to see that all the other requirements of the Stock Exchange are complied with.

5425. If it is a case where there is not going to be a Stock Exchange quotation the Board of Trade have no power to waive any of the requirements?—No.

5426. Would it not be more logical really if this power were given to the Board of Trade which they would exercise in conjunction with the Stock Exchange in cases where there was to be a Stock Exchange quotation instead of leaving it entirely to a private body? In effect the Board of Trade would then have discretion to waive the requirements of the Fourth Schedule and they would consult you?—I would have thought this valuable exemption could be operated much more easily by the Stock Exchange when it was applying its own requirements because I think one must have regard to what the law requires and what the Stock Exchange is going to require in the form of disclosure. The Stock Exchange may grant a certificate of exemption on the grounds that there is a very long list of contracts which it would be unduly burdensome to publish but in conjunction with that the Stock Exchange is going to take steps to ensure under its own requirements that there is published a summary of the general effect of those contracts. I think if you divide the exercise of this operation it might become rather difficult, become a bit inflexible and there might even be protracted negotiations which would delay issues.

5427. *Mrs. Naylor*: Do you think it would be objectionable if the nature of the modifications authorised from the requirements of the Fourth Schedule were

brought to the attention of investors when a certificate of exemption has been granted, because some of the requirements of the Fourth Schedule are imposed by your own regulations, are they not?—*Yes*, I think this is generally apparent in practice. First of all it is apparent in the case where a certificate is granted for a placing of a fixed income security where there are just brief particulars of security. I would say in practically all other cases it is apparent because there is some statement in the prospectus giving an indication that there is other information which has been excluded. The mere fact, for example, that you have got a summary of contracts makes apparent the reason for which the certificate has been granted. It may be that there is a paragraph explaining that the earlier accounts, profits and losses, have not been disclosed because they relate solely to a rubber company business which has no relevance to the future operations of the company or it may be that on some other ground again a short explanatory paragraph is in there dealing with the particular point. We are very jealous of this privilege and anxious that these exemptions should only be granted in regard to information which is of no advantage to the investor.

Mr. Hunter: We always put in a paragraph where the Fourth Schedule is left out which says what the cover of the capital is that is covered by the particular document and if there is quite a major change in the fortunes of the company we have a prospects paragraph as well; if it is in fact a debenture or share of a company where the earnings are going down rapidly for any reason there would be a paragraph covering that.

5428. *Mr. Mackinnon:* Would it not be more logical to make this certificate of exemption only relate to a particular matter? At the present moment you have the rather ridiculous situation that if you want to relieve somebody from disclosing a lot of contracts you grant a certificate of exemption which releases them from satisfying any of the requirements. Would it not be more logical to give you power to grant the exemption only in relation to particular matters?—*I think we would welcome both powers of exemption. I think we would welcome the ability to*

give certificate of exemption of particular matters but we would be sorry to lose the ability to give an overall certificate of exemption for certain companies. There is a very wide range of things which we think, in fact, are not relevant and possibly even confusing for which a partial certificate of exemption could not be given but which are covered by the present blanket certificate.

Mr. Wareham: It would be imperative to have the power to grant a general certificate of exemption in the case of the placings of fixed income securities where only brief particulars of those securities were listed. I think it would become almost impossible to detail the grounds on which you were granting partial exemptions. You would have to specify a mass of information already available in the statistical services.

I think, too, when you get exceptional issues such as the forthcoming steel issues those will be very special operations, very much akin to the operations for the placing of fixed income securities. There again it would be imperative to have the power of granting a general certificate of exemption: but I think there is a case to argue for the limited certificate of exemption in certain circumstances. It may be that it will be a little difficult to define in some cases but I do not think the problems are insuperable.

5429. *Professor Gower:* You do not think you have ever granted one where, looking back, you wished you had not?—*Mr. Hunter:* Yes, we have.

5430. You are not the only Exchange that can do this. It may be reasonable to give it to you. Is it reasonable to give this power to a small provincial Exchange?—*I would not like to answer that. We have, in fact, granted exemptions, which we have said we would not do next time. We make mistakes.*

5431. It would not help if you consulted the Board of Trade about these certificates?—*I think it would slow things down. There are a great many that come forward.*

Mr. Wareham: I think the certificate of exemption, that Mr. Hunter had in mind where we had some regrets, was granted

probably in circumstances in which any other department would have willingly granted a certificate. It was rather a case of being wise after the event; as a result of information which subsequently came to our notice. There was no evidence of any irregularity.

Mr. Hunter: In the case of property issues we now have complete detail of all leases, of their term, amount and everything else. That is a comparatively new requirement. We used to have just so much leasehold property and so much freehold property and the full details were not given. We now insist on the full detail of all leases being put in.

5432. *Professor Gower:* As regards your control over companies after they make an issue, this is exercised really through your general undertaking coupled with the power to suspend quotations. As has been pointed out, suspending quotations is a little hard on existing shareholders and therefore presumably you are reluctant to do this. Would I be right in thinking in most cases where you do it apart from the case of "shell" companies it will normally be as a result of a complaint by either the directors of the company concerned or the jobbers?—*Mr. Wareham:* I think it would be as a result of some complaint or someone calling our attention to the fact that there is absence of information. Basically the reason would be that people were dealing in the dark and we wanted to stop that. We would be prepared to allow resumption of dealings when the full facts were available.

5433. What exactly happens on suspension? It does not mean that shares are completely frozen, they can still be bought and sold but with much more difficulty?—*Mr. Hunter:* Each individual deal has to be approved.

5434. The jobbers can buy to complete their bargains?—Only with permission. They are put in exactly the same position as a member of the public.

5435. I have heard complaints that what sometimes happens is that jobbers

have sold short. They then find themselves in a difficult position and if there is anything at all suspect going on they have some grounds for asking for suspension of quotation. They ask for suspension of quotation. If in the result it is granted the price of the share drops. They can then buy at a lower price to complete their bargain and it is suggested that this may be a very good bit of business for them and therefore that they are not very good judges whether you should use this high-powered sanction.—*Mr. Quirk:* I do not remember when we have suspended a quotation that has been asked for by the jobbers.

Mr. Wareham: I cannot recall any request from the jobbers.

Mr. Quirk: Quite recently we have refused permission for a jobber to deal with the shares to level up his book in a share of which we have withdrawn the quotation.

5436. To what extent does the Stock Exchange scrutinise jobbers' books to make sure there are not undesirable market dealings going on? Is there any real policing of market practices?—*Mr. Hunter:* I think the answer is there are 13 members of the Quotations Committee from a very wide range of interests in the Stock Exchange, big and small brokers and jobbers. They are going round all the time, their ears are open, they are very often stopped and it is said: "Something funny is going on here". Through that method and through keeping their own eyes open, we do enquire into things which never see the light of day and about which no fuss is made. We had one very long enquiry only two months ago because we thought something funny was going on. We were quite satisfied there was not.

Chairman: Well, gentlemen, those are all the questions we have for you and I would just like to thank you again for coming here and being so very helpful and for your valuable contributions on paper. Thank you very much.

(The witnesses withdrew)

(Adjourned until 2.30 p.m.)

SIR CHARLES NORTON, MR. K. D. COLE, MR. G. F. H. DENNEHY, MR. N. F. HENLÉ,
MR. A. M. WELSFORD AND MR. D. D. MACKINTOSH *called and examined*

5437. *Chairman:* Gentlemen, we are very grateful to you for coming here this afternoon to help us, and also for the very careful memorandum with which you supplied the Committee. Sir Charles Norton, you are a member of the Council of The Law Society, and Mr. K. D. Cole, Mr. G. F. H. Dennehy, Mr. N. F. Henlé and Mr. A. M. Welsford are members of The Law Society; and Mr. Mackintosh is Assistant Solicitor to The Law Society?—*Sir Charles Norton:* That is correct.

5438. In your memorandum, under Heading (1)—Incorporation of Companies—Memoranda of Association—you make the recommendation that the minimum number of subscribers or members of a company should in all cases be two. I understand the reason to be that it is almost universal practice nowadays to form a company as a private company in the first place and so avoid the requirements for a public one. That, I suppose, is what leads to that recommendation?—*Might I explain that in order to simplify the working out of the evidence, the various paragraphs of your questionnaire have been allocated among the witnesses, and I am a sort of non-playing captain—if I may so describe myself. I will ask Mr. Welsford to deal with this question.*

Mr. Welsford: That was not the reason; we simply thought that no single person should be entitled to call himself a public company.

5439. Then the question comes in about wholly-owned subsidiaries, and there some people have gone so far as to say there should be only one member, namely, the holding company.—I do not think we were ever so optimistic as to suppose we should be able to get down to one member, even for the wholly-owned subsidiary. I think, however, that there would be no objection to having one member only in the case of a wholly-owned subsidiary.

5440. So long as it continued to answer that description?—Yes.

5441. There are other positive views about minimum membership. Have you

considered, from the point of view of regularity of procedure, the difficulties on death, and so on, requiring a larger number, say three?—The articles of association of a company ordinarily provide the minimum number as two members, and also provide that two members shall form a quorum. There would be nothing to prevent a company, if it were thought that inconvenience might be experienced, having three or more.

5442. The difficulty one feels about two members only is this. If you have two members, and, as you are now obliged to do, one director, and the member who is the director dies, are you not then in more difficulty than if you were left with two members?—It has worked in practice in the past where a company had two members only.

5443. I suppose you can say it has been working since 1908; so you would not be in favour of that. What would you say to the suggestion that one might make it obligatory to have two directors on the same kind of ground, so that you have still one director when the first one dies or becomes incapable, and the surviving or continuing director can set the thing going again?—Making it a statutory obligation I would say would be an unnecessary interference with the liberty of the shareholders to do what they think fit. If the director dies I think it should be for the shareholders, or the surviving shareholders, to take the appropriate action.

5444. It is already obligatory under the Act for all public companies to have two directors, is it not, and for private companies to have one. So this would only be a step in the same direction as adopted at the time of the last Act. It is not, I suppose, a point of first-rate importance, but one does sometimes feel that there is, or so one is told, some laxity in some of these private companies in carrying out what they ought to do as companies enjoying limited liability.—No statutory provision is going to prevent such laxity. It is a question of the value of the company; and, even if there are no directors, in practice it will carry on.

5445. You think one should not be too particular as regards the observance of all the rules and regulations?—The more rules in that respect the more rules there will be to get broken unintentionally.

5446. *Professor Gower*: Is not that an argument in favour of allowing a one-man company to do away with compulsory annual general meetings, which in fact are farces? Unless a member wants to have a meeting there is no reason to have one. Surely that is simple.—I do not know where exactly that would lead to.

5447. *Chairman*: Your answer to that question is that you are in favour of letting it remain as it is?—Yes.

5448. *Mr. Scott*: You suggest that there should be a minimum of two subscribers to a company on its formation, whether it is a public or a private company?—Yes.

5449. Does that also mean you think there need only be two members of any company throughout its whole life, public or private?—Yes—that is the recommendation of the Council.

5450. *Chairman*: The next point is this. As I expect you may know, at the end of 1959 there were 350,654 companies on the register, and new registrations were running at the rate of 29,000 a year or something of that order. In these circumstances some people might think that the position as regards companies in relation to the administration of the Act would be somewhat improved if limited liability was rather less easily obtained. Do you think that is a view which deserves any consideration? The type of thing one has in mind is altering the law so that all companies, including what are now exempt private companies, have to file their accounts. That is one possibility which it is thought might make people less ready to form companies in every kind of field.—If the proposal were intended to serve simply as a means of cutting down the number of companies which are registered, we should oppose that. It is another matter altogether whether every company should in the public interest publish its accounts; but as a method of cutting down the number of companies—no.

5451. This suggestion is made on both grounds, and the more important ground of course is the one you mentioned, that is, that people who take the advantage of limited liability ought to discharge certain obligations as well.—If as a matter of public policy companies, which are being registered, should be restricted in some way, I should have thought a better way of effecting this would be to enact a law imposing certain restrictions.

5452. Something like requiring a prescribed minimum capital or that kind of thing?—Perhaps that, yes.

5453. Then there is a suggestion that an annual registration fee might be imposed.—If it is considered necessary, as a matter of public policy, to restrict the number of registrations—and I am not saying whether it is desirable to restrict them—there is one method by which we would definitely recommend that the number of registrations should be cut down. A large number of companies are formed every year solely for the purpose of preserving a name. One may find three companies, A, B and C, which go into liquidation and their assets are transferred to a holding company; but the name must be different from A, B and C, so another company, named D, is formed. One then forms three private companies named A, B and C which are never intended to serve any purposes but hold the names. If some method whereby these names might be registered somewhere, so that other people were prevented from using them could be devised, that would save a number of registrations every year.

5454. *Professor Gower*: On this point the argument has been put up by the Registrar of Companies that although they are not carrying on business they are in operation, and you cannot strike them off.—He certainly is accommodating in that respect; he does not in practice strike them off.

Professor Gower: I think he tried it once.

5455. *Chairman*: There is another matter and that is the practice of various enterprising people of registering companies with limited liability for sale for a consideration over and above what it

has cost to register the company. Do you think that is a desirable use of limited liability?—I suppose they are performing a service which is required, and most practising solicitors in the company line from time to time do require companies at short notice. People who form these companies, and have them available, do perform a very useful service.

5456. You see no objections to that? —As a practising solicitor I should be rather sorry if it was stopped; I would rather put it that way.

5457. Then coming back to the broad issue, as I said, the total number of companies on the Register at the end of 1959 was about 350,000, and new registrations were running at the rate of, say, 29,000 a year. Supposing you were sitting in judgment on the public policy on this matter, would it appear to you that these numbers were really rather large?—The numbers are large, undoubtedly; whether the numbers are too large is entirely a different matter.

5458. The position is, I understand, that the Registrar is rapidly filling Bush House and will have to go somewhere else. There are so many companies now on the Register that only people of most remarkable imagination can think of a name that does not already belong to another company. The fact is that the administrative problem is becoming very formidable.—Yes.

5459. The thing is too popular, that is the trouble. That is why it has been suggested by some people that there would be no harm in a stepping up of the requirements. But you do not take that view?—I should be sorry to see the rights of the subject restricted in that way unless it was essential. It is a restriction on the rights of the subject if he cannot form a company when he wants to. If there must be restrictions I suggest making it more expensive. I think you could also save several hundred companies a year more in the other way I have suggested.

5460. In a sense the whole concept of the limited company restricts the rights of some of Her Majesty's subjects, does it not? You sell your goods to somebody, then he says "You cannot sue me because

this is a limited company", and so on. Is that not a restriction on the liberty of the subject?—I am not quite certain as to the gist of your question there, Sir.

5461. Looking at it from this point of view: you said everybody should be free to form as many limited companies as he likes, and to prevent him doing so would be an invasion of the liberty of the subject. I was only putting it from the other point of view that the privilege of limited liability invades the rights of those who do not belong to the limited company, who are not a limited company, so to speak. But so far on the matters I have put, your view is against any change? The next one is the abolition of the *ultra vires* rule. You are in favour of abolishing that rule as between the company and third parties; that is right?—Yes.

5462. You say that the company should be allowed to impose restrictions as to objects and powers in its memorandum?—As between itself and the shareholders it should be able to.

5463. That is the next thing. These restrictions operate only as between the company and its shareholders.—Yes.

5464. The third party is protected unless he has express notice of the fact that one or other of the restrictions is infringed? Your recommendation on that is in paragraph 25, where the Council recommend that the *ultra vires* rule should be abolished, and the company should be able to do anything an individual can do, and accordingly it should no longer be necessary to set out in the memorandum of association the objects of the company. Then, your third recommendation on this subject, the company should be entitled to incorporate in the memorandum such restrictions as regards its objects as it chooses, but these restrictions should operate only domestically as between the company and its members and directors. I think you have also said somewhere that the third party should not be affected by any restrictions in the memorandum unless he has had express notice?—That is in paragraph 44 dealing with the exercise of the company's powers by the directors. So far as the objects and powers of the company are concerned, the Council's recommendation is that the

ultra vires rule should be abolished in its entirety and the public should be able to deal with the company as it can deal with another individual. When it comes to the member of the public dealing with the company through the director as one of its agents, the recommendation there is that the member of the public should again be absolutely protected unless he has express notice that the director is acting beyond his powers. In fact the wording in paragraph 44 is not perhaps as clear as it might be, because it does refer there to the exercise by boards of directors of the powers of the company. The Council did intend to refer to the exercise of the powers of the company by not merely the board of directors but by an individual purporting to act on behalf of the company.

5465. It is not your intention, or is it your intention, so far as *ultra vires* is concerned, that the third party might be affected by express notice of the restriction?—The third party undoubtedly would be affected by the recommendation as to express notice when we deal with a director having the power to represent the company.

5466. So that your recommendation would not leave a third party completely unaffected?—No—if he had express notice; and it is appreciated that it does, perhaps, lead to the possibly anomalous position that the person himself in those circumstances might be better off by not inquiring into the company's memorandum of association. That aspect is not discussed.

5467. We have discussed this question many times in the course of our meetings. It is a very difficult topic and hard to get a really satisfactory scheme, short of abolishing the *ultra vires* rule. What would be your view of the proposal that the rule should remain but that the Court should be able in a proper case to hold that the contract should be binding, notwithstanding it was *ultra vires*?—I suppose it would give a modicum of protection to the third party in his dealings with the company.

5468. What I had in mind was that these cases are comparatively rare nowadays and when they come out it is almost

invariably in a winding up. Before that there is nobody sufficiently interested to raise the question. If the Court said the third party had acted honestly and reasonably and had had no grounds for supposing that the thing was *ultra vires*, the Court might approve the contract but only on condition that the third party performed his part of the bargain. Admittedly that would not be very artistic, and it would still leave the *ultra vires* rule hanging in the air, so to speak, but it might be better than nothing.—It might be better than nothing, because there would be some means for the third party to apply to get his contract validated. It is not nearly so satisfactory as a third party, having a valid contract, not having to attempt to get it validated.

5469. You would give a qualified and provisional blessing, as it were, to my suggestion?—It does not get over the difficulty of the third party being left to inquire on whatever he was dealing with.

5470. If the Court was given a wide discretion it could judge in the circumstances of each particular case whether the third party was acting reasonably and proceeding on the assumption that the company had got power to buy coal, for instance.—Yes.

5471. Mr. Scott: Would you see any objection to the memorandum and articles not being open to public inspection—that they should be documents for the shareholders only and not, as it were, for the public?—If you are going to follow the last line of thought I should have thought it would be essential there must be inspection, if the Court is going to deliberate whether a person has acted reasonably in making a contract.

5472. Forgetting the last suggestion for a moment and going back to your recommendation, would you in fact see any objection to the memorandum and articles no longer being public documents? I presume the main reason for their being public documents is to give the world notice of what the company does from the point of view of whether a transaction is or is not *ultra vires*?—I do not think any objection would be seen to their not being public documents.

Mr. Lawson: Would it be necessary for these to be published if someone wants to become a shareholder? If you are going to buy shares in the company you should be able to ask for them.

Mr. Scott: I doubt in fact whether the shareholders can really tell, looking at these documents, what in fact the company does.

Mr. Lawson: Quite a number of investors, including companies, when they want to buy shares in a company, want to look at the articles of association and memorandum.

Mr. Scott: I think they could ask. But I am putting forward the suggestion that it should not be open to everybody as a right. I think if there was a possibility of merger the directors would be able to make them available, but I put the question whether looking at the memorandum today gives anybody any idea of what the company does?

5473. *Mr. Bingen:* The majority of our troubles are very largely to do with objects and powers. Is there any objection to altering the law to give corporations the same power as a natural person, at the same time preventing the undue acquisition of powers by directors at the expense of shareholders, by providing that the company shall not make a major change in its operations without getting the consent of the shareholders at a general meeting?—That would be legislation on degree, and that would present so much difficulty. What constitutes a major change?

5474. That is going to be covered when we discuss a later question. But many people are asking themselves whether there is any objection as a matter of law to corporations having all these powers. As we know, the larger companies take all these powers.—That is the recommendation of the Council, that they should have the same powers as a natural person, in fact putting them in the position of a corporation incorporated by charter.

5475. I thought you referred in paragraph 44 to the position of a third party in the absence of express notice, so you must envisage some restriction of powers.—If you do not have a restriction of

that sort you are going to be in difficulties. Does it not virtually amount to a conspiracy if the third party contracts with the company to the detriment of the shareholders, knowing full well that what he is doing is *ultra vires* the company, outside the powers of the company, or alternatively is outside the powers of that particular director acting under his own signature and the seal of the company?

Mr. Bingen: I never thought of it in that light.

Professor Gower: If your recommendation were carried out what in fact would happen would be that the memorandum or articles would say that without the consent of the company in general meeting the following things should not be done. Under the rule in *Turquand's* case a third party dealing with the company would be entitled to assume that the consent at general meeting had been obtained, therefore unless he had express notice he would not be affected. The only circumstances in which he could be affected would be if he knew as a fact that the directors of the company with whom he was dealing were acting improperly and he was in a civil conspiracy with them.

5476. *Chairman:* In paragraph 26 you put in a plea for simplification of the provisions as to alteration of the memorandum of association, and I think the material point really is that the company should be able to alter its objects by special resolution in any respect and not for the limited purposes listed in section 5.—Yes.

5477. What is the possibility at present of having the thing upset in 21 days because the alterations are not within the power of alteration contained in section 5; perhaps the power of alteration is exercised in practice for purposes not covered by section 5 (1)?—Yes, in practice that is what tends to happen.

5478. Could you help us on this? The case of the company incorporated with a licence from the Board of Trade to dispense with the word "Limited". Some provision would have to be made for that, would it not, otherwise such a company might go ahead and alter its

objects and find that it had lost its licence?—I agree there would have to be some restriction in such cases. In the ordinary case, if there is any doubt, the company would be advised to alter the articles for the 21 days and after that see if the alterations were confirmed.

5479. Then the next one is paragraph 30 which concerns shares of no par value. You say the Council endorse the recommendation of the Gedge Committee on shares of no par value. Could you tell us what you think about preference as opposed to ordinary shares of no par value?—I think the subject of preference shares of no par value presents difficulties, because such shares seem to us to be almost a contradiction in terms. The essence of preference shares is to obtain a fixed preferential income, and to be repaid preferentially in liquidation. If preference shares of no par value really mean that someone subscribes for a share and he will receive £5 a year, it would appear to be a method of facilitating the issuing of preference shares at what would be really a discount. It is almost a contradiction in terms to talk of preference shares of no par value.

5480. If you eliminate the par value, you have got to stick on something which comes very near to par value in order to make the thing work and then you have to express your dividend as a sum of money and not as a percentage.—Yes. I am aware that preference shares of no par value do exist in America and Canada, but they do not seem to fit in very well with the English company set-up.

5481. A number of witnesses, I think, have shared your view; I do not know where the ultimate balance of opinion would lie. The criticism is that, having laboriously got rid of your nominal value preference shares you have got to put some substitute sum of money in its place, and it has been advanced that one might just as well leave them as preference shares with a par value.—The ordinary share of no par value is the logical share, because it merely means a share in the company and that is a clear conception, but to have preference capital cut up into no par value does not seem to make sense.

Mr. Mackinnon: What about the facility of issuing shares in effect at what we would consider a discount now? The Americans have said that it is a great facility to be able to issue a preferential slice without being tied to the nominal value at issue. There is that advantage in being able to issue at a discount. Money rates vary all the time and it may otherwise be difficult to issue further shares in line with existing shares.

5482. *Mr. Scott:* You have a class of 4 per cent. preference shares which was issued soon after the war. You cannot issue any more shares today *pari passu*; if they were all no par value shares then you could.—Yes; it would amount to the issue of shares at a discount.

5483. *Professor Gower:* I am not sure that par value preference shares are not being used sometimes to deceive the investor; a company issues preference shares, of a nominal value of 5s. at 6s. 3d., and the articles provide that on winding up you get the capital paid up thereon, that is 5s. If they are no par shares the true position would have to be stated, namely that the shares carry a dividend of so many pence per share, and on winding up they get back a fixed sum.—Yes.

Mr. Bingen: While we are on this question of preference shares, I would like to know the view of the Law Society, about preference shares being repaid at par on a reduction of capital.

5484. *Chairman:* While the company is a going concern the preference share gets its dividend. In a winding up, in accordance with its preferential right, it gets paid off at par in priority to any other shares, and it gets its arrears and accruals of fixed preference dividend. It has been held on a reduction of capital, when a part of the capital has been returned to the members, that for the purposes of distributing to the member he shall be entitled to the rights he would have in winding up, and that means that when there is a reduction in capital the 7 per cent. preference shares are paid off at par; and it might be difficult for them to find another investment so high in yield. Of course today it probably would be possible, but one has to imagine the preference share as carrying a dividend substantially higher

than the return that the holders would be likely to get on their money elsewhere. It is suggested that in a case of that kind they should be paid out on the basis of some kind of assessment of their fair capital value or something of that sort. —You are referring to the Spens formula, that they should be paid out at par or at average market price over the last six months whichever is the higher, which was devised to overcome the objection after the two House of Lords cases, when it was decided that there was no variation of the rights of preference shareholders, who were to receive the dividend until liquidation and then to be repaid on liquidation.

5485. *Chairman*: For what purpose was the Spens formula devised?—In order to avoid the hardship of a preference share being repaid at par on a reduction of capital.

5486. In connection with what event? —Following the two House of Lords cases which upheld the repayment of preference shares at par on a reduction of a capital.

5487. It was produced as a model or draft clause which it would be suitable to incorporate thereafter in the definition of the rights of any class of preference shares?—Yes, and it has been very widely adopted.

5488. There is therefore no particular difficulty with new companies or new issues, so it looks as if this difficulty narrows itself down to a rather diminishing class of preference shareholders?—Yes.

5489. There would be difficulty in introducing it retrospectively into articles which have the old-fashioned form.—Every preference share is taken subject to contract between the company and the persons who take its shares, and the question arises whether there is any justification for interfering with the sanctity of existing contracts at the expense of another class of shares.

Mr. Althaus: It may raise great difficulty for the issuing of preference shares in the future unless there is some provision.

5490. *Mr. Mackinnon*: Has not this point in practice been taken care of by various organisations. Whenever this

type of share comes up and there is a re-organisation, they have insisted on some protection being introduced into the constitution as a protection against repayment?—Undoubtedly there are bodies which bring pressure to bear in that way on certain occasions.

5491. So that the class affected is an ever-diminishing one each year?—I think it is fair to say that.

5492. *Chairman*: Provided the company draftsmen are sufficiently enlightened to adopt the Spens formula.—Or the people who are concerned with the company are sufficiently enlightened to insist on it.

5493. So that the only shares adversely affected by this from the practical point of view may be those already in existence before those two decisions in the House of Lords. That would be a diminishing class, as Mr. Mackinnon said.—I would say for one case when the Spens formula is adopted there are 49 cases when it is not adopted. Taking the very large number of companies, it is the enlightened people, those who are going to refer to the associations in the City of London, for example the big companies, that are going to have the Spens formula when making a public issue. They now know that a public issue of preference shares without the Spens formula will be looked at askance and probably would not be taken; but where there is no public issue it is only very occasionally that the Spens formula would apply.

5494. *Mr. Watson*: The interpretation of the law seems to be that in a capital reduction scheme whereby that company is enabled to get rid of its surplus capital it is entitled and indeed almost induced to pay off the preference shares at par. That might in certain cases be unfair and do you think the law might be amended to the effect that while the preference shareholders might be offered to be repaid at par they would have the right to reject that and to say that they were willing to see the cash going to the equity shareholders?—*Mr. Cole*: I think that some difficulties arise in that many preference share rights are drafted on a return of capital on liquidation or otherwise; they get all sorts of formulae which are difficult to apply to a proposition such as that.

5495. *Mr. Watson:* But preference shareholders might prefer to continue being preference shareholders even though this surplus cash were distributed in another direction, namely, to the equity shareholders. Do you see anything wrong with that?—*Mr. Welsford:* I should have thought it would be depleting the funds of the company at the expense of the preference shareholder; the answer would be that the preference shareholder had his opportunity to get out and he did not take it. Often persons choose the company, in which they want to hold preference shares, according to the standing of that company. They will not want to be placed in the position later on of being forced to accept the repayment of those shares. The other point about the unfairness of being repaid at par—cases have arisen from time to time whereby companies want to get rid of both preference shares and surplus cash. They have gone to the ordinary shareholders and asked them to alter the articles of the company so that the preference share rights would be altered first of all. Then the procedure would be followed of reducing the capital by repaying the preference shares, not however at par, but, as an example, at a premium of half-a-crown a share. This recognises the unfairness to which you referred.

Chairman: I think that is as far as we can carry that one. It looks as though it could hardly be dealt with retrospectively, but the point is one which will certainly be borne in mind by draftsmen in the future, and once it gets into one of the well-known precedent books it may be adopted in more and more articles. I think we might pass from that.

5496. *Mr. Lawson:* Could I make one point? We left no par value on the basis that there was apparently some advantage in having no par preference shares because they might be, in effect, issued at a discount. Arising out of that, is there any reason why preference shares, or indeed any shares, should not be issued at a discount on par valuation?—*Mr. Cole:* Does it not follow entirely from the conception of a fixed nominal capital that you have some sort of obligation to the public to maintain your fixed capital?

5497. You have that with your no par value preference shares too, you have that obligation; you say on liquidation they are to be repaid at £100, but they may be issued at £95.—With no par value shares you do have a stated capital. Members of the public do not expect to see a fixed nominal capital. One must examine the accounts. If there were the same thing with preference shares it would not do any harm.

Mr. Lawson: I find it awfully hard to see the difference; if you can issue no par value shares effectively at a discount I should have thought you ought to be allowed to do it with par value shares.

5498. *Chairman:* The next point is on partnerships with more than 20 members; that is dealt with in paragraph 34 of your memorandum. You recommend that the prohibition of partnerships with more than 20 members should be abolished. Leading up to that you say in effect that large commercial partnerships are now a rarity and you direct yourselves primarily towards the professional firms.—*Mr. Dennehy:* The recommendation was intended to be in respect of professional firms.

5499. I suppose there are still some difficulties in the case of large partnerships?—A partnership is a somewhat cumbersome organisation; the larger it gets the more cumbersome it is, but I would have thought the difficulties were mainly internal ones for the partners themselves, and if the matter is to be judged by the public good, then it is for the partners themselves to consider how large they are going to allow their organisation to grow.

5500. Am I right in thinking that now under current practice a firm can be sued in the firm name?—It can as a matter of procedure, but execution I think has to issue ultimately against the individual partners. I think the facility to sue the firm in the firm name is a procedural facility.

5501. You have to execute against the individuals?—Against the individual partners.

5502. Of course the fact that we are talking of professional partnerships would make it improbable *ex hypothesi* that there

are any large outstanding debts.—We would certainly hope that is so!

5503. I am seeking to draw the distinction between a professional partnership and a commercial partnership which might incur very large liabilities indeed.—Yes, indeed.

5504. Whereas a professional partnership, as long as they can pay rent and overheads and so forth, are not generally indebted in comparable sums.—Yes, and the Council would think that to be a relevant factor in the recommendation that the limitation should be lifted as regards, at any rate, professional partnerships.

5505. How would you define a professional as compared with a business partnership?—There would seem to be two ways of tackling it. One is through an attempt at a definition, but possibly the preferable way to deal with it would be that the Board of Trade should prescribe from time to time what professional partnerships were for this purpose by reference to the professional bodies existing. They would also be able to add to them from time to time. But there is a precedent for a statutory definition in connection with the National Defence Contribution and the Excess Profits Tax under the 1937 and 1939 Finance Acts.

5506. There was indeed. You remember the case of the optician who prescribed spectacles at the back of his premises and then he came into his shop and sold spectacles over the counter, and every person who had to deal with these cases found differently?—Ultimately there was a judgment of Solomon on the matter. As an optician he was held to be a trader; as an oculist he was a professional person and was exempt, and his profits had to be split accordingly. Essentially what appears to have been established by the case is that whether a profession exists or not in any particular instance is a question of fact.

5507. An attractive method of dealing with it would be the one you suggested, of listing all the various professional bodies and saying that the people who were members of these professions could have partnerships exceeding 20. You could define professions the other way by saying

that anyone who belongs to the specific bodies, which the Board of Trade could add to, should be deemed to be carrying on a profession for the purposes of the abolition of the prohibition.—That was the solution we would have preferred. If a definition were asked for one could take the precedent of the Finance Acts.

5508. It might interest you to know that a week ago we had a witness here who was one of 187 partners in a firm of accountants in the United States; he said they met once a year and hired a hall.—One read in the Press yesterday of a well-known American stockbroking partnership with 103 partners which appeared to be exceedingly prosperous.

5509. *Mr. Bingen:* Why not cut out section 434 altogether? There are not many commercial people who would want to carry on a partnership of more than 20.—The Council found concrete evidence on that matter rather hard to come by. One knows instinctively of the inherent unattractiveness of the large partnership organisation for active trading in modern conditions, and certainly that would impose its own restraint. It was thought that was so, but there is not really much concrete evidence to go on.

5510. *Professor Gower:* Do you not think it might lead to people trying to get round the Companies Act and the Prevention of Fraud Act by advertising in the Press for partners, collecting capital from as many people as they could?—I would think that kind of abuse would be best dealt with by specific legislation directed against the abuse rather than perpetuating a restriction of this kind.

5511. *Mr. Scott:* If you had more than 20 companies engaged in a joint enterprise, for example, building a large factory, various companies each undertaking their own particular part of the work—foundations, construction, electrical, all the thousand and one things that could arise—it is quite possible you could have a consortium assembled together in that way and they would be carrying on business in that particular enterprise in partnership.—That could come about, indeed.

5512. That does in fact in practice often happen. Even if only for one or two

isolated transactions involved in a consortium venture where they have not formed a special company for the purpose, they could all be jointly interested as partners.—Yes.

5513. It would be quite reasonable to permit that also, would it not, rather than to restrict such partnerships to 20?—Certainly. Limitation is not being advocated in any way. I find it difficult to answer that, because any of the considerations that one supposes are valid ones in favour of the limitation would equally apply.

5514. Might it not be better to delete the section entirely rather than try to exempt only the professional partnership?—The Council's recommendation as submitted is in line with that suggestion. The Law Society has no information to judge of the matter outside the scope of professional partnerships, but I think the Council's feeling would be that the abolition of the limit should apply also as regards commercial trading partnerships.

Sir Charles Norton: It was never the intention to restrict this to the professions, but we did not really feel there was sufficient evidence for advocating it in the industrial and commercial world as well.

5515. *Mr. Lawson:* Do you think there should be no upper limit at all?—*Mr. Dennehy:* No, I would think not; in putting a case for abandoning the limit of 20 I would think that there is no other figure which should constitute a limit.

5516. *Chairman:* I suppose you could have a partnership composed of a hundred limited companies?—Yes, indeed, as Mr. Scott was suggesting; but that, one would think, would be the least objectionable form of large partnership rather than the most. It has also to be borne in mind on Mr. Scott's point that a large group of companies engaged in that way would have the technical and professional advice available to them to prevent a partnership coming into being, if they were concerned that that result should not come about.

5517. *Chairman:* Then the next point concerns exempt private companies and you discuss the matter in your memorandum and express your conclusions in paragraph 39 where you say that the

Council recommend that the distinction between private companies and exempt private companies should remain. The important matter in that connection is one we have already touched on in our discussion, and that is the exemption accorded to the exempt private company from the ordinary obligation to file accounts. As I understand it you agree that they should be subject to the ordinary obligation of every other company as regards the auditing of their accounts and the qualifications of the auditor. But I gather it is your view that the exemption from filing the accounts, although they have to be prepared and audited as well as those of any other company, should remain?—*Mr. Cole:* That is so. We do not really see any reason to change the present position. We are not convinced that the availability of published accounts would really help people in deciding whether to give credit or not. We believe that if people do inquire they get bank references which are probably just as good, and in many cases what is shown on the file is not very indicative of the state of the company; if it has only got a capital of £2 and a debenture in favour of the bank, on the face of it it is not likely to be very creditworthy. The Council's recommendation against altering the present position is really based on the proposition that there is no evidence available that it needs to be altered.

5518. We have had evidence from a certain number of witnesses, such as insurers of credit risks, and I think they all say that they would much prefer to have the accounts filed at Bush House where they could go and examine them at leisure without being put under the necessity of going to the company which is going to be trusted and saying "May I see your accounts?"—I do not think we should in any way resist the abolition of this exemption if it were definitely shown that it would fulfil a public need if it were abolished.

5519. The figures are rather impressive. The proportion of exempt private companies to all kinds of companies is of the order of 80 or 90 per cent. So that in the end one cannot help feeling that the exemption may have extended more widely than the Coben Committee ever intended,

because they felt it was a sort of special exemption to protect what they referred to as the small family business, and it becomes a question when you have a percentage like that whether the field is not wider than the members of that Committee appreciated.—I suppose there are an enormous number of small family businesses. Every shop tends to be a limited company now.

5520. *Mr. Lawson*: Do you think there is any objection to the present arrangement by which the partner of a director of an exempt private company may be the auditor?—It seems difficult to justify that, because the whole essence of an audit should be that it is by a completely independent person.

5521. Even with the approval of the shareholders? The difficulty arises in practice when it is a case of a small town where perhaps you have got one firm of auditors and of course the whole town's business flows through that firm.—Yes.

5522. *Chairman*: I think there was a passage in the evidence given by Mr. S. E. Phillips of the Trade Indemnity Company which is relevant. The question was:

"1267. I think you have experienced your share of failures. Your company was involved in the failure of about 530 companies in Great Britain in 1958 and in 1959 in the failure of about 410 companies Can you say how many of these were exempt private companies?"

And the witness answered, "About 90 per cent.". I do not know how much that carries the matter further, but that is the evidence of that particular witness.—I suppose the answer would be that whether they had filed accounts or not they would be equally insolvent.

5523. It is fair to say if the exempt companies represent say 70 or 80 per cent. of the total of all private companies it would be thought not unreasonable that the larger body should contribute the larger amount to the quota of failures. But there it is; we have had evidence of that kind and we have had views expressed by a number of people in fact that exemption should not continue. And logically there is this additional argument that if you take the benefit of limited liability

you should also carry the burdens, so to speak.—Yes.

5524. There is the other exemption which allows an exempt private company to make loans to its directors. I do not know if you think that ought to be continued?—We would certainly be in favour of that going on. In the small family business which an exempt private company is supposed to be that sort of thing would be quite natural and I do not think it would do any harm.

5525. You are in fact rather in favour of relaxing that ban generally so as to enable working directors of public companies in certain circumstances to receive loans?—Yes, that is the view of the Council.

5526. We have received this morning from the Law Society a letter about a specific case where the learned judge decided in such a way as to deprive a company of exemption. I only saw this letter this morning and I have not gone through it in detail, but it does illustrate the extraordinary complication and complexity of the qualification.—Yes. I understand, too, that the Court of Appeal have this morning upheld the decision of Mr. Justice Cross. In view of this decision there must be many hundreds of companies signing exemption certificates which have been doing so wrongly for some years.

5527. Is not that point, as far as it goes, in favour of abolition? If the conditions under which it is extended are so amorphous and difficult, is it right that it should remain—at the expense, mind you, of people who are less fortunate in the quite fortuitous arrangements with regard to their family settlements and so forth?—Our argument, I think, would be that the Seventh Schedule should be amended so that what everybody thought was in fact the law should be made the law. This is just a point—this is the effect is it not—that it is all right if a family settlement held the shares from the start, but it is not all right if it acquired them later, even if it is part of the setting-up of the settlement. That is a small point which we would have thought could have been put right.

5528. But how many people, do you suppose, in perfectly good faith sign the

requisite certificate that the conditions for an exempt private company are fulfilled in a particular case when in fact they are not, for some unexpected reason like the one that emerged in the late case?—There must be many of this particular case—there must be hundreds and hundreds. But I do not know about other cases where any particular point has emerged.

5529. I do not know if we can carry it much further, unless you have got any further observations.—No. Our only observation on that case is that we would advocate an amendment to the Act to restore the position as it was thought to be before the decision.

5530. Then, passing to another topic, paragraph 46 of your memorandum, it concerns the delegation of powers to directors and control retained by shareholders. The question is whether, as a matter of principle, the consent of a company in general meeting should be required to certain matters concerned with fundamental changes in the company's activities, the sale of its assets or the undertaking, the borrowing and lending of money, and the issue of shares: these were, I think, the four matters. As I understand it, the view which you have taken is that these are all domestic matters which should be regulated by the articles of association of each company rather than by Statute; and I think it is your view that to require sanction of a company in general meeting in such cases would be likely to hamper the directors in their efficient management of the business?—*Mr. Welford*: I think on that I should like to refer back to paragraph 7 in the opening observations in the memorandum, where the Council refer to the flexibility of the system as having been one of the valuable features, and to impair this flexibility by increasing the number of statutory and departmental regulations would be a serious and retrograde step. It is considered that the division of duties between shareholders and directors should be, as it is substantially at the moment, a matter of domestic concern. We should not favour a long string of further things that have to be done by the company in general meeting. In practice it does lead to considerable difficulties. If one makes

a general rule of this sort one can find it applying in circumstances where one does not expect it, and it probably results in some scheme which should be going through being held up for 21 days. So it is advocated that this should be left as a domestic matter.

5531. But even such a matter as the sale of the entire undertaking—supposing the directors had power under the articles to do that, do you think it is really right they should be able to do it without the sanction of the shareholders?—If you envisage the sale of the entire undertaking, we should entirely agree; but if, shall we say, the managing director's house is to be excluded from the sale it will not be a sale of the entire undertaking. A rule of this sort is so easy to get round, and then comes the problem of definition of degree; if one says "substantial or major part"—words on which hours have been wasted—one is left up in the air, and ultimately the only advice one can give to a client is "I suppose, to be on the safe side, you had better do it".

5532. That is possibly how it would work out. Do you think that would be undesirable?—I think it would be most undesirable that the law should be evaded if you said "the whole undertaking": it would be most undesirable, and one would indeed be tempted to keep back the managing director's house, or some particular asset, in order to avoid it—not because one wants to evade the law, but because in the particular circumstances time becomes of importance. As a general rule, I would never advise a client to sell a company without going to the shareholders. He may have power under the memorandum to do it, but I should never advise it without going to the shareholders.

5533. You would see no merit in a provision that the directors should, wherever it was reasonably practicable, consult the shareholders on a category of transactions—a provision that if they find it impracticable to do so they should record a minute saying they have considered the matter and resolved that it was not one which was practicable to leave to the decision of the shareholders. Would that be any good? There is a good deal of pious

hope in it, I admit.—What, Sir, do you mean by “practicability”?

5534. It is a question of time very largely: time and publicity are the two great factors, I think. In some cases you would have an offer only open for a very limited period and there might not be time to go to the shareholders; and in another case you might know the things you were going for were very much favoured by a rival concern and if they knew you were in the market they would follow suit, and the market would be spoilt. Those are the kinds of considerations.—You are going to make the way for the practitioner a very difficult way under that.

Chairman: One does not want to introduce refinements, but one feels that underlying this question there is a certain amount of principle. I do not think it is entirely illusory. The principle is that the shareholders are morally at present, and might be legally hereafter, entitled to know if the directors propose to do something really exceptional with the company so as perhaps to alter completely its character.

5535. *Mr. Bingen:* There is a difficulty here. I can quite see what Mr. Welsford is saying: if it was the sale of the undertaking, of course the reputable company would advise the shareholders and would not do anything beyond the pale. But in the case of more dubious companies, is it not possible that if the powers of the directors were slightly shortened it might stop some of the funny business which has happened in the past; and if so, it would help some of the major companies? —To impose an absolute requirement that on the sale of the undertaking or major or substantial part of the undertaking the consent of the shareholders must be asked for would, I think, impose a serious restriction. The shareholders came into that particular company on the basis that it was going to carry on such and such a business, and I would advise the directors, if my advice were sought, never to dispose of the whole or a substantial part of the undertaking without consulting the shareholders. The difficulty, as I see it, is whether some particular transaction comes within that degree.

5536. *Professor Gower:* But, as you have pointed out, when in doubt you play

safe. It seems to me wholly admirable. The South Africa Act has this requirement that a company cannot dispose of the whole or a substantial part of the undertaking without consent of the shareholders in general meeting. So far as I know, the only difficulty is that the Chief Land Registrar will not register such a sale unless he is satisfied on the point. That is quite unnecessary and could easily be avoided here, but subject to that, would it in fact cause any practical difficulties? It would certainly reduce the scope of directors in some of the medium-sized companies which Mr. Bingen referred to.—The expression of degree very frequently comes in. There are enforcements in relation to A, B, C, D, E, and so on, one of which is the sale of the undertaking or any substantial part of the undertaking; and from time to time interminable discussions will arise as to what constitutes a substantial part of the undertaking, and in practice it is more or less indefinable. It seems undesirable, on the general principle of maintaining flexibility, to make a statutory obligation on directors to define for themselves a degree.

Chairman: It would be no use putting it in the articles, because you would say every careful solicitor would advise the directors to get the necessary majority vote to remove it?

Mr. Brown: But in fact the only difficulty is the 21 days' delay in calling a meeting, and there are many things—such as take-over bids—for which you generally need to call a shareholders' meeting. They still seem to go on without much difficulty.

5537. *Chairman:* So really your view is as has been already stated in the memorandum. You think on the whole the existing law should be preserved, and you say that reasonable directors, properly advised, would, in any matter of major importance, if it was practicable to do so, consult the shareholders. You do confide to some extent in the good sense of the directors and the advice of their solicitors? —Yes, and I would like to qualify that by one more observation. In a very large number of cases it is quite impracticable, on major things, to explain things to

shareholders in such a way that the shareholders can take any opinion on it whatsoever. They cannot form an opinion: matters are far too complex. Directors and their professional advisers have to sit down and take a decision on it. To refer to shareholders as often as one has to do it is really a waste of time. They do not, or cannot, understand it. They probably will not come to the meeting: they will fill up the proxy in the way they are told by the directors.

5538. And there is also this: it would not be enough for the directors to write round to shareholders and say, "We have an excellent offer for such and such a brewery company, and we are holding a meeting of the shareholders to approve our purchase of it." That would not be good enough in itself, because that notice would have to be amplified so as to give them all the pros and cons of the affair; and that would make it a much more formidable matter.—Certainly. As an example of the sort of document that the shareholder is faced with nowadays, the other day I received a merger notice for three or four investment companies. I had to put it away till I got a two-hour train journey to read it and assimilate what was in it. And after all, practically speaking, it is my job to do these things all day and every day, and if a person who is supposed to be an expert and a professional has to approach a scheme of this sort in that way, there is no sense whatever in sending it round to shareholders and expecting them to understand. It really means the unfortunate bank manager is plagued by his customers coming round and saying, "I have received this long document. Will you please tell me what I have to do?"

5539. Of course, that implies, I think, a partial answer about the difficulty of complicated documents. Though the shareholder might not be able to appreciate it himself, he can get someone like you who would.—They would have to spend a couple of guineas or more; and even then a shareholder is only going to another professional to say, "What do you think of it, because I can't understand it?"—whereas it has been prepared originally by a competent board of directors with their advisers.

5540. *Mr. Bingen*: It is rather a counsel of despair, is it not? You are saying that a company's business is too complicated for shareholders to understand it, and therefore they are not entitled to vote?—I regret the first part is true; and more often than not in big companies the board is much more competent to make a decision. If it is a matter of statute, and you have to go to the shareholders, the shareholders ultimately have to thumb that document and find a paragraph saying what is the directors' recommendation on it; and then they will fill up their proxies accordingly, in 90 odd per cent. of the cases.

5541. *Mr. Mackinnon*: Will not the financial Press read a scheme of that sort and make notes on it, so that the man in the street gets criticism of anything that may seem wrong? We would neither of us expect the average shareholder to understand a tithe of the documents he gets, but the circulation of the information puts it into the hands of experts, who will be able to weigh the defects or criticisms publicly.—Certainly.

Mr. Mackinnon: Would not that be the answer on this?

Mr. Althaus: Are you not rather striking at the root of the whole proposition that the shareholders are the owners of the company, and are they not entitled to some consideration as well? We will freely admit they may not be competent, by their own unaided efforts, to understand what is put before them, but on the other hand are they not entitled to have it?

5542. *Mr. Brown*: Is it not the case that 99 per cent. of what people call these protective clauses are to protect the shareholder in the small number of doubtful cases, and is not the sanction of publication in the Press and the scrutiny of other experts a real deterrent?—Yes, I would say certainly. Publicity in the Press and examination of it by the Press and the financial people who examine it would be a very real deterrent against the dubious scheme.

5543. *Chairman*: I think we have your position very clearly. Then, as regards the issue of shares, the point has been

developed that, in the absence of a decision otherwise by the shareholders in general meeting, cash issues of new shares should only be offered *pro rata* to existing shareholders.—The views of the Council on that, Sir, are that under the articles of association, whatever control there may be, the directors should retain their discretion in regard to the issue of the shares, without being obliged to offer them to the existing holders of the equity.

5544. That might be a good thing to do possibly, in the majority of cases, but you would like it left to the discretion of the directors in each particular case, to decide whether it was the right thing to do on that particular occasion?—Yes, subject to the initial matter when those shares are created: it depends on the terms of the articles of association. The articles may provide as to how those shares may be issued, and they may provide—and in the case of private companies very frequently do provide—that they must first of all be offered to existing shareholders. But if the articles do not contain that provision but place shares at the discretion of the directors, then the Council favour not detracting from the discretionary powers vested in the directors.

5545. Would you be in favour of Table A containing the provision about offering shares to existing shareholders which was, I think, in all Tables A from 1862 to 1929? Do you think that would be a sensible article to have?—I think the answer to that is no, Sir. We should not think so, because it is re-imposing a rigidity which was removed in 1929.

5546. I believe the explanation of it was that when the latest Table A was being got out there was a tax on bonus issues, and they thought this article would never be used because there would probably be an element of bonus in the rights issue, which would attract tax; so they took it out. Anyhow, I do not think it was any hostility to this *pro rata* conception that made it go, but because of the tax position as it stood at the time.—That was a 10 per cent. tax on bonus issues.

5547. *Professor Gower*: Is your reply the Council reply? I thought there was a

certain amount of dissent being expressed with this view by other representatives? —*Mr. Henlé*: The only reason I shook my head was simply this, that if there is a feeling that shares ought to be offered first to existing shareholders, then it seems to me it is better that it should go in Table A, which can be negative, rather than go into the Act, which cannot. That is the only point I had in mind.

5548. But would you approve the change?—I would probably negative it.

5549. *Chairman*: The next point is the protection of minorities, which is section 210 of the Act, and I think you will find it dealt with in paragraphs 62 to 65 of your memorandum. As regards that section the position is this, is it not—that there was found to be great difficulty in applying it till there were two cases, one of *Meyer* and one of *Harmer*, which put a more liberal interpretation on it than the judges had been disposed to do before; and the suggestion is now that this section is quite workable, provided it is amended by taking out the reference to a winding up. I appreciate that you have gone further and have suggested an additional section, but as regards this first proposal, what would be your view of section 210, if the winding up criterion were taken out?

—*Mr. Cole*: The Council would certainly be in favour of that criterion being taken out. Even assuming that were taken out I think it can be stated that difficulty has been found in practice in obtaining the evidence to be able to take advantage of the section. On the other hand it is felt strongly that one must not make it too easy. There are plenty of troublemakers about; if the section were made too easy one would be confronted with the professional troublemaker turning up in any company which was not paying a full dividend. The Council therefore suggested this other section, which was on the basis that individuals did not need so much protection in a public company, particularly a quoted one, because they could always get out—it may be at an unfavourable price, but they are not locked in. We felt the private company presented a more difficult problem, and therefore something easier is needed. But if the winding up criterion is taken out it could certainly go a long

way towards making section 210 workable. Whether it would then be easy enough in fact for the person who was being maltreated in a private company, I would not know, but that was the reason for the suggestion.

5550. So you would preserve section 210, with the amendment of taking out the winding up criterion and would enact a fresh section dealing exclusively with the private company?—Yes, whether we ought to have said “a company in respect of which there was not a quotation”, I do not know. The information available was to the effect that there was rather a problem in private companies in that there were a good number of companies where, for instance, there are two members and one of them dies and his widow succeeds to his shares. However, the other member is obtaining an adequate remuneration and sees no reason to pay dividends at all. That might be perfectly proper in some respects but it would cause hardship to the minority shareholder, the widow, who could do nothing about it. It is felt some protection would be desirable to cover that type of case.

5551. Would not the substance of your section in fact be included in the very broad terms of section 210, as it stands, without the winding up criterion?—The word “oppression” is very difficult.

5552. The view has been advanced to the Committee that “oppression” connotes a course of conduct. Is that the difficulty? I do not know if there is any foundation for it, but it has been suggested. —I suppose the particular example I gave you might be held to be oppression. Possibly in the past dividends had never been paid, in which case it would be a continuing course of action which had previously been quite all right.

5553. Would “unfair” be a more suitable word, do you think?—Yes, I would think “unfair” would be preferable.

5554. You really intend your new section as a special provision for private companies, while preserving section 210 for companies generally?—Yes, that was the intention.

5555. Yes, we follow that. Broadly, you are in favour of this section being made more effective?—Within reason, yes, certainly.

5556. *Professor Gower*: Is there not a great weakness at the moment in that it is only a member of a company who can take advantage of this section. In the hypothetical case you gave, the widow might never have succeeded in getting registered as a member, in which case she could not invoke section 210?—That, if I may say so, is an excellent point.

5557. *Chairman*: That is a matter which the Committee will have to consider: and allied to the question of section 210 is what you say at paragraph 63 about evidence. You say, “Moreover, a minority shareholder may find that it is impossible to obtain, before the filing of the application, the information upon which that application may be based.” I do not know if you have any suggestions for getting over the difficulty?—The suggestion I would make would be a freer use by the Board of Trade of the power to put an inspector in.

5558. Yes. I have certain suggestions here. One is that a prescribed minority of shareholders should be given access to the books of the company; but that would be a rather dangerous thing possibly?—Yes, one can foresee a minority being obtained by an attractive circular, and it might do a lot of harm.

5559. Then as regards putting an inspector in, who in this case would put the Board of Trade in motion to appoint an inspector?—The shareholder who, amongst other things, would obviously not have been receiving information which he could reasonably have expected to receive.

5560. And he would be empowered to require the Board of Trade to step in?—No, only to apply to the Board of Trade, with a view to them, if they thought there were certain suspicious circumstances which led them to think there would be a case for inspection, putting an inspector in to report.

5561. In one of the cases an example is mentioned of the aggrieved party not having received as much information as he is entitled to expect—which is the type of

formula you would want to apply here, is it not?—Yes, it might need to be even wider than that, because there is a belief that if you get all the information the Companies Act entitles you to, and very little more, you have got more than you are entitled to expect.

5562. A further suggestion was that the Court should be empowered to order the enquiry upon the applicant establishing a case for investigation. I mean, a widow comes into Court and says her husband has been dead for 20 years and in those 20 years she has never received a dividend and never received any accounts, nor been summoned to any meeting—that sort of thing—and this is all that can be done, because the defendants are in possession of all the facts and they then stay mute of malice and will not give any explanation at all. Would there be any advantage in giving the Court, in a case of this kind, the power of enquiry, because there was need for investigation?—I would have thought there would have been.

5563. That is, to give the Court power to make such enquiry in circumstances somewhat short of a *prima facie* case, so to speak?—The answer might be that the Board of Trade, if they found there was nothing, could issue a report. The difficulty about section 210, in my mind, is the possibility of its being abused by the troublemaker, and if he could get access to all the company's papers by trumping up some story which might show, at first sight, something to be investigated, it might go too far.

5564. Now if the matter was left to the Judge and the proceedings were heard in Chambers, that might be a help, I suppose—at least as regards the troublemaker?—Yes. The only danger I had in mind was that it might become too easy to get discovery.

5565. Yes, you would get fishing applications and all that trouble?—Yes.

Mr. Bingen: Do you know how far the Board of Trade's power to appoint inspectors is applied in the case of private companies as opposed to public companies?

Professor Gower: The Board of Trade have told me that among the cases in

which they have appointed inspectors was a surprisingly high number of private companies.

Mr. Bingen: Of course, one does not hear of them.

5566. Chairman: And then there is a point about special classes of shares. It has been represented to us that in cases where you have preference and ordinary shares and no modification of rights clause, the rights of shareholders can be affected by a simple special resolution altering the article; and it is suggested it would be a reasonable safeguard to shareholders if it was indicated that in the absence of an express modification of rights clause the provisions of what is now article 4 of Table A should apply. I do not know if you have any views on this?

—Mr. Dennehy: To make generally applicable an article in terms of article 4 of Table A would not exactly be a safeguard for shareholders. As it is understood, the purpose of article 4 is to make alterable class rights which might not otherwise be alterable at all, or alternatively as to which there might be doubt as to their alterability, or which might be alterable only by unanimous agreement of every member of that class. Article 4, as it is understood, is not a right at all: it is rather the reverse. It is an incident of ownership, looked at from the point of view of the individual shareholder. It is not so much a right as a condition, to which a shareholder is subject, that his special class rights are capable of being altered against his own wishes and by merely a majority of his class. Therefore I would not, for that reason, regard the universal application of an article in those terms as being a safeguard, as you have put it.

5567. Then you are saying that where you get a capital divided into preference and ordinary shares and no modification of rights clause, the rights of the preference shareholders are unalterable—is that your view?—No, not at all. I do not think it can be put as simply as that. As I understand the law, the alterability of the rights of a class of shares, regarding which the articles and memorandum are silent, is a matter of some uncertainty. If there is unanimity of every member of the class, those rights may be altered, but short of

that it is uncertain and, as I understand it, it is for that reason that it became the practice for articles to include a clause providing a means for alteration of rights by the majority. Thus, the only answer that can be given to the question is that if the articles and memorandum are silent on the question of the alterability of class rights, the matter is one of uncertainty. Probably only unanimity of accord by the class will serve to alter those rights.

5568. Would it not be quite a good thing as regards the future if some ordinary type of modification of rights clause should take effect as being included in the articles of association?—Yes, but one is only dealing with the very rare type of instance, where the memorandum and articles are silent.

5569. I agree it would be a rare occurrence today, but there must be some old companies of which it is true?—We would accept that where there was no express power or indication as to the alterability of rights then it would be a convenient and reasonable facility for rights to become alterable in terms of article 4 of Table A. As to the proposition that it should be statutory that all articles should contain such an article, or alternatively that the statute itself should so prescribe, I would say that that conflicts with the principle of freedom of choice and, thereby, flexibility. Let share rights be conditioned appropriately, according to need; but no supervening right should be imposed on top of existing rights.

5570. You would object to the position being tied up as regards the future?—I would in this way: I would object to the effect of an enactment being that all shares which are shares of a class must be alterable in one particular way only, laid down by statute. That would conflict with our principle of freedom of choice and flexibility.

5571. And would put a curb on the ingenuity of company draftsmen?—On meeting the needs of the investing public!

5572. *Professor Gower*: Are you against section 72 as well, because that imposes an arbitrary restriction?—No, I am not

at all against section 72, because that operates for the redress of grievances and in relief of a shareholder who thinks he has been wronged. The principle supported is solely to avoid the imposition of rigidity and inflexibility; and there are misgivings about this proposition for a variety of reasons. Supposing that something like article 4 of Table A goes into all articles, is the suggestion that this particular article should be an inviolate one? If it is, I would say that if there is a case for this at all—which I do not accept without many reservations—then it should be a matter for statute rather than articles, comparable with the provision where 90 per cent. of the shareholders may consent to short notice of meetings. Let it be in the statute: let it not be interpolated in the articles, because that can be foreseen to be dangerous. Then I see difficulties in introducing an article of that kind—how is it to be fitted in with existing companies with existing articles and a complex share structure? So, without wishing to be obstructive, and without in any way being against there being some reserve relief or statutory provision to resolve a condition of catalepsy or unalterability—which I would say would be a good provision—I have misgivings about this proposal.

5573. *Chairman*: I follow. As you know, in some old-fashioned memoranda and articles the rights attached to preference shares are attached by the memorandum, and the position now appears to be that the only way of altering those rights is by way of a scheme under section 206 of the Act. I think you would answer "so be it: it would not be right to introduce any amendment enabling those rights to be altered by any modification clause"?—I would agree with that proposition, that if rights are entrenched in that way, so be it.

5574. Yes: then I think I can pass to disclosure of ownership and control, which is in paragraphs 73–77 of your memorandum. You have come to the conclusion that the existing position should be preserved, and you express the view that no attempt should be made to enforce disclosure of beneficial interests in shares. And you object to such disclosure as a matter of principle on the

ground that a man can deal with his property as he pleases, and if he chooses to put it in the name of a trustee for himself, he is entitled to do so and the fact that he has done so is a matter between himself and his trustee?—That is the Council's view, and they are not aware of any sound reason for distinguishing that particular item of property, i.e., the share, from other items of property which a person may own.

5575. Yes. You appreciate there has been a good deal of discussion and so forth on this question; and of course, as you say in your memorandum, it was considered and dealt with in a certain manner in the Cohen Committee's Report, but that part of the recommendations in their Report did not find its way into the Act. I think the general feeling of people who have discussed this matter with us is that it is desirable that disclosure should be made, but the practical difficulties in the way of providing for disclosure without a quite inordinate amount of work are formidable.—We would certainly feel more confident and sure of our ground on the practicability point, namely that it is impracticable, than we do on the very difficult question whether it is desirable.

5576. Perhaps the most promising suggestion, in some ways, that has been made is that an investigation by the Board of Trade could be set on foot under section 172 at the request of the directors, as well as by the prescribed minority of shareholders. What would you say to that?—I think the Council might agree with that proposal. In a sense it is felt that if anybody, or any set of persons, is entitled to know who the proprietors of a company are, it is the directors of that company. I would favour that amendment being made, namely that the rights now conferred on shareholders should also be exercisable in a corresponding fashion by a board of directors to require the Board of Trade to ascertain the beneficial ownership.

5577. Thank you. Now as regards nominee directors and enforcing the disclosure of their principal, again you are opposed to any alteration of the present position?—Yes.

5578. Referring to section 200, the Register of Directors, subsection 9(a)

provides that a director includes any person in accordance with whose directions the directors are accustomed to act—would not that bring in a nominee's principal as a director for the purposes of that definition?—That has not been present in my mind—speaking for myself. I would agree it is arguable that it could be so, but it is a somewhat startling proposition that the word "director" is intended to include persons who are the powers behind the throne. It would be a more natural interpretation that the category of persons caught by that are those who are ostensibly directing affairs, not those who are able to control the direction of affairs of the company.

5579. It is at least a possible construction that the principal of a nominee director would have to be disclosed for the purpose of proper completion of the document under section 200.—Yes, I would not feel the difficulty of definition of a director for the purposes of the Companies Act generally but the disclosure of a principal would be a difficulty if it be a principle that nominee directorships, as such, do not require disclosure.

5580. Yes, I see how you put it. Then, if I might pass from that, the next point concerns the practice of carrying on business through associated and subsidiary companies; and that is paragraph 95 of your memorandum. I do not think you have dealt with the point which I wish to raise which is, given that there is no objection to carrying on business through subsidiary and associated companies, is it not only right but reasonable that a company should disclose the names, and perhaps other particulars, of its subsidiary companies? Are there any views held on that?—*Mr. Cole*: I suggest, Sir, it might be very harmful sometimes to the company if it had to do it. If this was to the benefit of the public generally and gave them some advantage, it might be helpful.

5581. Would you be less allergic to the principle laid down of disclosure if the Board of Trade were given a dispensing power on case shown? For example, where a subsidiary was carrying on business in another country, where the political climate was such that it would be inadvisable that its connection with the

parent company at home should be too easily discernible?—That would be right, I think. I think a number of big companies might object to disclosing their subsidiaries on the ground—this is not a very good ground—that ostensibly they were all in competition but they may be owned by the same parent. I do not know whether that is thought to be a bad ground.

5582. I am not sure about that.—*Mr. Dennehy:* The Council would not favour the proposal that there should be compulsory disclosure of the names of subsidiaries wholesale for the reason that it would be somewhat illusory, if the purpose of so doing was supposed to be to give useful information to shareholders, to select arbitrarily a particular item, namely the names of subsidiaries. It might happen that in some cases it would be informative; but it might be very misleading indeed. It would be completely hit or miss just to publish the names of the subsidiary companies. It would be informative if the principal activities were given, or if the names were so indicative as to be themselves informative.

5583. Put it as the names and principal activities?—Yes. The proposition of which we were given notice was the disclosure of the names of subsidiaries, which seemed to us to be ineffective.

Mrs. Naylor: If the names were given, Bush House would give some indication.—Well, they would afford the opportunity for investigations of objects as set out in the memoranda of association of an infinity of companies.

5584. And also the accounts.—And the accounts, indeed, yes; but with respect, it is not thought to be very logical, if the purpose is more fully to inform shareholders, merely to seek to do so by giving the names of subsidiary companies: it is not particularly logical, because you could have, under one kind of set-up, a number of activities all carried on by one subsidiary company, and under another a few. Therefore we would think it would be an illogical requirement.

5585. *Mr. Bingen:* The trade unions might say that it would be interesting to know whether a small company was a

subsidiary company of a large organisation on the basis that if the employees of that company knew who they were working for they would have a useful wage negotiation lever.—Would not that be using the Companies Act for social, political or trade union purposes; and if there is merit in that proposal, is not that something which should lie outside the scope of purely company legislation?

5586. You could argue that you want to know who you are working for.—Yes, but the wish to know who one is working for—perhaps that should find its sanction in legislation outside the company field.

Mr. Brown: It could be held surely that the benefits of association are held by certain employers and in return one obligation should be to tell their employees for whom they were working.

5587. *Mrs. Naylor:* Of course, the employees can go to Bush House, if it is a subsidiary of a public company.—I can only say that that seems to come under the heading of information for public well-being, for social good and social usefulness, and I would feel somewhat doubtful whether company legislation is the appropriate statutory vehicle to give effect to that end.

Professor Gower: It is the fact of incorporation which the companies can provide which enables the information to be concealed. If it was not for the company, you would know who you were working for—by pyramiding down through companies one can conceal it more effectively than in any other way.

5588. *Mr. Lawson:* Is it not a fact that quite a number of companies give this information—quite a number list their subsidiaries?—They do indeed.

5589. And I wonder whether this suggestion is really doing very much more than asking everybody to conform to something which, in large measure, has become common practice already?—It would open up this difficult question, the decision as to how far it is right to disclose in the interests of those different categories whose interests do call for disclosure—how far is it right that that very grave matter should reside for decision in the board of directors? It

seems that if you had a board of directors who felt, for good reasons, it was desirable not to make disclosure of a certain matter of information concerning the company—some activity which it carries on or some asset it owns, or the fact that it is operating in some particular territory—that board might decide not to form a subsidiary. The difficulty raised by this sort of question is how far is it right, as a matter of principle, for the board to be put in that position? To tackle the matter by legislation rigidly about disclosure of subsidiaries seems to be tinkering with a very fundamental matter.

5590. *Mr. Brown:* But surely you cannot leave everything to the board of directors—hence the Eighth Schedule. If you left disclosure entirely to the directors you would not have an Eighth Schedule laying down what has to be put in the accounts?—Quite so, but it remains that it seems an imperfect and illogical way to cause the given required amount of information to emerge publicly, merely by requiring disclosure of the names and the activities of subsidiaries. My point is merely that it is not the logical, and probably not the most effective, way to set about the matter.

5591. You must include subsidiaries' profits in the consolidated accounts but you do not need to show what the subsidiaries are?—Certainly. But the point is that if the information which is to be given in compliance with the existing law is not adequate, then I merely say, as a matter of logic, the way to tackle that is not to require that information shall be given about the subsidiaries, because it is not necessarily going to achieve the answer of adducing the information needed. The problem goes deeper than that: it is what is this extra amount of information which is to be given, not, with respect, the hit or miss method of disclosure of subsidiaries, that is all.

5592. *Chairman:* There is one final question I should like to put. We have been asked to include in the matters we are considering the question whether, on a take-over bid, it should be made obligatory that the consideration, or some part of it, should consist of cash. What would you say to that?—*Mr. Cole:* We cannot

see any useful purpose would be served at all, but very much the reverse. Take the first example: many take-over bids are pure amalgamations. It would detract from that completely. The ideal take-over bid is agreed between the two boards, the shareholders agree they will take shares in the other company or in a holding company, and they are just exchanging their shares. Therefore it would attack in a way the basis of the ideal take-over bid. The next thing I think one would say is that in the sort of case where the suggestion was first publicised, I think it would not give rise to the slightest difficulty—a substantial company can always raise money if it wants to, though it may have to pay an underwriting commission, but it would not be any obstacle in the way of it in any normal case at all. It would just introduce a complication which we would not see any justification for. There are all sorts of minor difficulties, for example, over stamp duty exemption. If the cash comprised more than 10 per cent. you would never be able to get stamp duty exemption. It would also give rise to difficulties under the 1960 Finance Act about amalgamations of property companies, and we frankly have seen no advantage in it at all. Everything we have thought about it shows that it would be a mistake.

5593. But supposing you wanted to stop take-over bids or make them more difficult—would the imposition of such a requirement make them more difficult?—We would not have thought so, because if a company can issue shares—it is perfectly certain to be able to raise the cash it would need. We would not have thought it would have put an obstacle in the way, if it was the desire to do so.

5594. *Mr. Lawson:* Could I ask one or two questions on this point of subsidiary and associated companies? Have you any views on the situation where company A owns 25 per cent. of the shares in company B, and company B owns 25 per cent. of the shares in company A—so that if the rest of the shares are widely dispersed it is almost impossible for shareholders of either company to remove the directors? Have you come up against that?—There are some well-known

cases, I think, are there not, where that is believed to exist. I do not think it would be possible to stop it. You can, I suppose, reduce the 50 per cent. which defines the subsidiary, so that, for the purpose of holding shares in the holding company, something lower than a holding of 50 per cent. would be treated as a holding company. But you can bring in other companies, can you not? If somebody wants to put together a position of that sort, it can be done, can it not? And if you cannot do it with two companies, it can be done with three or four.

5595. *Professor Gower*: The Cohen Committee said the definition of a subsidiary company should be one of control. In this situation, one controls the other; and in framing a definition it should be something embodying this. Then the ban upon owning shares in the holding company would effectively prevent it.—But having control, you would get away from 50 per cent. of the votes plus one, and how could you say what in practice was control?

5596. *Mr. Lawson*: Would it be your view that you would rather like to stop this but you cannot at the moment see any clear way of preventing it?—I do not think any of us would support it as desirable.

5597. And the other thing is, do you think there would be any objection to allowing a company to reduce its capital in cases where that reduction was merely giving practical effect to losses already incurred, and there was no repayment of cash to shareholders?—*Mr. Henlé*: I am not quite sure I quite see the object of the question.

5598. There are a number of possible and practical advantages. One would be in connection with the problem you have mentioned in your memorandum, of pre-acquisition profits in mergers. Sometimes in an amalgamation, if you were to hold that you had to establish a share premium account and the pre-acquisition profits get frozen, if you were later allowed to use that share premium account by way of meeting any losses that were incurred—if the losses were incurred in the early years of the new merger company—that would go some way towards meeting this problem that emerges. That was one of

the ideas I had in mind. Is there any purpose in going to Court, because you do not have to circularise creditors in that type of case?—But at the same time I would think going to the Court does add a protection to something which is, by some people, considered unorthodox.

5599. You think on balance it is better to go to the Court?—I think so.

5600. *Professor Gower*: Even if you have to get consent of class meetings—you would still think it was necessary?—Not so necessary, no.

5601. *Mr. Lawson*: Perhaps it is an unfair question. May I just ask one more question on your evidence as regards the situation which arises when assets are written up and a surplus is created. I am not absolutely sure I follow your evidence as to what may be done and what you think should be allowed to be done with that surplus. Am I right in thinking that the surplus which emerges is usually of two kinds: firstly it arises through over depreciation in the past—that is one type of surplus, and that is something which can be put to the profit and loss account and reserve and therefore is available for distribution in cash to the shareholders as a dividend, if the directors so desire. But any surplus that arises over the original cost of the assets is really only a paper figure. I was under the impression the legal view on that is that it can be used for issuing bonus shares, but not for the distribution of dividend?—I think it was only last Friday that Mr. Justice Buckley held that an unrealised dividend of that nature can be distributed.

5602. Distributed in cash?—Yes: it may be undesirable.

5603. And what do you think about that as regards the Act? Do you think we ought to amend it so as to prevent that?—I would have thought that is a matter which is better left to the directors, because I think there is no doubt that it would be considered in a large majority of cases to be an imprudent thing to distribute unrealised profits.

Professor Gower: It is all very well to leave it to the directors of a public company—would you be as happy in the case of a private one?

5604. *Mr. Watson*: In paragraph 44 you seem to make a definite recommendation that the distribution should be allowed in cash or specie.—Yes. We do here recommend that the present position as found by Mr. Justice Buckley should continue.

5605. *Mr. Lawson*: I thought there was a case the other day, a Scottish case, in which they decided exactly the opposite.—I was told by the person who told me about the decision given by Mr. Justice Buckley that the latter would not listen to that case.

5606. Your view is you would be willing to see unrealised profits distributed?—No, I would not be willing to see unrealised profits distributed, but I would prefer that the power to do so be retained even in a private company, because so often in a private company it is of great advantage to shareholders who require the money.

5607. Yes, but a grave disadvantage to the creditors.—From that point of view of course it is a matter of prudence, and if the directors have acted recklessly, I would have thought a creditor might hold the directors accountable.

Professor Gower: Not if the law allows them to do it. If the company is insolvent, yes. If the company is solvent apparently the law allows them to do it.

Mr. Lawson: You go right against a basic accounting principle.

5608. *Mr. Mackinnon*: There could be confusion here. Supposing you sold one asset at a profit, on paper you would have a realised accretion on that particular asset. No Court says you can distribute that profit without looking at the accounts overall, so before you distribute an accretion in respect of one asset you should make a valuation of the other assets at that moment to see whether your capital is left intact. If that be the true view, there seems to be little difference in principle between realised and unrealised surpluses. Realisation normally provokes people into enquiring whether they have a capital accretion.—I think I would look at it that way.

Professor Gower: There is surely a difference between realising one asset and

writing up your other assets and distributing the whole of your surplus.

Mr. Mackinnon: In fact, but in principle you would have to go through the valuation motion whichever way you did it. You would merely have rather stronger evidence that you have a capital profit if you have realised it than if you have not.

5609. *Mr. Lawson*: It can happen, of course, that when assets are revalued in this way it makes a very appreciable difference to the amount of depreciation that has to be charged in the accounts.—Yes.

5610. And that additional depreciation is not allowed for tax; it has to come out of net profit. It is possible to imagine cases where as a result of that the rights of participating preference shareholders could be affected. Have you any views on that?—As a solicitor, I am afraid I have very few views on that; it does strike me as peculiarly in the field of accountants. I cannot quite see at the moment how the rights of preference shareholders could be affected.

5611. They can be affected if the additional depreciation is so large as to affect profits; then of course it could in an extreme case prevent a preference dividend being paid, and in an ordinary case it could reduce the participating rate for the time being.—Is that not the sort of case where a preference shareholder who would suffer in that way could possibly go to the Court under section 210 for relief?

5612. Perhaps that might be the answer—if section 210 is amended.—Amended so that the winding up criterion is removed.

5613. *Professor Gower*: Surely not? If the law prevents the dividend being paid, no Court can hold the directors in breach for not paying it.—I would agree with that taken by itself, but the object of the revaluation surely must be to benefit the ordinary shareholders? I cannot see any other object.

5614. *Mr. Lawson*: It very often is in order to increase their borrowing powers.—You increase the borrowing powers to enable the company to raise more money for the purpose of doing a better trade to the advantage of equity shareholders.

Mr. Bingen: Surely the real explanation is you do not want your balance sheet to have two forms of currency—fixed capital valued at old prices and current assets valued at today's prices. You want to see that you are realistically providing for depreciation on those assets. I would have thought myself it was to the advantage of the preference shareholders. I cannot see how it can be to the detriment even if in a year or two with a greater depreciation dividends fell in arrear, because really you are strengthening the company's finances.

Professor Gower: With cumulative preference I think you would be right, but not necessarily right with non-cumulative.

Mr. Watson: Perhaps the Court being approached in circumstances of this kind might order it be reversed—where the preference dividend was not covered on disclosed earnings. Then it would seem that the preference shareholder might reasonably have some complaint.

Mrs. Naylor: We are assuming that there is no revenue reserve out of which the preference dividend could be paid—rather an unusual situation.

5615. *Mr. Lawson:* I am assuming that even a write-up of assets and possibly a distribution of the surplus in the way that has been suggested may be legal, but the company comes upon adverse trading conditions and you may get the position of a loss. Then I would have thought that even a cumulative preference shareholder, and certainly a non-cumulative preference shareholder, would have had a legitimate grievance.—*Mr. Cole:* I would suggest another difficulty. When you value the fixed assets of a company that is doing well, the fact that it is doing well affects the valuation—the same assets with a company not doing so well are not worth so much and not valued as high. Really if you are handing out in cash something which is at any rate dependent on the expectation of the way the company is going to go on doing—that is dangerous too. In other words although it is not valued expressly as a going concern, that always comes into it.

Mr. Lawson: They may have distributed a theoretical surplus which you find does not exist.

5616. *Mrs. Naylor:* Sir Charles, do you think it would be useful to extend the powers of the Board of Trade so that where there are complaints they can make private investigations? In other words not announced to the public? The public appointment of inspectors is so damaging to a company that it appears from experience that they are generally only *post-mortems*.—*Mr. Dennehy:* Yes, Madam, we do indeed, and we have recommended in paragraph 71 that the Board of Trade be given statutory power to demand documents and information from the directors and officers of companies. The power would assist the Board of Trade in determining whether there is a *prima facie* case to warrant the appointment of an inspector. And we therefore do mean by that recommendation, that facilities for a private investigation not incurring damaging publicity would be an extremely good thing to give.

5617. *Mr. Scott:* Do you really see any objection to a company reducing its capital when it is merely recording that in fact some of its assets have been lost? Do you think it is necessary to have that approved by the Court?—*Mr. Heinle:* Yes, I do.

5618. I cannot see why. What advantage is there that the Court confers by sanctioning something it only sanctioned, of course, on the basis of the company producing affidavits to say that a loss has been incurred. Creditors do not seem to be affected at all. It is more or less making heavy weather of a book-keeping entry.—*Mr. Welsford:* Given the appropriate safeguards, I think the view might be taken that there is no objection to that. It cuts out what otherwise becomes a necessary prolonging of the procedure.

5619. One other question arising on that. Do you see any objection to a company having greater freedom to buy its own shares?—*Mr. Cole:* On the American basis?

5620. Particularly on the American basis where public companies have apparently unrestricted right to buy and take their shares into treasury and re-issue them. I was thinking perhaps more of a private company which might be only

too glad to buy out a deceased shareholder: in other words to use the company's assets for purchasing shares of a deceased shareholder, rather like a partnership buys out the estate of a deceased partner from the partnership assets. The only step that appears to be necessary to ensure that the creditors are not affected is that perhaps some kind of declaration of solvency might be required. But broadly do you see any reason why that same benefit should not be extended at any rate to private companies?—*Sir Charles Norton*: I think it depends very largely what restrictions are attached to it. We have discussed the broad principle, and we thought that there would not be any objections, but obviously there would have to be restrictions and I think it rather depends what those restrictions are.

Professor Gower: The Americans can only do it out of surplus. The shares, while in the treasury, cannot be voted and receive no dividend.

5621. *Mr. Scott*: But the company can do it without having to go to the Court.—It rather depends how it is going to be done. Obviously the company could not do it if it was an application of its assets, apart from distributable profits or something of that sort. You really would then be reducing the capital.

5622. Even if the shares are no par value?—*Mr. Cole*: You have then got your stated capital, have you not?

5623. It would be a reduction of stated capital.—*Sir Charles Norton*: I think there are many occasions when it would be extremely useful. We saw no objection in principle, but it is difficult quite to see whether we agree without seeing what actually we are agreeing to. One thing I had in mind was that so many are these employee shareholdings, and employees retire or die. In that sort of case it would probably be extremely useful.

5624. *Mr. Watson*: Can you give us any help on the interpretation of section 54? It has been criticised as being honoured more in the breach than observance?—*Mr. Cole*: I think it is very unlikely that any solicitor can give a really competent answer in most of the cases that arise. It is presumably thought

it is a desirable principle to insist on; it would obviously be desirable to get a clearer definition where to draw the line. I think the best that might be considered would be that where the purchase of the shares had been effected and there had been no commitment in advance to use the company's assets, whose shares you had bought, that should be all right.

5625. *Mr. Mackinnon*: You say presumably it is considered a good principle. Have you any doubts as to whether the section should be preserved?—We have heard arguments to the contrary which were quite convincing. In effect it is any worse to lend money to a perfectly good borrower who is intending to buy your shares than to lend it to somebody else, if you have the money and it is a good debt?

5626. So you would favour consideration of the retention or non-retention of section 54 as a whole?—That is the great difficulty; I should like to see it out of the way. On the other hand, it is very difficult to see what the consequences of suddenly saying you may now use your money to finance the purchase of your own shares would be. It would ostensibly throw the whole thing wide open; it is very difficult to see what advantage people would take of it.

Mr. Henlé: And to what uses they could put it.

Mr. Welsford: It has certain incongruous effects as it stands. Company A buys company B; section 54 would preclude any of the assets of company B being used in connection with the raising of the money for that purchase, and therefore those assets could not be used. If you liquidate company B and push all its assets into company A so that you have one undertaking, you could use the whole of those assets for raising more money. I remember one public prospectus where company A was buying company B, and the obvious thing was to have a debenture issue on the two companies; so the prospectus gave a debenture issue on company B with a covenant to liquidate company B within 12 months and bring the assets into company A whereupon they would fall on a given charge. So precisely the same result was achieved by that indirect method.

Mr. Henlé: The same result could also be achieved if the cash held by the company, whose shares are being bought, represents largely undistributed profits available for dividend, because if within one minute after completion of the purchase which was done through a bridging transaction the acquired company declares the whole of its assets as a dividend, that dividend can be used to repay the bridge.

5627. *Mr. Watson:* In a transaction of this kind where company A seeks accommodation from its bankers in order to purchase company B, succeeds in doing so and acquires all the shares of company B, then company B becomes a subsidiary, and it is quite right and proper for company B to grant off-setting authority for its cash balances against the overdrafts of company A. In these circumstances

while that seems to be quite regular, it is obviously at variance with what appears to be the intentions of this section. And therefore it would seem that the section calls for some re-drafting, and I wondered whether you could assist us in that way? —*Mr. Welsford:* The best form of re-drafting is very often deletion.

Mr. Cole: What I suggested just now would have met that point. There would have been no commitment before to use the money for repaying the new parent company's bank advances, and therefore it would be perfectly all right.

Mr. Watson: Thank you.

Chairman: Those I think are all the questions we have managed to think of to put to you gentlemen. It only remains for me to thank you very much for coming here and helping us.

(The witnesses withdrew)

APPENDIX XLIII

Memorandum by The Stock Exchange, London

Introduction

The extent to which the Council of the Stock Exchange is qualified to assist the Committee on Company Law Revision on the various matters included in the list of subjects under review is confined to the Council's experience in the affairs of companies quoted on the Stock Exchange, London. The Council has not, therefore, been in a position to deal exhaustively with the subjects under review, but has directed its attention to matters on which it felt most competent to express an opinion. The Committee are therefore asked to read the comments as applicable to quoted companies and other companies in which the public have an interest except where otherwise stated.

Before dealing with those subjects the Council feels that it would be advantageous to submit the following review of the procedure at present used in connection with applications for the grant of quotation.

Applications for the Grant of Quotation for Securities on the Stock Exchange, London

General

1. An issue of securities by companies has to comply with the requirements of the Companies Acts whereas borrowings and capital issues by central and local authorities, public boards and statutory undertakings must comply with the legislation appropriate thereto and in certain cases the requirements of the Companies Acts.

2. If it is desired to have a quotation on the Stock Exchange, London, then the requirements of the Stock Exchange must also be fulfilled. The procedure to be adopted in connection with an application for permission to deal in and for quotation for the securities of a company is contained in the rules and regulations of the Stock Exchange. The appropriate rules being:

- (a) Rule 159 (2) which states that applications for quotation must be made to the secretary of the Share and Loan Department and must comply with the requirements of the Council as contained in Appendix 34*.
- (b) Rule 163 which is expressed in permissive form and in clause (1) states what securities may be dealt in. Clause (2) gives permission for isolated bargains to be transacted in securities not quoted on the Stock Exchange; permission in each case must be sought for these transactions and a market is not allowed to develop.

3. The Council's powers and duties in connection with quotations are delegated to the Committee on Quotations which consists of some ten members of the Council. A small group of this committee sits on a panel which considers and discusses the various problems arising from the committee meetings or from preliminary points with regard to prospective issues or with any administrative problems. The administration of these rules and rulings by the committee or panel is undertaken by the Share and Loan Department of the Stock Exchange.

Methods of bringing securities to the Stock Exchange

4. Securities of companies may be brought to the Stock Exchange by any one of the methods listed below:

* In this Memorandum, all references to Appendix 34 relate to Appendix 34 to the Stock Exchange Rules and Regulations.

By a public prospectus

5. This method is usually confined to the case of a new company or where a company is offering to the public an entirely new security. The contents of the prospectus (ignoring foreign companies) must comply with the requirements of sections 37, 38, 40, and 41 of and the Fourth Schedule to the Companies Act, 1948. In addition the requirements of Appendix 34 to the rules of the Stock Exchange have to be satisfied and these frequently go beyond the requirements of the Companies Act, 1948. For example, a report on profits and losses for the last 10 years is normally required instead of 5 years in the Companies Act, 1948. The Stock Exchange requirements are by no means rigid and may be varied to meet differing situations. The sanction behind these requirements is the power of the Stock Exchange to refuse or defer the grant of quotation.

By a public offer for sale

6. This method is most commonly used in respect of companies with established businesses a block of whose securities has been purchased by a bank or issuing house with a view to resale of all or part to the public—in the majority of cases the document of offer is subject to the prospectus requirements of the Companies Act, 1948. In any event the prospectus requirements of Appendix 34 have to be satisfied.

By a placing

7. This method is most commonly sought where the costs of a public offer for sale would be unduly burdensome or where there is little public demand for the securities. The grant of such a method is a concession and an application setting out the reasons for seeking such concession must be made to the Committee on Quotations.

A broker or issuing house purchases the security and then offers the security with a view to resale of all or part to the public. In order to ensure a fair distribution to persons other than the clients of the issuing broker or issuing house the committee normally insists that at least 25 per cent. of the issued amount of equity capital and at least 20 per cent. of the issued amount of fixed dividend/interest securities, should be the subject of such placing. Not less than 25 per cent. of the amount of equity capital placed and 20 per cent. of other securities placed must be offered to clients of other brokers through the medium of the market. The marketing arrangements must be submitted to the committee so as to ensure that there is an equitable distribution. The placing letter and other documents when taken together constitute a prospectus and are subject to the statutory requirements of the Companies Act, 1948. The requirements of Appendix 34 must also be satisfied.

By an introduction

8. The fundamental difference between a Placing and an Introduction is that in an Introduction there is no commitment for the disposal of any of the securities—there must therefore be a sufficiently wide spread of holdings already in existence to establish a Market. This method also requires the preliminary approval of the Committee on Quotations but while an Introduction of fixed interest securities is fairly common it is exceptional for equity capital to be permitted to be handled in this manner apart from (a) cases where a market has already been established in another centre, and (b) new companies carrying out a segregation of assets and whose shares are being distributed to the shareholders of an existing quoted company.

By a tender

9. This method has been confined for many years to the securities of certain water supply undertakings. The public are asked to say at what price they will take the security offered. Usually a minimum price is fixed below which offers will not be considered. The most suitable tenders are accepted. In addition to complying with the Fourth Schedule to the Companies Act, 1948 the provisions of the Water Act, 1945 and Appendix 34 have to be satisfied.

By other methods

10. A company may issue new securities in one or more of the following ways:—

- (a) By way of rights to the existing holders of securities of the company in proportion to their holdings. Under Appendix 34 the circular of offer must disclose *inter alia* information as to the financial position of the company since the publication of the last balance sheet and the purpose and terms of the issue. There are certain additional administrative requirements not contained in the rules which have been introduced to meet current needs. For example, three weeks is recommended as being the minimum period of time for acceptance and the use of air mail postal services for overseas shareholders is encouraged.
- (b) By way of capitalisation of reserves and of undistributed profits. The form of the document of issue must comply with Appendix 34.
- (c) By way of open offer to holders of shares or other securities. The Stock Exchange requirements are substantially the same as those for a rights issue.
- (d) As consideration for assets acquired. If the assets to be acquired or earnings attributable to those assets are material in relation to the position of the purchasing company, the Stock Exchange requires a circular to be issued to shareholders giving adequate information about the acquisition including an accountant's report on the profits and assets. In other cases a press announcement giving short details of the acquisition may suffice. Each case is however considered on its merits.

Procedure

11. As already explained the Committee on Quotations' requirements are administered by the Share and Loan Department of the Stock Exchange which consists of permanent officials.

12. Brokers intending to make applications for quotation for securities new to the Stock Exchange normally consult the department at an early stage. If a concession is sought such as a placing or introduction or a waiver from full advertising requirements, a letter is submitted through the department whose members assemble material facts and place them before the panel of the committee for consideration. In exceptional cases the full committee may be consulted. The panel sits on Tuesdays, Wednesdays and Fridays, and the full committee sits on Wednesdays and Fridays. Proof prospectuses or advertised statements must be submitted through the broker to the department at as early a stage as possible and in any case not later than 14 days prior to publication or posting. Four copies of the prospectus or advertised statement are deposited one of which is passed to the Records Office which examines the personnel and corporate bodies named in the document, the second and third copies are examined within the department and the fourth is returned to the brokers with any comments written on it.

13. The primary function of the examination by the department is an endeavour to ensure that all relevant information is disclosed to enable the potential investor to make a fair assessment of the proposition. Usually three proofs and occasionally as many as eight proofs have to be submitted before the requirements are satisfied. The questions raised on these proofs are in the main directed towards clarification of the profits and assets and securing supporting evidence for claims made in the profits and prospects paragraph and various other factors relating to the business. In the course of this examination the department may find it necessary to seek the advice of their legal and accountancy consultants.

14. The examination by the Records Office is designed to protect the public from unscrupulous persons.

15. In a small number of cases the examination may result in some alteration in the proposed organisation or even the abandonment of the proposition. In certain cases the proposition may be considered wholly unsuitable for quotation or not sufficiently developed to justify quotation; in these cases it is discussed with the panel which may indicate that it would not be prepared to grant a quotation or that quotation would only be considered after, say, the publication of the first accounts to show a full year's operation of the proposition.

16. Whenever the department is not satisfied about the adequacy of disclosure or in some other respect, the panel is available for consultation before any decision is taken.

17. At this stage the question of Certificates of Exemption may arise and if so the solicitors to the issue will be required to submit a case in writing which after examination by the department will be submitted to the full committee for their decision. Further particulars of the grounds upon which a Certificate of Exemption may be considered are set out in the Stock Exchange reply to question 17 (c) of the questionnaire.

18. The rules require at least 48 hours to elapse between the publication of the advertisement and the time of the committee meeting when the application is considered. This time lapse enables potential buyers to assess the position before dealings commence and provides an opportunity for members of the public to write to the Stock Exchange giving information about the company or the personalities which may hitherto have remained undisclosed.

19. In accordance with the terms of the general undertaking given by companies making an application for quotation, draft circulars, notices of meetings, resolutions, etc., must be submitted to the department for examination. These may or may not involve issues of further securities. A similar process of examination is applied with a view to ensuring the adequacy of the information available either to assess the position of the company or to enable the shareholder to exercise his vote intelligently on matters submitted for his approval; also to ensure that any procedure proposed will fit into Stock Exchange machinery.

General administration

20. Besides the work connected with applications for quotation of new issues of securities, the enforcement of subsequent requirements, the study of reports on unusual occurrences in market prices, the Committee on Quotations is regularly reviewing existing machinery and considering suggestions submitted by the Share and Loan Department.

21. In recent years the question of continuation of a quotation has frequently been before the committee. The quotation for a security will almost certainly be cancelled if some 95 per cent. of a class of security passes into the control of one holder and may be cancelled if a lower percentage is so held. Where the purpose for which a company was granted quotation has ceased the quotation will normally be suspended. The same course may be followed upon a change of control. Frequently it is known that it is ultimately intended to use the company for a different purpose and the suspension is announced as being "a temporary suspension pending a fresh application following any reorganisation".

22. When the fresh application is made the company is treated as being a new company and must conform to the whole of the procedure applicable to a new company and publish a prospectus or advertised statement giving full particulars of the company in its new form.

23. The sanction of withdrawing quotation or, where there is merely a right to deal under the provisions of rule 163, the prohibition of dealings may follow a report to the committee of unusual occurrences in market prices or the inadequacy of information about changed affairs of a company or other event.

24. Subjects undertaken by the committee in recent months are set out below:

- (a) When a company applies for quotation in the first instance it is required to sign a general undertaking relating to certain procedures and the supply of information to the Stock Exchange. This undertaking is periodically revised in the light of experience. As a small proportion of quoted companies which have not made applications in recent years have not given the latest general undertaking, these have been invited to complete it.
- (b) Under the Stock Exchange rules the borrowing powers of companies must be limited. After consultation with legal advisers a new form of requirement relating to group borrowing powers has been adopted to avoid excess borrowing through subsidiaries.
- (c) Alternatives to placings and offers for sale have been considered in conjunction with the Issuing Houses Association and Accepting Houses Committee and the Clearing Banks. The problem is still under review. The committee has issued a memorandum of guidance as to the terms under which placings would be considered, for example, it has indicated that it is not prepared to allow placings of initial issues of property companies' securities at the present time.
- (d) The extension of requirements under Appendix 34 in cases where companies carry on two or more activities which are material to include information as to their relative importance having regard to the profits or losses.
- (e) The adequacy of Stock Exchange requirements in regard to property valuations in prospectuses is being discussed with the Royal Institution of Chartered Surveyors, the Chartered Auctioneers' and Estate Agents' Institute and the Incorporated Society of Auctioneers and Landed Property Agents.

25. The powers of the committee are wide and flexible and in reaching decisions it endeavours to see that reasonable safeguards are taken to protect the investor to whom all relevant information should be available. In making these endeavours it is the practice of the committee and the Council to consult the relevant professional and business bodies. Examples can be seen in paragraphs 24 (b), (c) and (e) above and the answer to question 12 of the subjects under review. This practice of consultation and of *ad hoc* committees drawn from the business world at large to consider problems which affect the financial body as a whole is a growing one and one which the Council is eager to encourage. It leaves the final responsibility with the Council while maintaining flexibility and ensuring that the various problems are considered by such committees with the widest available experience.

Subjects under Review

The following memorandum is submitted in connection with the subjects under review. The paragraphs have been numbered to accord with the list of subjects enclosed with the letter dated 15th January, 1960, from the Secretary to the Committee.

1. Incorporation of Companies—Memoranda of Association

- (a) *Requirements as to minimum number of members, and other conditions of incorporation*
- (b) *Limitation of objects to those stated in the memorandum obsolescence of ultra vires rule in view of universality of modern objects clauses: effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*
- (c) *The company as a legal entity distinct from its members—"one-man" companies*
- (d) *Shares of no par value. (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)*

(a) and (c) The Council has no comments to make on these subjects.

(b) The Council does not object to the present wide framing of modern clauses.

The Council considers that in an age of many new developments companies should not be prevented from taking advantage of exploiting such developments. It is essential, therefore, to have machinery whereby a company can readily undertake entirely new operations; at the same time shareholders should be kept fully informed of these developments. The shareholders should also be given particulars of any interest (direct or indirect) of any director or proposed director in any company, business or other assets which have been or are proposed to be acquired.

When a company comes to the Stock Exchange for a grant of quotation it presents to the public facts about a particular business. It is this business that is assessed by prospective shareholders. It is on the basis of this business that quotation is granted. It is now the practice of the Stock Exchange to require a suspension of quotation if the general nature of the company's business changes until such time as the full facts of the new business are available for publication to the shareholders. This requirement applies even though the new business is within the terms of the company's objects clause. Generally the request for a "temporary" suspension comes from the board of directors, but if such request is not forthcoming the quotation is suspended by the Stock Exchange. Documents in support of the application for regrant of quotation will have to comply with the full prospectus requirements of Appendix 34 to the Stock Exchange Rules and Regulations. It is treated in the same way as a new company applying for quotation for the first time.

The Council is concerned primarily with the practical effect of the present law from the point of view of safeguarding the investing public. From this point of view it is of the opinion that the powers vested in it are adequate and sufficiently flexible to deal with varying situations of quoted companies.

(d) While the Council is unable to assess the demand for shares of no par value it sees no reason why they should not be permitted.

The Council is of the opinion that the question of sub-division or a consolidation of shares of no par value requires consideration. Under the present system sub-division or consolidation of shares requires the approval of the company in general meeting whereas units in which stock is transferable may subject to any provision in the articles of association be varied by resolution of the directors.

The Council sees no reason why the sub-division or consolidation of shares of no par value without any alteration in the stated value of the capital should not be effected by resolution of the directors but where there is more than one class of shares provision should be made for maintaining the aggregate of the votes of the class of shares which have been sub-divided or consolidated.

Consideration should also be given to the controlling of companies wishing to reduce the stated value of their shares as opposed to their reserves.

The principal benefit of shares of no par value over those with a par value is that the dividend is stated as an amount per share rather than as a percentage of what in effect is a value unrelated to fact. For example, a company announcing a dividend of 25 per cent. on a £1 share when £5 per share is employed in the business gives a wrong impression of the amount of its dividend.

2. Prohibition of Partnerships with more than 20 Members

(Section 434 of Companies Act, 1948.)

The Council has no comment to make on this subject.

3. Classification of Companies

(a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

(b) *Nature and merits of distinction between exempt and non-exempt private companies (sections 127, 129 of Companies Act, 1948)*

(c) *Unlimited companies and companies limited by guarantee*

The Council has no comments to make on these subjects.

4. Donations by Companies for Charitable and Political Purposes

The Council recommends that the total amount of donations for charitable and political purposes by a company should be disclosed in the annual accounts.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

The following are suggested as some of the matters calling for consideration under this general heading:—

(a) *Fundamental changes in company's activities*

(b) *Disposal of undertaking and assets*

(c) *Issue of shares*

(d) *Borrowing money and charging property*

(e) *Lending money otherwise than in the ordinary course of business.*

(a) and (b) The Council has discussed the question of changes in a company's activities under the heading of 1 (b). The Council considers that the approval of shareholders should be obtained to any fundamental changes in the activities of the company or to the sale of the whole of the undertaking and assets of the company.

(c) The policy of the Council in regard to equity capital issues is reflected in the notice issued to the Press dated 1st February, 1960.

ISSUES OF EQUITY CAPITAL

The Council of the Stock Exchange have had under consideration the question of issues of equity capital for cash and the granting of options over equity capital.

"It has been the practice of the Council, in the absence of very exceptional circumstances and apart from extremely small issues, to require that further issues of equity capital for cash should be offered in the first place to the equity shareholders. This policy has also been extended to issues of securities convertible into equity capital. In addition to ensuring that the equity shareholder receives the benefit of any bonus terms this policy enables him to maintain his stake in the company."

The Council have noticed that arrangements for providing further finance sometimes include the granting of an option to subscribe for equity capital of a company or of one of its subsidiaries.

"Whilst it is recognised that these arrangements may be advantageous to the company, the Council are of the opinion that, in the absence of very exceptional circumstances, it should be possible to preserve that advantage and at the same time to seek the specific approval of the equity shareholders to such arrangements or any other proposal for issuing for cash, to other than the equity shareholders, equity capital or securities convertible into equity capital or conferring a right to subscribe for equity capital."

The Council does not feel that it would be practicable for further issues of capital in general to be made subject to shareholders' approval. Consideration might, however, be given to ensuring that issues which would result in a change of control being subject to prior approval of the shareholders in general meeting.

(d) Under the provisions of Appendix 34 to the rules and regulations of the Stock Exchange, companies seeking a quotation are required to provide in their articles of

association that the borrowing powers of the board are limited so that the aggregate amount at any time owing in respect of moneys borrowed by the company and its subsidiary companies (exclusive of inter company borrowings) shall not exceed a reasonable and readily ascertainable amount except with the consent of the company in general meeting.

The Council requires a limit on group borrowings not only to underline the directors' responsibilities to the group but also to ensure that shareholders and creditors are aware of the directors' powers in regard to the group.

While the Council appreciates that in certain types of businesses, it may be necessary to have recourse to temporary borrowings on a large scale at certain periods of the year, it feels that it would be reasonable to impose some ascertainable limit on directors' powers, even though such limit might be fairly high. It is therefore suggested that consideration might be given to a prohibition of unlimited borrowings (whether secured or unsecured) of directors except perhaps in the case of banking and insurance companies.

The Council is not in a position to comment on the second part of this subsection relating to the charging of property.

(e) The Council has no comments to make on this subject.

6. Directors' Duties

- (a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*
- (b) *Are directors generally aware of the legal duties arising from their fiduciary position?*
- (c) *Directors' and officers' dealings in their own companies' shares*
- (d) *Disclosure of directors' interests*
- (e) *Should bodies corporate be allowed to be directors?*

(a) The Council has no comments to make on this subject.

(b) The Council has no knowledge of whether directors generally are aware of the legal duties arising from their fiduciary position in the normal running of the company. The comments therefore are confined to the Council's experience in new issues. From this experience it appears that a number of directors have a strictly limited understanding of their responsibilities under the Companies Act, 1948, and this is supported by views expressed by some of the broker members who are actively connected with new issue work.

(c) The Council does not object to directors and officers dealing in their own company's shares provided that adequate information of the transactions is made available and that the transactions have not taken place as a result of the receipt of privileged information. It considers that the present provisions as to directors and contained in section 195 of the Companies Act, 1948, should be extended to officers of the company. The Council also considers that there should be an additional provision requiring companies to draw attention in the notices calling the annual general meeting to the provisions of section 195, subsection 7, and to the fact that the information is available for inspection for the 14 days prior to and at the meeting.

(d) Appendix 34, Schedule II, Part A of the Rules of the Stock Exchange in respect of new companies seeking quotation for the first time and Schedule II, Part B, in respect of quoted companies seeking quotation for further issues require directors to disclose their interests. These requirements relate to the directors' emoluments, their powers to vote remuneration to themselves and particulars of their interests in the promotion of the company or in property acquired or to be acquired by the company or any of its subsidiaries. The Council recommends that the law should be strengthened in the case of all public companies by the inclusion of similar requirements.

The Council also draws the Committee's attention to the fact that at present if a prospectus is issued more than two years after the date at which the company is

entitled to commence business no such information is required by the Companies Act, 1948, as paragraph 22 of the Fourth Schedule to that Act excludes the application of paragraph 16 of the same schedule.

(e) The Council has no comments to make on this subject.

7. Shares with Restricted or No Voting Rights

The Council issued the following notice to the Press on 19th August, 1957, concerning non-voting shares:

"The Council of the Stock Exchange have watched with attention the growth of the practice of issuing non-voting equity share capital.

"They do not look with favour on the voiceless equity share, and have taken such steps as are open to them to ensure that the public are not misled as to what they are buying or are being offered.

"Companies that issue non-voting shares are within their rights under the Companies Act, and the Council do not consider it to be justifiable to use the high-powered sanction of refusing a quotation to non-voting shares, which would have the effect of taking away from companies powers which they legally possess.

"Even if the Council had considered it possible to take some action, there are difficulties that would be very formidable; for example, in most cases securities are in the form of unnumbered shares or stock units. If the Stock Exchange were to require in the case of future applications that all ordinary shares should have equal voting rights, it would necessarily result in the refusal of quotation in all cases of non-compliance. It would further follow that in cases where new issues were to be identical with and indistinguishable from existing ones, the quotation of such existing securities would also have to be cancelled. This would inevitably result in denying the facilities of a free market to companies who have exercised their legal rights in creating non-voting shares and also to those shareholders who have preferred to buy non-voting shares because they are cheaper.

"The proper remedy against the issue of non-voting shares is an amendment of the Companies Act; but in the meantime no person or company is compelled to hold or to buy, or to subscribe for or underwrite non-voting shares, and if such attitude were consistently adopted the issue of non-voting shares would cease to be a practical proposition."

Apart from requiring companies issuing non-voting shares to insert the words "non-voting" in the title of such shares or stock, the Council considered that it was not in a position to do more than was indicated in the notice.

The Council is, however, of the opinion that all equity shareholders should have the right to receive notices of meetings and be allowed to attend meetings even though they may have no right to vote.

8. The Protection of Minorities

Adequacy of existing remedies. Winding up under the "just and equitable" rule (section 225 (2) of Companies Act, 1948); the remedy afforded by section 210

The Council is not satisfied that sections 225 (2) and 210 of the Companies Act, 1948 afford as much protection as was intended when the Act was drafted and as is desirable. The Council would therefore welcome any measure that would strengthen the law without hampering legitimate business.

9. Protection of Special Classes of Shares

Modification of class rights (section 72 of Companies Act, 1948)—getting rid of preference shares by winding up or return of capital

The Companies Act, 1948 regards preference shares as part of the share capital of a company and apart possibly from the provision for the issue of redeemable preference

shares, the shareholders are treated as proprietors although investors generally regard the shares as having more in common with loan capital.

The whole position of preference capital has become confused and many protective provisions attaching to modern issues give the holder the appearance of a creditor rather than a proprietor. These provisions have, however, been made to meet the demands of investors who set great store by knowing the term of their investment as well as its security.

Considerable alarm among investors was caused by the House of Lords decisions in *Scottish Insurance Corporation v. Wilsons and Clyde Coal Co.* 1949 1 ALL ER 1068 and *Prudential Assurance Co. Ltd. v. Chatterly-Whitfield Collieries Ltd.* 1949 1 ALL ER 1094 in which the Court confirmed that a company wishing to distribute cash in excess of its requirements could repay preference capital in accordance with its rights without placing the company in liquidation.

In view of the fact that the law treats preference shares as being part of the share capital as opposed to loan capital, the Council considers that repayment of preference shares by winding up or return of capital should in all cases have the separate consents of the preference shareholders of the class concerned.

10. Board of Trade powers to appoint Inspectors

The Council considers that the present provisions of the Companies Act, 1948 are adequate.

Arising out of the powers conferred on the Board of Trade, the Council views with concern the length of time the Board of Trade has taken to appoint Inspectors, the length of time that has been taken in the past for an Inspector to produce a report and the adequacy with which the Board of Trade has exercised its powers.

The Council appreciates that the Board of Trade are probably faced with many difficulties in deciding what investigations are justified. There must also be anxiety on the part of the Board of Trade in safeguarding public money. The Council considers that there should be a change in the administrative machinery which would accelerate the exercise of the powers of the Board of Trade.

11. Disclosure of Ownership and Control

- (a) *Nominee shareholders and debenture holders (including nominee holding companies)*
- (b) *Control through nominee directors*

(a) and (b) The Council is of the opinion that the use of nominee holdings has many administrative advantages and would regret its prohibition or any attempt to restrict its usefulness.

12. Share Transfer and Registration Procedure

This subject is at present under consideration by a special committee comprised of the City interests most immediately concerned. This committee upon which the Council is represented will no doubt co-ordinate the views of the various parties and their recommendations will presumably become available in due course.

13. Multiplicity of Directorships held by one individual

The Council has no comments to make on this subject.

14. Practice of carrying on business through Associated and Subsidiary Companies .

The practice of carrying on business through associated and subsidiary companies has many advantages, but the only observation which the Council wishes to make is in connection with the amount of information which is available to shareholders. It

has been noticed that a number of companies include details of their associated and subsidiary companies in the annual reports of the directors. It is recommended that the names and nature of the businesses of the associated and subsidiary companies should be given in the annual report.

It is also suggested that the information made available should include the percentage of capital held in subsidiary companies and also in associated companies. Such information would assist the shareholders to assess the extent to which companies' interests are varied or diversified.

15. Loan Capital

- (a) *Debentures and debenture stock*
- (b) *Trust deeds—duties of trustees and receivers*
- (c) *Registration of charges*

(a), (b) and (c) The Council has no comments to make on these subjects.

16. Take-over Bids

- (a) *Procedure*
- (b) *Securing disclosure of information on which shareholders can form an opinion*
- (c) *Functions of directors*
- (d) *Disclosure of identity of bidder*
- (e) *The financing of such transactions*
- (f) *Disclosure of directors' interests—compensation for loss of office (sections 191–194 of Companies Act, 1948)*

The Council considers that the existence of free market conditions is in the best interests of shareholders and others interested in investment and it would regret any restriction on the freedom of a shareholder to dispose of his securities.

The Council is, however, of the opinion that sufficient information should be placed before shareholders to enable them to assess the merits of the offer.

For these reasons the Council welcomed the Notes on Amalgamations of British Businesses prepared by the executive committee of the Issuing Houses Association in co-operation with other bodies and issued in October, 1959.

The control exercised by the Stock Exchange, London, over information disclosed to offerees in a bid has been confined to cases of quoted companies issuing a circular of offer to its shareholders or intimating to its shareholders the existence of an offer. In such circumstances four copies of the proofs of circulars to shareholders or debenture holders and notices of any meetings are required to be submitted to the Share and Loan Department. Cases have occurred, however, in which a cash offer was being made for the shares and the draft circulars were not submitted to the Share and Loan Department; the application of any sanction in these cases was, of course, valueless because of the likely success of the offer and consequent termination of the quotation of the relevant securities.

Although there is no Stock Exchange control over offers made by issuing houses, bankers, solicitors and other persons directly to holders of securities, most of the issuing houses, merchant banks, and several of the holders of principal's licences have, as a matter of courtesy, submitted proof documents of offer for comment by the Share and Loan Department. More recently of course the notes issued by the Issuing Houses Association recommended that documents concerning offers for securities which are quoted on the Stock Exchange should be cleared with the Stock Exchange authorities before their issue.

Where documents have been submitted the particulars required to be disclosed by the Share and Loan Department in such offers are summarised below.

Offers for Cash

Requirements

1. Reference to Board of Trade consent (if necessary).
2. Name of offeror and on whose behalf (if appropriate).
3. Title of security for which offer is made.
4. Purchase consideration.
5. Time, date and place for acceptance.
6. Any other conditions attached to acceptance or otherwise, e.g.—
 - (a) Right to dividends.
 - (b) By whom expenses payable.
 - (c) Acceptance in respect of minimum percentage of shares.
 - (d) The passing of any necessary resolutions by the offeree company.
7. Any material change in company's financial position since the last published accounts.
8. Middle market quotation on the Stock Exchange, London, of the security immediately before first intimation of offer.
9. Documents required to be completed and lodged for valid acceptance.
10. Date of settlement of consideration.
11. Directors' interests and recommendations regarding acceptance.

Offers for Exchange of Securities

1. Reference to Board of Trade consent (if necessary).
2. Name of offeror and on whose behalf (if appropriate). Nature and particulars of offeror company's business.
3. Title of security for which offer is made.
4. Purchase consideration and how new shares rank for dividends, capital and redemption.
5. Time, date and place for acceptance.
6. Any other conditions attached to acceptance or otherwise, e.g.—
 - (a) Subject to quotation by a certain date.
 - (b) Right to dividends.
 - (c) By whom expenses payable.
 - (d) Acceptance in respect of minimum percentage of shares.
 - (e) The passing of any necessary resolutions by the offeree company.
7. Any material change in company's financial position since the last published accounts.
8. Middle market quotations on the Stock Exchange, London, of the security to be offered and that to be acquired immediately before first intimation of offer.
9. Documents required to be completed and lodged for valid acceptance.
10. Date of settlement of consideration and document of title to be issued.
11. Directors' interests and recommendations regarding acceptance.
12. Comparative financial histories including dividends, assets and future policy.
13. Any other financial advantage expected to accrue as a result of acceptance of the offer.
14. Memorandum and articles of association and audited accounts for last financial year of offeror company and contracts (if any) available for inspection at a place in the City of London.

12. In the case of a partial offer that acceptances will be on a *pro rata* basis in the event of acceptances exceeding the amount required.

*13. Statement that the funds to satisfy full acceptance of the offer are available.

14. The offer should normally be open for acceptance for not less than three weeks.

*15. If the offer is made *direct* to shareholders include statement as to whether or not the directors have been consulted.

15. In the case of a partial offer that acceptances will be on a *pro rata* basis in the event of acceptances exceeding the amount required.

16. The offer should normally be open for acceptance for not less than three weeks.

*17. If the offer is made *direct* to shareholders include statement as to whether or not the directors have been consulted.

Subjects for Enquiry

16. In the case of a partial offer for a class of securities an explanation of the reasons for the unwillingness or inability to make an offer for the whole of the securities of that class.

*17. When compensation is being paid to an outgoing director full information as to the manner in which compensation payments for loss of office has been arrived at.

*18. Intentions of purchasers regarding—

- (i) continuance of business; and
- (ii) employees.

*18. In the case of a partial offer for a class of securities an explanation of the reasons for the unwillingness or inability to make an offer for the whole of the securities of that class.

*19. When compensation is being paid to an outgoing director full information as to the manner in which compensation payments for loss of office has been arrived at.

*20. Intentions of purchasers regarding—

- (i) continuance of business; and
- (ii) employees.

These requirements are not exhaustive and individual cases may call for some extension or modification.

* Those items marked with an asterisk were not incorporated in the department's requirements until the Autumn of 1959.

The Council welcomes publication of a Statutory Instrument containing rules for licensed dealers in connection with offers to acquire or dispose of securities and recommends, that the rules in regard to take-over offers should be applied to all companies and to all persons whose business involves dealing in securities.

The Stock Exchange has recently altered its rules to permit a member, subject to the prior consent of the Council, to issue a circular to the shareholders of a company offering to acquire their shares. The above listed information together with such additional particulars as are contained in the Statutory Instrument are required to be disclosed in these circulars.

(g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority (section 209 of Companies Act, 1948)*

(g) The following points in connection with section 209 (1) have been brought to the Council's notice:—

- (a) That it is possible for a company to acquire the shares of dissentient shareholders if it has obtained nine-tenths in value of the shares the subject of an offer, even though the offer is for more than one class of shares.

The Council considers that it should be necessary for at least nine-tenths in value of such class of shares to have been acquired under the terms of the offer relating to that class before the shares of dissentient shareholders of any class of shares may be acquired compulsorily.

- (b) That there is a time limit within which notices may be sent to dissentient shareholders but there is no time limit for the acquisition of such shares.

The Council recommends that a limit of time be set within which the shares of dissentient shareholders may be acquired.

- (c) That where one company offers its shares in exchange for the shares of another company and, having acquired nine-tenths in value of the shares, issues the appropriate notices to acquire the shares of dissentient shareholders and declares a dividend, practices have varied as to whether the dissentient shareholders have the benefit of such dividend.

The Council recommends that there should be a uniform practice in this respect.

17. Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

- (a) *Adequacy of protection afforded to investors by existing law*
(b) *Usefulness and necessity of the existing provisions*
(c) *Certificates of exemption (section 39 of Companies Act, 1948)*

PROSPECTUSES AND OFFERS FOR SALE

(1) The written requirements of the Stock Exchange with regard to prospectuses go beyond the requirements of the Companies Act, 1948, and in so doing they are designed to provide the potential investor with as much information as possible to enable him to assess the merits of the proposition.

(2) In addition the circumstances of particular cases frequently call for information outside the written requirements of the Stock Exchange.

(3) In the experience of the Stock Exchange, the two items in a prospectus which are more likely than others to present difficulties either before or after publication of the prospectus are profits' estimates and the valuation of stock and work in progress.

(4) It is the practice of the Stock Exchange to require companies to furnish a statement as to the financial and trading prospects of the company together with material information which may be relevant thereto and in certain circumstances to ask for the profits' estimates to be accompanied by evidence supporting the basis on which they have been determined. The Council would welcome legislation which included such information in the prospectus requirements of the Companies Act.

(5) In regard to the valuation of stock and work in progress, the Council considers that this is sufficiently important to justify a requirement that the accountants reporting on the profits and losses and assets and liabilities should certify that they are satisfied that stock and work in progress has been properly taken and valued throughout the period in question.

(6) Having regard to the necessity to provide adequate safeguards in cases where no application is being made to a recognised Stock Exchange, the Council considers that

the following written requirements of the Stock Exchange should be incorporated in the requirements of a revised Companies Act:—

- (a) The authorised share capital, the amount issued or agreed to be issued, the amount paid up and the description and nominal value of the shares.
 - (b) The authorised loan capital of the company and any of its subsidiaries, the amount issued and outstanding or agreed to be issued, or, if no loan capital is outstanding, a statement to that effect.
 - (c) Particulars of any bank overdrafts of the company and any of its subsidiaries as at the latest convenient date or, if there are no bank overdrafts, a statement to that effect.
 - (d) The provisions or a sufficient summary of the provisions of the articles of association, by-laws or other corresponding document with regard to:—
 - (i) Any power enabling the directors, in the absence of an independent quorum, to vote remuneration (including pension or other benefits) to themselves or any members of their body.
 - (ii) The borrowing powers exercisable by the directors and how such borrowing powers can be varied.
 - (e) The date and country of incorporation and the authority under which the company was incorporated.
 - (f) The general nature of the business of the company, and in cases where the company carries on two or more activities which are material, having regard to profits or losses, assets employed or any other factor, information as to the relative importance of each such activity. The situation, area and tenure (including in the case of leaseholds, the rent and unexpired terms) of the factories or other main buildings.
 - (g) The name, date and country of incorporation and issued capital of any company which is or is about to become a subsidiary and whose profits or assets make or will make a material contribution to the figures to be included in the auditors' report or next published accounts, together with details of the capital held or about to be held by the company (if not wholly-owned). The general nature of the business, the situation, area and tenure (including, in the case of leaseholds, the rent and unexpired terms) of the factories or other main buildings of each such subsidiary.
- (7) The Council also directs attention to the Memorandum of Guidance issued by the Stock Exchange in regard to reports by auditors and accountants which is set out in Annex A to this memorandum.
- (8) Other information outside the written requirements (if not already referred to in the accountants' report or elsewhere in the prospectus) normally called for by the Stock Exchange is:—
- (a) Whether the company is indemnified (when appropriate) against liabilities for:—
 - (i) Surtax under section 245, Income Tax Act, 1952, or alternatively whether surtax clearances have been obtained under section 252, Income Tax Act, 1952, in respect of all periods up to the latest possible date.
 - (ii) Estate duty under section 46, Finance Act, 1940.
 - (b) Where a valuation of fixed assets, which has not been adopted for the purposes of the books and accounts, is used by the directors in the prospectus in order to indicate the assets cover or for information purposes only whether it is the intention of the board to adopt that valuation in the books and accounts and to increase the depreciation charges in future in view of the enhanced values.

- (c) Whether there are in existence any arrangements, such as life or long term service agreements with the holding company or any of its subsidiaries, whereby the holding company is unable, without a claim for substantial damages arising, to make such changes as it desires in the board or higher management of the subsidiaries.

(9) The Council considers that there should always be included in any prospectus a statement as to whether or not the company has any litigation or claims of material importance pending or threatened against it.

FURTHER ISSUES

(10) Issues to existing members or debenture holders of a company or issues of shares or debentures which are or are to be identical with shares or debentures already quoted on a prescribed Stock Exchange are relieved by sections 38 and 417 of the Companies Act, 1948, from compliance with the provisions of the Fourth Schedule to the Act.

(11) Such issues which are often the means of raising very large sums of money and are made for cash could therefore be made without giving investors very much information. In 1957 the Stock Exchange extended the amount of information required in the circulars relating to such issues which were made for cash.

(12) The information which the Stock Exchange requires to be given includes the following:—

(a) A statement as to the financial and trading prospects of the company, together with any material information which may be relevant thereto. This paragraph is construed as including particulars of any change in the financial position of the company since the date to which the last accounts were made up.

(b) Where the securities for which quotation is sought were issued for cash since the date to which the last published audited accounts of the company were made up or will be issued for cash, a statement or an estimate of the net proceeds of the issue and a statement as to how such proceeds were or are to be applied.

(c) Particulars of current indebtedness.

* (d) Particulars of any capital of the company or of any of its subsidiaries which has, since the date to which the last published audited accounts of the company were made up, been issued or is proposed to be issued fully or partly paid up otherwise than in cash and the consideration for which the same has been issued or is proposed to be issued.

* (e) Particulars of any capital of the company or of any of its subsidiaries which has, since the date to which the last published audited accounts of the company were made up, been issued or is proposed to be issued for cash, the price and terms upon which the same has been or is to be issued and (if not already fully paid) the dates which any instalments are payable with the amount of all calls or instalments in arrear.

* (f) Particulars of any capital of the company or of any of its subsidiaries which is under option, or agreed conditionally or unconditionally to be put under option, with the price and duration of the option and consideration for which the option was granted, and the name and address of the grantee.

Provided that where an option has been granted or agreed to be granted to all the members or debenture holders or to any class thereof, it shall be

* (i) In any case where information is not given under any of these paragraphs, the prospectus must state that no such payments, etc., have been made.

(ii) Under these paragraphs reference to subsidiaries is to be construed as including any company which will become a subsidiary.

sufficient, so far as the names are concerned, to record that fact without giving the names and addresses of the grantees.

- * (g) Particulars of any commissions, discounts, brokerages or other special terms granted, since the date to which the last published audited accounts of the company were made up, in connection with the issue or sale of any capital of the company or of any of its subsidiaries.

(13) The Council's experience in regard to quoted companies leads it to suggest that some similar extensions to the provisions of the Companies Act would be advantageous in regard to such issues generally.

(14) The Council considers that the statement suggested in paragraph 9 on page 1174 should be included in any circular of offer relating to these further issues.

CERTIFICATES OF EXEMPTION

(15) By section 39 of the Companies Act, 1948, a certificate of exemption can be given where application is made to a prescribed Stock Exchange for quotation on the grounds that having regard to the proposals as to the size and other circumstances of the issue of shares or debentures and as to any limitation on the number and class of persons to whom the offer is to be made compliance with the requirements of the Fourth Schedule to the Act would be unduly burdensome. Section 418 extends these provisions to certain companies incorporated outside the United Kingdom. It is the practice of the Stock Exchange to require an application for a certificate of exemption to be made by the solicitors to the issue.

(16) The most common ground for exemption is where the offer (a placing) is to be made of a security of a quoted company to a limited number of persons, e.g., preference shares or prior charges offered mainly to institutional investors, and where the Council has for these reasons waived the full advertising requirements.†

(17) In two or three cases a certificate of exemption has been granted where the offer is limited to shareholders of one quoted company but relates to the securities of another quoted company, the offer being by way of right upon a circular and letter of rights. Particulars in regard to both companies would already be available in the statistical services and the Stock Exchange Official Year-Book.

(18) Other grounds given for exemption are where the parties and details of a number of relevant contracts would expand the prospectus unduly without giving any compensating advantage to investors, e.g., a large number of contracts relating to the building and chartering of ships by a tanker company, or the names and addresses of all the shareholders from whom shares in another company had been acquired; also where the information required to be given in the accountants' report would involve considerable research overseas or in the files of subsidiaries without securing any material advantage to investors; also in cases where the information would not be relevant to the business currently being carried on.

* (i) In any case where information is not given under any of these paragraphs, the prospectus must state that no such payments, etc., have been made.

(ii) Under these paragraphs reference to subsidiaries is to be construed as including any company which will become a subsidiary.

† In those cases where the only particulars not already available are the rights and conditions attaching to the security and any agreements relating to the issue it is the practice of the Committee to waive the full advertising requirements. In these cases a card giving the aforementioned particulars is prepared and inserted in the statistical services and a box advertisement is inserted in the Press directing attention to the application for quotation and the existence of the card and naming a place where copies of the card may be obtained. The placing letter and card containing the short particulars taken together would constitute a prospectus.

(19) Another plea sometimes made is that disclosure of certain information would be damaging to the company's interests or involve disclosing trade secrets. Counsel have, however, advised that there is no power to grant a certificate of exemption on such grounds. A certificate of exemption having been granted on particular grounds, it is understood that the company is then in a position to avoid disclosure of any other information required to be disclosed under the Fourth Schedule. The requirements of Appendix 34 to the Stock Exchange Rules would still however have to be satisfied. If, therefore, the Stock Exchange had granted a certificate of exemption for one of the reasons mentioned in the previous paragraph the responsibility for disclosure of other information falls on the Stock Exchange under Appendix 34. The Stock Exchange could (if it so wished) waive under its own rules disclosure of such other information.

(20) The Council has no recommendations to make on any change in the law with regard to certificates of exemption.

(21) The Council wishes to make the following further observations on prospectuses and offers for sale.

ALLOTMENT

(22) Section 50 (5) states that where a prospectus is issued generally an application for shares is irrevocable until after the third day after the opening of the subscription lists.

(23) Section 50 (7) states that section 50 does not apply in relation to a prospectus to which paragraph (a) or (b) of subsection (2) of section 39 applies, i.e., the section does not apply to a prospectus issued in the abridged form under a certificate of exemption.

(24) This means that members of the public may withdraw their applications prior to the lapse of the three-day period where an abridged prospectus under a certificate of exemption has been issued. The Council is doubtful whether it was the intention of the 1943 Committee on Company Law Amendment to limit the operation of the provisions with regard to withdrawals and application in this manner.

FORMS OF APPLICATION

(25) The prohibition by section 38 on the issue of forms of application unless the form is accompanied by a prospectus does not apply in cases in which a certificate of exemption has been obtained. The Council considers that the Act should be amended so that in these circumstances no form of application may be issued except with the prospectus for which the certificate of exemption has been granted.

RADIO AND TELEVISION ADVERTISING OF PROSPECTUSES AND OFFERS

(26) The Council believes the question of advertising over the radio and television services invitations to subscribe or purchase or sell securities requires examination.

(27) In so far as this advertising is limited to directing attention to a document advertised in or about to be advertised in the national Press and expresses no opinion either directly or by implication as to the merits or demerits of the invitation or of the company or other body whose securities are involved, no serious difficulty would appear to arise.

(28) If, on the other hand, radio or television advertisements were to include any statement, either or by implication, as to the merits or demerits of the relevant securities or company or other body then the door would seem to be wide open to abuse.

(29) It is suggested that if such advertisements are to contain anything more than a reference to the fact that the invitation in question is to be advertised in the national Press on such and such a date, any additional information contained in the advertisement should be limited, as is now the practice in relation to abridged particulars in the Press, to relevant and fair extracts or summaries from the document itself and should

contain words to the following effect: "Copies of the full prospectus, on the terms of which alone applications will be considered, can be obtained from X."

(30) Such advertisements could however be extremely brief but powerful enough to encourage the public to make applications for securities without obtaining the prospectus or other invitation to subscribe for the securities. It might therefore also be desirable to amend the Companies Act so that it contains a provision that no allotment shall be made of any securities offered to the public for subscription or sale unless the form of application contains a statement that the applicant has received a copy of the prospectus or offer for sale or other relevant document.

(31) If it is contemplated that radio and television services are going to be used for advertising offers which would not be advertised in the national Press, then the Council suggests for consideration that the right to use such form of advertising should be limited to "Exempted Dealers".

18. Control over Business of Dealing in Securities

(Prevention of Fraud (Investments) Act, 1958)

1. While it has no evidence to support its contention the Council of the Stock Exchange is confident that the major proportion of dealing in securities in the United Kingdom is carried out through members of the various Stock Exchanges and that of this by far the greater amount is done on the London Stock Exchange.

2. The Council has pursued a policy aimed at educating the general public in the functions of the Stock Exchange and is fully aware that the change in economic conditions has caused and will continue to cause a much wider interest in investment. The Council considers that it is the principal duty of the Stock Exchange to provide an efficient market for both buyers and sellers and to ensure that its facilities are known to and are within the reach of all who wish to use them.

3. The Council is concerned that the good name of the City of London in general and of the Stock Exchange in particular should be preserved and that the highest standard in dealing in stocks and shares should be attained. It suggests that the following steps should be taken:—

(a) The status conferred by section 2 (1) (b) and (c) of the Prevention of Fraud (Investments) Act, 1958, on the Bank of England, statutory or municipal corporations, exempted dealers, industrial and provident societies, building societies and managers or trustees under authorised unit trust schemes should remain unchanged.

(b) Section 2 (1) (a) of the Prevention of Fraud (Investments) Act, 1958, should be amended so as to include only members of the Stock Exchange, London, the Associated Stock Exchanges, the Provincial Brokers' Stock Exchange, the London Discount Market Association, the Association of Canadian Investment Dealers and members of the Toronto and Montreal Stock Exchanges in Great Britain, the Association of New York Stock Exchange member firms having representation in the United Kingdom and the Law Society of Scotland.

(c) The granting of licences to dealers in securities and their representatives should cease and existing licences should be withdrawn.

With reference to the persons who though authorised under existing law would cease to be authorised if this proposal were to be adopted, the Council suggests that they should either apply for an order to be declared an exempted dealer or seek admission as a member or agent of a recognised Stock Exchange.

4. The Council feels that it should draw attention to the fact that none of the persons who would have to apply for exemption, membership of an Exchange or

recognition as an agent is at present subject to the strict discipline enforced by the London Stock Exchange and other Stock Exchanges and bodies enumerated in paragraph 3 (b).

5. The Council believes that it would be possible to achieve the desired standard in dealing in securities by its taking administrative action in conjunction with the other Exchanges but it is reluctant to take such a drastic step until its feelings on the matter have been made known and its proposal discussed.

19. Unit Trusts and "Open End Mutual Funds"

The Council has no comments to make on these subjects.

20. Reduction of Capital and Purchase by a Company of its own shares

The Council has no comments to make on these subjects.

21. Accounts

Do the accounts require the disclosure of sufficient information about the financial position of the company including its subsidiaries and associated companies? Are all the existing provisions necessary and useful in present-day conditions?

In particular evidence would be welcome on the following points:—

- (a) *Revaluation of fixed assets and use of any resulting surplus*
- (b) *Share premium account*
- (c) *Use of pre-acquisition profits of subsidiaries*
- (d) *Description of reserves*
- (e) *Definition of profits*
- (f) *Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948*

The Council welcomes the steps taken in recent years to make company accounts more readable and considers that the more information that is revealed the better it is for the investing public. The Council would welcome the inclusion in the profit and loss account or directors' report of a trading company of information about the volume of effective sales to the public.

The Council would also welcome legislation that provides for the publication of half-yearly progress reports. It is suggested that if the financial year of the company is altered so as to delay the publication of the accounts by more than six months after the usual date of publication there should be provision for a further progress report during the intervening period.

(a), (b), (c), (d) and (e) The Council has no comments to make on these subjects.

(f) The Council considers that the present exemptions granted to banks and assurance companies should not be disturbed. The Council does not however, feel convinced that there is any justification for granting exemption to shipping companies. There should be a statutory obligation on each company to which statutory exemption is granted to append a note to the accounts stating that exemption has been granted.

22. Audit

- (a) *Qualifications and appointment of auditors*
- (b) *Duties and responsibilities of auditors*
- (c) *Exemptions of "exempt" private companies from the provisions of section 161 of the Companies Act, 1948*

The Council has no comments to make on these subjects.

23. Provisions as to Returns

The Council has no comments to make on this subject.

24. Company and Business Names

Effectiveness of present provisions (see sections 17 to 19 of Companies Act, 1948, and the Registration of Business Names Act, 1916); similarity of names; misleading names.

The Council has no comments to make on these subjects.

25. Foreign Companies

The Council has no comments to make on this subject.

26. Internal Management and Administration

In particular:

- (a) *Annual and other general meetings*
 - (b) *Mode of passing extraordinary and special resolutions*
 - (c) *Securing proper disclosure of information in circulars seeking proxy votes*
 - (d) *Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g., by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company*
- (a) The Council has no comment to make on annual and general meetings other than to welcome any steps that may be taken to ensure that shareholders are given as much information as possible about them. A copy of the chairman's speech to shareholders at the annual general meeting should be required to be circulated to all shareholders. At an annual general meeting at which the accounts are not ready for submission to shareholders the directors should be required to submit as an alternative a progress report.
- (b) The Council has no comments to make on this subject.
- (c) In view of the fact that very few shareholders are able to attend meetings in person, information upon which their votes are based is contained in the circulars accompanying the notice calling the meeting. These circulars often do not contain sufficient information to enable the shareholders to make reasoned decisions. Most of the companies whose securities are quoted on the Stock Exchange have given the modern form of general undertaking which requires drafts of these circulars to be submitted to the Stock Exchange for its observations. There still remain however, a small number of quoted companies whose circulars are not submitted in draft before despatch to their shareholders and companies whose securities are not quoted on a Stock Exchange who may feel under no obligation to issue an explanatory circular with the notice of meeting. The Council therefore recommends that notices of meetings should be accompanied by circulars which should contain full information to enable shareholders to make a reasoned decision and include particulars of directors' interests in any proposal to be put before the meeting.
- (d) The Council has noticed that voting rights have been used by some companies to maintain the existing management of those companies by means of interlocking shareholdings and the ownership of the company's shares by the trustees of the employees' pension funds. Whereas such continued management may be advantageous to the company where the management is good it will be most unfortunate if the opposite is the case. Further, the Council questions the suitability of the trustees of an employees' contributory pension fund investing in the company's equity capital. The Council, therefore, wishes to put on record that it is not in favour of control being exercised by either of these methods.

27. Winding Up

The Council has no comments to make on this subject.

28. Problems of Administration and Enforcement of the Law

In particular, are any difficulties caused by provisions which appear obsolete or inappropriate in modern conditions?

(1) STOCK

Fully-paid shares can be converted into stock which in practice is transferable in multiples of a prescribed amount. This amount is frequently the unit in which dealings in the stock take place and the investor and others tend to refer to a stockholding as so many units rather than an amount of stock. Many companies have been advised that only an amount of stock is recognised by the Companies Act, 1948 and that transfers made out for a number of units should not be accepted for registration. Recently, however, some companies having satisfied themselves that the Registrar of Companies would accept the annual return of stockholders completed as to the number of units without reference to the amount of stock, have issued stock certificates expressed as to a number of units and are prepared to accept transfers made out either for an amount of stock or a number of units.

If confusion is to be avoided the Council believes that it is necessary that units of stock be recognised in law.

The Companies Act, 1948 requires that shares must be issued in the first place even if they are immediately converted into stock. This appears to be unnecessary where stock is being issued fully-paid. In regard to partly paid stock the avoidance of which was presumably the object of the prohibition the Council does not believe that this would lead to any difficulty. The Council therefore invites consideration of legislation enabling a company to make a direct issue of stock.

(2) UNNUMBERED SHARES

Under the Companies Act, 1948 if all the issued shares of a class are fully paid, none of those shares need have a distinguishing number so long as it remains fully paid and rank *pari passu* with all the shares of that class.

If a further issue of shares which does not rank *pari passu* were made it would appear that all the shares of the class must be numbered and not merely the new issue.

This has not, however, always been carried out in practice; in so far as the Stock Exchange requirements are concerned it has been sufficient for the new certificates to be distinguished by the enforcement of a short legend as to how the shares rank in those cases where the new shares did not become identical with the existing shares before the date of issue of the new certificate.

It is recommended that any numbering of shares or other distinction which it might be decided to apply should be confined to the new issue.

(3) SITUATION OF REGISTERS

The Council considers that companies should not be obliged to keep their registers in the country of registration (England, Scotland or Northern Ireland) if a substantial proportion of the shareholders are not resident in the country of registration.

(4) SHARES OR DEBENTURES DEALT IN OR QUOTED ON A STOCK EXCHANGE

The Council wishes to draw the Committee's attention to the references in sections 38, 39, 51, 417 and 418 of the Companies Act, 1948 to "shares or debentures being dealt in or quoted on a prescribed Stock Exchange".

At the time the Committee on Company Law Amendment reported in 1945 there were two lists of securities on the Stock Exchange. The one included the securities for

which permission to deal was granted and was known as the Supplementary List and the other included securities for which official quotation had been granted and was known as the Official List. Since 1947 the formal granting of permission to deal or quotation has been merged into one process the formal grant of quotation. The two lists were also amalgamated.

Since that date "permission to deal" relates only to the automatic permission to deal in certain categories of securities ranging from Treasury Bills and short-term securities of local government authorities to securities quoted on foreign Stock Exchanges and to specific bargains in securities outside those categories which may be made with the permission of the Council. A copy of the relevant rule will be found at Annex B.

The reference in those sections would appear to assume that certain formalities have been complied with in the case of securities dealt in or quoted on a Stock Exchange whereas formalities only have to be complied with where official quotation is sought and granted. The Council believes that the exemptions provided by the Companies Act, 1948 were intended to be applied only in cases where some formalities had been complied with in connection with applications to a Stock Exchange, i.e., those securities quoted on a prescribed Stock Exchange.

29. Any Other Matters within the Terms of Reference

The Council has no comments to make under this heading.

ANNEX A

Memorandum regarding Certificates of Profits and Net Assets for Purposes of Prospectuses, Offers for Sale and Advertised Statements

(1) Appendix 34* to the Rules of the Stock Exchange, London, requires, *inter alia*, that prospectuses, offers for sale and other advertised statements relating to securities in a company should include a report by the auditors of the company or by qualified accountants with respect to the profits or losses of the company for each of the ten completed financial years preceding the issue of the prospectus, offer for sale or advertised statement. A similar report has to be furnished where the proceeds of an issue of shares are to be applied directly or indirectly in the purchase of a business or of shares of a company which is, or will by reason of such purchase become a subsidiary company, the report in those cases covering the business or the company concerned. If the business or company does not have audited accounts covering ten years, the period has to be restricted accordingly.

(2) Neither Appendix 34 nor the Companies Act, 1948 (hereinafter referred to as the Act), lays down the basis upon which profits or losses are to be computed. It is the practice, however, for the reporting auditor or accountant to indicate the basis which has been adopted in his report. This normally states that the profits or losses have been arrived at after charging all expenses, after dealing with such items as depreciation, amortisation, directors' remuneration, interest, etc., on defined basis, and after making such adjustments as are appropriate.

* See Appendix 34, paras. 36, 37 and 56.

(The paragraph numbers refer to the serial numbers set out in the right-hand margin of the Appendix.)

(3) Provision is also made in Appendix 34* for the submission to the Share and Loan Department of the Stock Exchange of "a written statement signed by the auditors or accountants setting out the adjustments made in the report on the profits and giving the reasons therefor." This statement has to be available for inspection by the public for a reasonable time (being not less than 14 days) at a place in the City of London.

(4) In order that the Share and Loan Department can obtain the information it requires in sufficient detail and on a reasonably uniform basis, it is suggested that the "written statement" should be divided into two sections, as follows:—

Section A. This section should begin with the net increase or decrease in the balance at credit or debit of profit and loss account as shown by comparison of the balance sheets at the beginning and end of each of the financial periods under review; there should then be shown and added to or deducted from this amount:—

- (i) The items which, if the provisions of the Act had been in operation in the respective periods, would in any event have had to be stated separately in the profit and loss accounts including particulars of directors' emoluments as defined by section 196 of the Act but excluding therefrom in respect of any period to which the Act did not apply, the estimated money value of any benefits received by the directors otherwise than in cash as referred to in the said section 196 sub-paragraph (2).

Notes should be inserted in section A to disclose any further information which would have had to be disclosed by way of note to the profit and loss accounts if the Act had been in operation.

Except in those cases where depreciation, amortisation and diminution in value of fixed assets are not material factors in relation to the amount or trend of profits, the amounts included in section A for these items should be sub-divided to show the charges (a) in respect of which no corresponding allowance was made for taxation, and (b) in respect of which allowances were made. For comparison with the latter there should be given for each period the tax allowances obtained on the basis (e.g., income tax, profits tax, etc.) considered most appropriate in the particular case.

In less simple cases it may be more convenient to deal with the matter in a separate schedule containing a statement showing in columnar form for each period:—

- (a) the depreciation etc. charged in the accounts (as in section A),
 - (b) any additional charges made in arriving at the adjusted profits (as in section B),
 - (c) the total of (a) and (b) apportioned between those amounts in respect of which corresponding taxation allowances were and were not made, and
 - (d) the amounts of the tax allowances obtained.
- (ii) Interest charges (analysed under appropriate headings) other than those payable on debentures and other fixed loans.
- (iii) Material revenue items which have been dealt with otherwise than through the profit and loss account.

The sum finally arrived at in this section would normally be the profit for the year before taking account of items which the Act requires in any event to be stated separately.

* See Appendix 34, Schedule II part A, para. 31 and Part B para. 18.

Section B. This section should commence with the final figure of profit or loss shown in section A and should show in detail the adjustments made thereto in arriving at the profits or losses shown in the report of the auditors or accountants; the reasons for such adjustments should be given.

(5) If the company is a holding company, the "written statement" may deal with the consolidated results of the company and of its subsidiaries or with the results of separate companies or groups of companies comprising the holding company and its subsidiaries. In the latter case, a summary combining the final figures so as to arrive at those shown in the report of the auditors or accountants should be submitted.

(6) In the case of businesses with overseas interests, the basis on which overseas currencies have been dealt with should, if the accounting treatment of these matters is material, be set out in the "written statement".

(7) The "written statement", a draft of which shall be submitted at least 10 days prior to the date upon which it is proposed to publish the prospectus, offer for sale or advertisement in the Press, should be accompanied by a letter from the reporting Accountants to the Share and Loan Department of the Stock Exchange which should confirm that all adjustments have been made in respect of each year under review which are appropriate for the purposes for which the report on the adjusted profits is being made and that no other adjustments have been made.

(8) Although the report by the auditors or qualified accountants and the "written statement" called for under Appendix 34 to the rules of the Stock Exchange, London, are required to deal with the profits of each of the preceding ten financial years, application may be made to cover a shorter period where it is considered that inclusion of the earlier years may be irrelevant or misleading.

(9) There should be submitted to the Share and Loan Department of the Stock Exchange by the auditors, a letter confirming that they have satisfied themselves that stocks and work in progress (if any) have been properly taken and valued throughout the period covered by their report.

(10) In appropriate cases the accountants' report should deal with the "contingent" liability arising from profits tax non-distribution relief.

(11) Provision is made in Appendix 34 for the reporting accountants to deal in their report with the emoluments of the directors. The exact comparison to be given must depend upon the circumstances of each particular case, and, where appropriate, the report should deal with the emoluments of those persons who are the directors at the time of the report.

(12) The reporting accounts should submit to the Share and Loan Department of the Stock Exchange a letter confirming that they have satisfied themselves that the provisions for depreciation charged in arriving at the adjusted profits, considered in conjunction with any qualifications or notes included in their report, are adequate and proper for the purpose having regard particularly to—

- (a) assets in respect of which it has been the company's practice to make no provisions for depreciation or amortisation, and
- (b) the provisions for depreciation or amortisation which must be found out of taxed profits, and
- (c) the effect of any revaluation of fixed assets either already in the company's accounts or to be incorporated therein.

ANNEX B

Permitted Dealings

163 (1) Dealings are permitted in the following securities:—

(a) Securities which are quoted in the official list or which have been removed from that list on account of lack of dealings.

(b) Treasury bills and the bills, mortgages and short-term securities of local government authorities and public boards of Great Britain and Northern Ireland.

(c) Securities of statutory or public companies or public boards operating canals, docks, railways or electricity, gas or water undertakings in Great Britain or Northern Ireland which have been issued not less than three years previous to the date of the bargain.

(d) Securities which are quoted in the lists or supplementary lists published by Stock Exchanges affiliated to the Council of Associated Stock Exchanges, or which have been removed from those lists on account of lack of dealings, or which are regularly dealt in on such Exchanges.

(e) Securities which have been granted a quotation on a Stock Exchange or stock-brokers' association recognised by rule 203a (1) or a foreign Stock Exchange provided that a security granted quotation by the Johannesburg Stock Exchange subsequently to March 20th, 1950, may not be dealt in under the terms of this paragraph. Applications for permission to deal in such securities must be made to the secretary of the Share and Loan Department.

Bargains will be recorded on special boards provided for the purpose, but will not be recorded in the official list until quotation has been granted by the Council.

(f)(i) Obligations of or guaranteed by the governments of the United States of America or Canada or any of their provinces, states or municipalities.

(ii) Securities of the United States Federal Agencies, and

(iii) Securities of any bank or trust company organised under the laws of the United States of America or any of its States, and being a member of the Federal Reserve System.

(iv) Securities of any bank organised under the laws of Canada or any of its Provinces and operating under the provisions of the Bank Act.

(v) Securities of any insurance company organised under the laws of the United States of America or Canada or any of their States or Provinces.

(vi) Securities of any company organised under the laws of the United States of America or Canada or any of their States or Provinces for the purpose of supplying, at retail, electric power.

(g) Securities dealt in "over-the-counter" in the United States of America or Canada but not coming within the provisions of clause (f) above, provided full details of bargains are returned on forms available at the secretary's office and at the marking boards. These forms must be completed and lodged by 12 noon on the next business day following the execution of the bargain.

(h) Sub-units of unquoted unit trusts if negotiated by brokers with unit trust managements; but dealings between members in unquoted sub-units are not allowed.

(2) (a) In the case of securities of public companies or corporate bodies not falling within the above categories specific bargains may be made with the permission of the Council. Application for permission must be made on forms provided in the secretary's office and at the marking boards.

(b) In the case of exceptional circumstances application for permission to dispense with the forms mentioned in clause (a) may be made to the secretary of the Share and Loan Department.

(3) Except as above provided dealings are not permitted in any securities until the date from which quotation has been granted.

APPENDIX XLIV

Memorandum by the Council of the Law Society

Introduction

1. The Departmental Committee on Company Law which was appointed by the President of the Board of Trade has invited the Council of the Law Society to submit evidence within the terms of reference of the Committee.

2. The terms of reference of the Departmental Committee are:—

“To review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable.”

3. The Committee have also submitted to the Council a list of specified subjects within their terms of reference on which the views of the Council would be particularly welcome. This memorandum of evidence is arranged by sub-headings corresponding with the specified subjects in the list of the Committee. The Council have also made some comments of a more general scope.

4. The Council issued an invitation to all practising solicitors to comment on the working of Company Law and the present memorandum is, therefore, the product of very wide practical experience.

5. All references in this memorandum are to sections or schedules in the Companies Act, 1948, unless otherwise stated.

General

6. The Council believe that, in general, the Act and the other statutory enactments and departmental regulations relating to companies are working well. At the same time, however, they feel that some improvements are possible, many of which would provide additional safeguards for inexperienced investors.

7. The Council believe that one of the most important factors contributing to the outstanding industrial, commercial and financial progress of the country during the last century has been the flexibility of the system of registration and functioning of companies under English Company Law. To imperil this flexibility by increasing the number of statutory and departmental regulations applicable to the administration and financing of companies would be a serious and indeed a retrograde step.

8. Most companies depend for their prosperity on the speed and efficiency of their operations, and to regulate them unduly can only cause harm. Over-regulation tends to frustrate genuine enterprise. Furthermore, it does not of itself guarantee honesty or propriety of behaviour, and the Council are opposed to it. On the other hand, the Council do not advocate a policy of unrestricted *laissez-faire*, and recognise that investors and the general public must be given reasonable protection.

1. Incorporation of Companies—Memoranda of Association

(a) *Minimum number of members*

9. The Council believe that there is no merit in the distinction between private and public companies as to the minimum number of subscribers to the memorandum of association and members of a company.

10. *The Council recommend—*

- (1) *that the minimum number of subscribers or members of a company should in all cases be two;*
- (2) *that if membership of a company falls below the statutory minimum, the Board of Trade, as well as the persons referred to in section 224 as applied to section 222 (d), should be allowed to apply to the Court to have such company wound up;*
- (3) *that unlimited personal liability if membership falls below the statutory minimum should be abolished.*

(a) *Other conditions of incorporation*

11. The Council believe that the present method of incorporating companies can be simplified.

12. They can see no reason why the memorandum and articles of association and the copies of resolutions which are required to be filed with the Registrar of Companies must be printed. The documents should, of course, be legible and durable, and a requirement as to such legibility and durability should be substituted for the requirement as to printing.

13. The Council believe that the Statement and Notice of Nominal Capital involve unnecessary duplication.

14. The Council are of the opinion that the forms dealing with the situation of the registered office and the particulars of directors and secretary should continue to be filed with the Registrar of Companies.

15. The Council have also considered whether directorships in other companies should be disclosed. Owing to the large number of directorships held by some persons, the return to be made to the Registrar of Companies is often of great length. A possible solution would be the establishment by the Registrar of Companies of a complete index of directors showing the directorships which they hold. The Council, however, question whether such an index would be worthwhile in view of the amount of work involved in compiling and maintaining it. The Council are indeed doubtful of the practical usefulness of information regarding directorships. Information is only available after a director has been appointed and is not normally given to shareholders in advance when they are invited to elect a director. The Council would therefore favour the abolition of the necessity to give particulars of other directorships. If, however, compulsory disclosure is not abolished, the Council believe that no change in the present procedure should be made.

16. The Council consider that the restrictions on commencement of business imposed on a public company by section 109 serve no useful purpose. In the vast majority of cases companies are incorporated as private companies and so become entitled to commence business without further formality. Having so become entitled to commence business, the companies are then converted into public companies. There appears no good reason for retaining provisions which in practice are applicable to only a small number of companies.

17. The Council believe that neither the requirement contained in section 181 (1) that a signed consent to act as a director of a public company, nor the requirement contained in section 181 (4) that a list of persons who have consented to act as directors of a public company must be filed at the Companies Registry, has any value. All directors of a public company must sign a prospectus or statement in lieu of prospectus, and particulars of all directors must be filed. The above provisions would, therefore, appear to lead to an unnecessary duplication of work.

18. The Council believe that undertakings to take up qualification shares should be abolished.

19. The Council are concerned about the delays which now occur in connection with the formation of companies. The Council believe that the simplifications which they have suggested may help to reduce these delays.

20. *The Council recommend—*

- (1) *that documents for registration should be required to be legible and durable and should not be required to be printed;*
- (2) *that the Statement and Notice of Nominal Capital should be combined;*
- (3) *that compulsory disclosure of other directorships should be abolished;*
- (4) *that section 109 should be repealed;*
- (5) *that section 181 should be repealed;*
- (6) *that administrative action be taken to avoid the present delays which occur in the Companies Registry in connection with the formation of companies;*
- (7) *that all the forms of articles of association set out in the schedule to a new Act be made capable of adoption by companies in whole or in part by reference.*

(b) *Limitation of objects to those stated in the memorandum*

21. The Council believe the *ultra vires* rule is now out of date and moreover that considerable hardship to third parties having dealings with a company can be caused by the rule. Historically the first corporations to be founded were those incorporated by Royal Charter and such corporations were regarded as corporate bodies subject to all the provisions of the common law and as having the same full powers as natural persons. Then followed the corporation created by statute which was regarded at law as strictly circumscribed in its powers by the terms of its statute of incorporation. Next came corporations incorporated pursuant to a general statute with objects as set out in the memorandum of association and it was a logical development of the law applicable to the statutory company to hold, as was done in *Ashbury Railway Carriage and Iron Company v. Riche* (1875), 33 L.T. 450, that such a company also was circumscribed in its objects by the terms of its memorandum of association.

22. With industry and commerce today run almost entirely by limited companies the time is long past when a person having dealings with a company can be expected to inspect a company's memorandum of association at the Companies Registry in London, Edinburgh or Belfast in order to satisfy himself that some contemplated transaction is within the objects of the company as defined by its memorandum. In the majority of cases he accepts the risk of not inspecting the memorandum. Commerce and industry would be at a standstill if he did not accept the risk, yet the loss which may result, should the transaction prove to be *ultra vires* the company, may be extremely serious. This in the opinion of the Council should not be so and accordingly the Council consider that for the protection of persons having dealings with a company the *ultra vires* rule as established in the case cited above should be abolished. If the directors exceed the powers contained in the memorandum of association, any loss should fall upon the shareholders (leaving the company or the shareholders to exercise such right of recourse as they may have against the directors) and not upon third parties. See also paragraphs 44 and 45 as regards the exercise by directors of the powers of a company.

23. The Council consider that, notwithstanding the abolition of the *ultra vires* rule, a company should be entitled to incorporate in the memorandum such restrictions as regards its objects as it chooses but these restrictions should operate only domestically as between the company and its members and directors.

24. The Council consider that any restrictions as regards its objects incorporated in the memorandum should be capable of being altered only in accordance with the provisions of section 5, but with the modification of the provisions of that section recommended in paragraph 28.

25. *The Council recommend—*

- (1) *that the ultra vires rule as enunciated in Ashbury Railway Carriage and Iron Company v. Riche be abolished;*
- (2) *that a company should be able to do anything an individual can do, and accordingly it should no longer be necessary to set out in the memorandum of association the objects of a company;*
- (3) *that a company should be entitled to incorporate in the memorandum such restrictions as regards its objects as it chooses, but these restrictions should operate only domestically as between the company and its members and directors;*
- (4) *that any restrictions as regards its objects incorporated in the memorandum should be capable of being altered only in accordance with the provisions of section 5, but with the modification of the provisions of that section recommended in paragraph 28.*

26. Whether or not their recommendations in paragraph 25 are accepted, the Council consider that there is no need to limit the purposes for which the objects clauses in the memorandum of association may be altered as is at present done in paragraphs (a) to (g) of section 5 (1). Section 5 (9) provides in effect that the validity of an alteration shall not be questioned on the ground that it does not fall within the provisions of any of the sub-paragraphs (a) to (g), except in proceedings taken within 21 days of the resolution effecting the alteration. This provision is essential for the protection of the company and its directors. In consequence, the company is not normally concerned whether the proposed alteration can in fact be brought within the scope of sub-paragraphs (a) to (g), since it relies on the validating effect of section 5 (9) after 21 days have passed without proceedings being taken to challenge the alteration.

27. The Council believe that it is undesirable to fetter in any way the power of the Court on an application to it under section 5 and accordingly consider that the proviso to section 5 (4) should be deleted.

28. *The Council recommend—*

- (1) *that section 5 (1) be amended by the deletion of the words "so far as may be required to enable it" and also by the deletion of sub-paragraphs (a) to (g);*
- (2) *that section 5 (2) be extended to provide that notice of a meeting for the alteration of the objects of the company be given to all members whether otherwise entitled to receive notices of meetings or not;*
- (3) *that the proviso to section 5 (4) be deleted.*

(c) *"One-man" companies*

29. The Council can see no objection to the existing law as it affects so-called "one-man" companies, but in this connection reference should be made to paragraph 38.

(d) *Shares of no par value*

30. The Council endorse the recommendations of the Gedge Committee on Shares of No Par Value.

2. *Prohibition of Partnerships with more than 20 Members*

31. The prohibition of partnerships with more than 20 members was contained in the Companies Act, 1862, it being intended, to quote the words of James, L.J., in *Smith v. Anderson* (1880), 15 Ch. D. 247 (C.A.), "to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies." It has been included in all subsequent Companies Acts, and is now to be found in section 434.

32. It cannot now be said that there are many large trading undertakings which remain partnerships. The desire to limit the liability of members and the incidence of

taxation have caused the incorporation of large trading undertakings. The Council therefore believe that the original basis for the provision has gone, and that it is an obsolete legislative restriction which has long out-lived its usefulness.

33. In their consideration of this matter the Council have concerned themselves in particular with professional firms with regard to which there are the following cogent reasons in favour of the abolition of the limitation:—

- (a) In modern conditions any suggestion that dangers to the public arise more from large partnerships than from small ones is without foundation.
- (b) The Registration of Business Names Act, 1916, provides a safeguard against the dangers of dealing with unknown persons.
- (c) The increase in variety and complexity of the topics dealt with calls for a higher degree of specialisation than in the past and a consequent increase in the number of partners if competent advice is to be given.

34. *The Council recommend that the prohibition of partnerships with more than 20 members be abolished.*

3. Classification of Companies

(a) *Distinction between public and private companies*

35. The Council believe that the most important distinction between public and private companies is that a private company cannot make a public issue and therefore a prospectus or a statement in lieu of prospectus must be filed only in the case of a public company. They recognise that, if the shares or debentures of a company are to be dealt in on a market of any kind, the relevant information ought to be made available to the public. It would, however, be unfair to compel a company whose shares are not so dealt in to incur the trouble and expense of preparing and filing this information.

36. The Council are aware that the debentures of some private companies originally privately placed have become quoted on a Stock Exchange, and they consider that the number of debenture-holders of a private company should be limited. They are of the opinion that 50 is an adequate maximum, but if compelling arguments for a higher maximum should be put forward, the Council would see no objection to the provision of such a higher maximum.

37. *The Council recommend that the present definition of a "private company" set out in section 28 should remain but that a company should cease to qualify as a private company if the number of persons holding debentures is more than 50.*

(b) *Distinction between exempt and non-exempt private companies*

38. At present, if a beneficial owner of shares in an exempt private company appoints a nominee to hold any of his shares, the exemption is lost. It is necessary, however, that in the case of a "one-man" company the sole owner of share capital should be able to appoint a nominee or nominees to hold one or more of his shares in order that the company may comply with the provisions of section 1 as to number of members.

39. *The Council recommend—*

- (1) *that the distinction between private companies and exempt private companies should remain;*
- (2) *that the conditions contained in section 129 and Schedule VII be revised to permit the beneficial owner of the whole of the share capital to appoint one or more nominees to hold up to 5 per cent. of that capital.*

(c) Companies without a share capital

40. In order to be classified as "private" a company must comply with the provisions of section 28. This has entailed when forming a private company without share capital the incorporation in the articles of association of the restrictive provisions set out in section 28 although wholly inappropriate so far as they relate to shares.

41. *The Council recommend that sections 28 and 129 and Schedule VII be amended to make it clear that companies without a share capital can be private companies and exempt private companies.*

4. Donations by Companies for Charitable and Political Purposes

42. The Council can see no objection in principle to the making of gifts for charitable and political purposes by companies.

43. *The Council recommend that no exception should be made to their general recommendation that a company should be able to do anything which an individual can do and, therefore, that companies should not be prevented from making gifts for charitable and political purposes.*

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders*General*

44. In paragraphs 21 to 25 the Council have recommended that the *ultra vires* rule should be abolished so that a company would have all the powers of an individual, but that restrictions on its objects could be imposed as between the company, its directors and its shareholders by its memorandum of association. The purpose of this recommendation would be defeated if third parties were to be affected by limitations imposed by articles of association on the exercise by boards of directors of the powers of companies. In the view of the Council therefore third parties should not be affected (in the absence of express notice) by directors acting in breach of any such limitations.

45. *The Council recommend that limitations on the exercise by a board of directors of the powers of a company imposed by its articles of association should operate only domestically as between the company and its members and directors and that except in the case of express notice that a particular transaction would be in breach of such limitations third parties should not be affected by any such limitations.*

46. The Departmental Committee, in their list of subjects, referred to the powers of directors with regard to fundamental changes in the nature of the business of a company, the sale of the undertaking, the issue of shares, and the borrowing and lending of money. All these matters relate to the disposition of powers as between shareholders and directors, and in the view of the Council are matters to be regulated by the articles of association of the company and not by statute.

47. The Council are aware that such powers are capable of abuse but believe that it would be unwise to introduce any further statutory protection of shareholders in connection with the powers vested in directors and the exercise of those powers for the following reasons—

- (i) that the exercise of such powers is normally a matter of propriety;
- (ii) that further restriction would be contrary to commercial practicability (e.g., opportunities lost through time lag or premature publicity);
- (iii) that the existing legal responsibility of directors is satisfactory;
- (iv) that the size and complexity of the undertakings of many public companies render it impracticable for shareholders to formulate an informed view, and leave them no alternative but to rely on the directors.

48. *The Council recommend that there should be no change in the law regarding the disposition of powers as between shareholders and directors.*

6. Directors' Duties

General

49. The Cohen Committee made a thorough review of the question of the duties of directors, and the Companies Act, 1947, contained a large number of provisions regarding those duties. The Council do not believe that there is anything which can usefully be done now to improve the situation without unduly hampering the ability of directors to carry out their functions in the interest of the shareholders.

(b) Awareness of duties

50. There is undoubtedly today both a lack of precision in the definition of directors' duties and a failure by many directors to realise that their basic duty is of a quasi-fiduciary nature. Codification of these duties is impracticable. It is considered that any attempt at codification would inevitably produce more evils than it would cure because no code could cover every set of circumstances, but would lead to an unfortunate application of the principle of *expressio unius, exclusio alterius*.

51. *The Council recommend that references in the Act to the duties of directors should remain unaltered.*

(c) and (d) Dealings in shares and disclosure of directors' interests

52. The Council do not recommend any change in the existing law as regards dealings by directors (or officers) in the shares of their own companies, or in regard to disclosure of directors' interests.

(e) Bodies corporate

53. The Council believe that an important consideration is that a shareholder in a company should know by whom the company is directed. In any case shareholders should not, if another company is named as director, have to make a search in the Companies Registry against that other company in order to ascertain the identity of the persons who are in control of his company. The Council have two recommendations to make which are in the alternative. They would prefer that their first recommendation should be carried into effect, but if this should not be possible, they suggest that very serious consideration should be given to their second recommendation.

54. The Council recommend—

- (1) that (except in the case of a holding company acting as a director of its subsidiary company) companies should not be capable of appointment as directors of other companies;*
- (2) and that in any event information be given to the shareholders as to who are the directors of a company which is the director of their company.*

Loans to directors

55. At present loans to directors (not being directors of an exempt private company) are absolutely prohibited. The Council believe that this prohibition is unnecessarily restrictive and that it may well tend to make it difficult for some companies to obtain suitable directors. In particular there seems to the Council to be no reason why a company should not be allowed to make loans to "working" directors for the purpose of house purchase.

56. *The Council recommend that loans in connection with house purchase to "working" directors should be permitted.*

7. Shares with Restricted or No Voting Rights

57. The Council are opposed to any change in the law with regard to shares with restricted or no voting rights on five grounds:—

- (1) They think that the issue of such shares is essentially a domestic matter for arrangement by the incorporators or the members, and that the relevant provisions should be made in the articles of association.
- (2) In certain cases, restrictions on voting may be eminently desirable (e.g., in connection with the retention of British control, and for family companies).
- (3) It would be impracticable to define the quantum of voting right to be attached to any particular class of shares.
- (4) The imposition of statutory control in the United States of America has been to some extent evaded by the issue of deferred loan capital with participation rights.
- (5) Investors often value the chance to obtain non-voting shares at a discount on the price payable for voting shares.

58. The Council have considered arguments often used on behalf of preference shareholders. It is said that ordinary share capital should not be reorganised or additional share capital issued without the consent of the preference shareholders if the effect is to alter, to their detriment, the percentage voting power of the preference shareholders.

59. In the view of the Council, however, the ordinary shareholders in essence own the equity of the company subject to the prior preference share capital and charges. The whole benefit or loss of the expansion or contraction of the value and extent of the equity is intended to be received or lost by the ordinary shareholders. If there is an expansion, it is therefore reasonable that any increase of voting rights should belong to the ordinary shareholders. Furthermore, all existing shares have been acquired voluntarily by the holders and market values tend to reflect the absence or quantum of voting rights attached to them.

60. In short, the Council consider that voting rights is a matter to be borne in mind by investors at the time they subscribe for or purchase preference shares.

61. *The Council recommend that there should be no change in the law on this subject.*

8. Protection of Minorities

62. Where there is a complaint that the affairs of a company are being conducted in a manner oppressive to some of its members, but a winding up order would not be an appropriate remedy, an application to the Court may be made under section 210. The Court may thereupon make an order regulating the conduct of the affairs of the company or an order for the purchase by other members or by the company of the shares held by the petitioner.

63. The Council believe that section 210 does not in all cases provide a sufficient protection for minorities. The onus of proving oppression, which is placed on the applicant under section 210, is heavy, and the risk of failing to discharge it is accordingly considerable. The expense of the procedure presents a great deterrent against the bringing of actions. Moreover, a minority shareholder may find that it is impossible to obtain, before the filing of the application, the information upon which that application must be based.

64. It sometimes happens, in a small private company, that a "working" director holding a bare majority of the shares so arranges the affairs of the company that his own salary is paid regardless of whether the company makes a profit. The Cohen

Committee envisage this situation in paragraph 59 of their report, but the Council understand that the remedies provided by section 210 are not in practice granted by the Court in these circumstances.

65. *The Council recommend—*

- (1) *that the scope of section 210 should be extended to afford protection to minority shareholders in private companies who neither receive reasonable dividends nor are able to sell their shares at a reasonable price;*
- (2) *that in order to implement their proposals, a new section be incorporated in the Act to provide that:—*

- (1) Any member of a private company who complains that the affairs of the company are being conducted in a manner which causes or is likely to cause hardship to him for which neither the provisions of this Act nor the articles of association of the company afford him any remedy, may make an application to the Court for relief.

- (2) On any such application if the Court is of opinion that:—

- (a) the profits of the company are being applied in such a manner that the petitioner receives an unreasonable sum having regard to his holding of shares; and

- (b) that there is no purchaser available who is willing to purchase the petitioner's shares at a price which is reasonable having regard to the circumstances of the company;

it shall have power to make such order as it thinks fit for securing to the petitioner a reasonable share of the profits of the company or the purchase of his shares by other members of the company, or by the company, or for securing to the petitioner the value of his share holding in the company by the conversion of the shares or part of the shares into debentures, debenture stock or loan stock upon such terms as to repayment, or otherwise, as the Court may consider reasonable, or for the winding up of the company.

9. Protection of Special Classes of Shares

66. The Council see nothing unfair or inequitable either in the existing provisions for modification of class rights, or in the cancellation of preference shares by winding up or return of capital if expressly or impliedly permitted by the terms of issue. The preference shareholders must be deemed to have taken their shares upon this footing.

67. In this connection the Council can see no reason why it should not be possible to attach redemption rights to preference shares already issued.

68. *The Council recommend—*

- (1) *no change in the existing law regarding modification of class rights or the cancellation of preference shares;*
- (2) *that section 58 be amended accordingly.*

10. Board of Trade Powers to Appoint Inspectors

69. By section 165 (b) the Board of Trade may appoint an inspector if "there are circumstances suggesting" certain irregularities. In the opinion of the Council, there seems to be a certain reluctance on the part of the Board to appoint an inspector on its own initiative.

70. The Council believe that this reluctance may be due to a doubt whether the Board can act on deductions inferred from public information such as reports and

accounts. It may be that supporting evidence of the kind specified in section 164 (2) is required. Thus in the case of *Hide & Co. Limited*, significant qualifications were included in the auditors' report for two successive years for which accounts were presented in 1954 and 1955. The accounts were, however, formally approved at two annual general meetings by majority votes, and it was not until 1957 that inspectors were appointed on the application of a member, and the chairman was prosecuted in respect of the same transactions in September, 1958. (*The Times*, 7th October, 1958, page 14.)

71. The Council believe that, whilst generally the powers are operating satisfactorily, the position would be improved if the Board of Trade were given statutory power to demand documents and information from the directors and officers of companies. The power would assist the Board in determining whether there was a *prima facie* case to warrant the appointment of an inspector. The exercise of the power would be within the absolute discretion of the Board.

72. *The Council recommend that the Board of Trade be given a statutory power to demand documents and information.*

11. Disclosure of Ownership and Control

(a) *Nominee interests*

73. The Cohen Committee in paragraphs 77 to 85 of their report made recommendations which may be summarised as follows:—

(a) The provision of an elaborate system of declarations designed to show:—

(i) whether or not each registered holder was a beneficial owner of his holding; and

(ii) the identity of any beneficial owner of more than one per cent. of the class of shares concerned who was not registered as the holder thereof.

(b) The provision of machinery to enable an investigation to be made by an inspector appointed by the Board of Trade to ascertain the true ownership of shares when the Board considered it necessary in the public interest.

The Cohen Committee itself thought that recommendation (a) would not be, and could not be made to be, wholly effective, and in fact, the Companies Act, 1947 and 1948, did not implement it. Recommendation (b) was effectively adopted by sections 172 to 175.

74. The Council know of no principle of English law which requires that the principal must disclose his identity in any transaction, nor, except for section 195, which requires or suggests that the existence of beneficial or other interests underlying registered holdings in companies calls for disclosure thereof. The Council do not accept that it is in the public interest to change this principle. In so far as the public interest may in any particular case require the real ownership or control of a company to be ascertained, the Council consider that it can adequately be served by the operation of section 172. There are overwhelming practical difficulties in imposing a fully effective obligation on "beneficial owners" and others to make disclosure, and the Council do not consider that legislation for this purpose would be either desirable or practicable. The Council do not recommend any change in the existing legislation regarding disclosure of nominee interests.

(b) *Nominee directors*

75. The Council can see no objection to a director "representing" some particular interest provided that in doing so he continues to carry out his primary and quasi-fiduciary duty as one of the board of directors. The phrase "nominee directors" is difficult to define. If regulations were made, they would probably be capable of being evaded by those who wished to do so.

76. The Council are of the opinion that machinery for disclosure of the true control of a company under sections 172 to 175 is entirely adequate and indeed more satisfactory than any further regulations as to "nominee directors".

77. *The Council recommend that no regulations should be made to prohibit "nominee directors" from being appointed or to enforce disclosure of their "principals".*

12. Share Transfer and Registration Procedure

Simplification of procedure

78. The Council are aware that the recent volume of work on the Stock Exchange has inundated the staffs of Stock Exchanges and of registration departments of companies, and that delays have resulted. They believe that the remedy for the most part lies in alterations of procedure and practice and not of law, and that this is a matter for articles of association and Stock Exchanges.

79. The Council are of the opinion that the rules relating to the closing of the register of a company should be simplified in the manner suggested in the recommendations below. However, the Departmental Committee may consider that the recommendations of the Council would facilitate improper refusals of inspection. In this case, provisions could be made under which a member would be entitled to require a certificate from the secretary or other official of the company as to the resolution of the board authorising the closing.

80. Section 79 defines what is meant by certification of transfer, and section 81 defines what is the effect of a share certificate. In practice, a company normally certifies a transfer when the share certificate has been produced to it. The two definitions ought, therefore, to be the same, and basically they are the same, despite different phrasing. The Council believe that the two sections might conveniently be combined.

81. Section 110 states that the register of members of a company must contain, *inter alia*, the date on which any person ceased to be a member. The effect of this section is that, if a person has sold all his shares even 50 or more years ago, the current register must still contain a note of the fact. In view of the very limited liability of a past member under section 212, it would seem necessary to keep records only of those past members who have held partly paid shares during the preceding 12 months. An amendment of section 110 would be of great value to the secretaries and registrars of large companies whose registers are maintained with the assistance of mechanical aids.

82. *The Council recommend—*

- (1) *a simplification of the procedure relating to the transfer and the registration of the transfer of shares, bearing particularly in mind the following:—*
 - (a) *that transfers of shares need not be made under seal unless the articles of association of the company in question so require;*
 - (b) *that unless the articles of association do require a seal, shareholders who are companies, should be permitted to execute transfers under hand by the signature of an authorised official as is the normal routine in connection with most contracts;*
 - (c) *that in order to save time and trouble transfers be permitted to be signed by an authorised agent, for example, a stockbroker, particularly in the case of a transferee;*
 - (d) *that signatures on transfers need not be witnessed;*
- (2) *that a company should be enabled to close its register in respect of one or more classes of shares without having to close it in respect of all classes;*

- (3) *that the requirement that the closing of the register should be advertised be abolished;*
- (4) *that sections 79 and 81 be combined;*
- (5) *that section 110 be amended in the manner suggested in paragraph 81.*

Registration of transfers

83. The case of *Re Indo-China Steam Navigation Company* [1917] 2 Ch. 100 would seem to be an authority for the proposition that a transfer of shares even if registered with the company and the name of the transferee entered on the register of members does not validly pass a title to the shares to the transferee. The Council regard this decision as contrary to the basic principle that the entry of a name in the share register is evidence of ownership.

84. It sometimes happens that registration is delayed whilst a transfer is awaiting adjudication in the office of the Controller of Stamps. In the meantime sub-sales take place, and difficulty and disorganisation occur.

85. *The Council recommend—*

- (1) *that the decision in Re Indo-China Steam Navigation Company be overruled in a new Companies Act;*
- (2) *that consideration be given to the surmounting of the difficulty referred to in paragraph 84.*

13. Multiplicity of Directorships held by One Individual

86. Multiple directorships have, on several occasions since the publication of the Cohen Report in 1945, been the subject of comment in the Press and elsewhere. In most instances it has been argued that no one man can genuinely fulfil the duties of a director in respect of more than some particular (but unspecified) maximum number of companies. In other cases, the comment has concerned the very large number of directorships held by some individual whose interests have for good or had reasons become momentarily topical.

87. In paragraphs 90 and 91 the Council state that they can see no objection of principle to the practice of carrying on business through associated or subsidiary companies. It follows logically that there can be no objection of principle to multiple directorships, since any particular group organisation may well find it desirable, or even necessary, that one or more of the executive directors of the holding company should be on the boards of most, or all, of its associated or subsidiary companies. In such cases, the Council feel that it is unrealistic to argue that the directors concerned cannot properly fulfil their duties to all the companies in question.

88. Furthermore, the Council believe that there can be no objection of principle to a director whose chief concern is with his own main occupation, accepting a seat on the board of another company. He may well be able to make available to them his general experience of business or specialised technical knowledge, without necessarily taking any executive part in the business of that company.

89. *The Council recommend that no restrictions should be placed on the number of directorships held by one individual.*

14. Practice of Carrying on Business through Associated and Subsidiary Companies

90. Business considerations, and to a less extent the incidence of taxation, often dictate that the affairs of a major group should be organised through the medium of a large number of separate subsidiary companies. The fact that almost any method of organisation can prove in a particular case to have been mistaken does not of itself

justify its prohibition or regulation; nor does its occasional adoption for deliberately dishonest purposes so justify.

91. *The Council recommend that no attempt should be made to prevent the practice of carrying on business through associated and subsidiary companies or, indeed, any other method of organising a group of companies.*

15. Loan Capital

(a) Debentures

92. In *Carse v. Coppen* [1951] S.L.T. 145 it was decided that debentures in English form created by a Scottish company and registered in England do not create a valid floating charge over English assets. The Council believe that this decision should be overruled.

93. *The Council recommended that the law of Scotland should be assimilated to the law of England as regards the creation of a floating charge.*

(b) Trustees

94. The Council are aware that the recommendations contained in paragraph 64 of the report of the Cohen Committee as regards the duties of trustees were not fully implemented but, as they have no evidence of any abuse, make no recommendation.

(c) Registration of charges

95. The Council have no recommendations to make with regard to section 95.

16. Take-over Bids

General

96. In order to define the term "take-over bid" the Council propose to adopt the same definition as the definition of "take-over offer" in paragraph 18 of the Draft of the Licensed Dealers (Conduct of Business) Rules, 1960, issued by the Board of Trade under the Prevention of Fraud (Investments) Act, 1958. According to this definition, "take-over offer" means an offer to acquire securities of a corporation calculated to result in any person acquiring or becoming entitled to acquire control of that corporation.

97. Many take-over bids go through without adverse criticism; the terms are negotiated between two boards of directors, are then recommended to the shareholders concerned and are accepted by the majority needed to bring section 209 into operation. A few cases have attracted much attention but this merely emphasises that those cases are exceptional. The fact that in certain cases large profits have been realised by the shareholders of a company who have received one or more bids for their shares has aroused comment, but such profits arise out of a normal commercial transaction.

98. The practice of take-over bids is not a new one. The Council consider that they are ordinarily the result of normal commercial factors and, as a general proposition, operate in the national interest as they tend to promote the best utilisation of resources. In recent years there have been many economic factors which have led to amalgamations and there has, therefore, been a great number of take-over bids.

99. Although private companies and companies whose shares are not quoted on a Stock Exchange may be the subject of take-over bids these, from the nature of the companies concerned, are generally the subject of agreement and the observations of the Council are therefore directed primarily to take-over bids for companies whose shares are quoted on a recognised Stock Exchange.

100. A shareholder can expect to make a profit when a bid is made for his shares for two reasons. First the normal market price for a share is the price which strikes

a balance between the normal daily supply and demand for parcels of shares. A small rise will only encourage selling by some holders. A large rise is needed to persuade the majority of holders to sell and give a buyer control. Secondly the bidder will have formed the opinion that the assets of the company being acquired will be of particular value to him, and he is, therefore, willing to pay more per share for control than the current market price.

101. The Council consider that it is undesirable to make regulations as to take-over bids which might hinder amalgamations, or cause undue delay or complication in organising them. Delay after the announcement of an intended take-over is particularly harmful. Rumours of bids, if there is delay in confirming or denying them are even more harmful because they lead to speculation in the shares concerned and damage the morale of employees. But as a practical matter the remedy lies in the hands of their directors who alone have the necessary information to decide whether or when to make an announcement.

(a) and (b) Procedure and disclosure of information

102. The Council have considered the draft rules mentioned in paragraph 96, and are satisfied that, subject to criticisms which they have already represented to the Board of Trade, they constitute a valuable code of conduct as to those take-over bids which fall within their terms. The Council also endorse the code of conduct laid down in the "Notes on Amalgamations of British Businesses" published by the Issuing Houses Association in October, 1959. In the view of the Council, the maximum publicity should be given to these rules. They suggest that the rules should be followed even in the case of the many offers to which they are not directly applicable, for instance, an offer by a holding company for a minority equity holding in a subsidiary, or offers for preference shares or offers by persons to whom the rules do not apply and who are not subject to Board of Trade approval under the Act itself.

(a) Procedure

103. The existing control over circulars contained in the Prevention of Fraud (Investments) Act, 1958, does not cover circulars recommending against acceptance.

104. *The Council recommend that circulars recommending against acceptance should be subject to the same control as circulars recommending acceptance.*

(c) Functions of directors

105. At the present moment, whether, as a matter of law, the directors have any standing in a matter of this kind is doubtful. The offer is an offer to each shareholder, individually, and whilst the directors may be involved in expenditure, and are more or less obliged to give advice, it is by no means clear that, as a matter of law, they can procure the company to pay professional fees or other expenses arising out of the work in which they are involved. This is a matter of argument, but it should be cleared up. Directors should be placed in the same position regarding a take-over bid as they are in connection with a proposal for amalgamation which involves the acquisition of the undertaking of their company as opposed to its shares. This particularly applies when directors decide, after advice, not to recommend a bid, or not to mention it to the shareholders at all.

106. *The Council recommend that it should be made clear in the Act that directors of an offeree company are entitled to reimbursement by the offeree company of expenses properly incurred by them arising out of an offer for shares of the offeree company, and that the Act should be amended accordingly.*

(d) Disclosure of identity of bidder

107. Any person interested in acquiring any sort of property is at present free to conceal his identity if he wishes. The Council cannot see any reason why a person wishing to acquire control of a company should be placed in a position of peculiar disadvantage.

108. *The Council recommend that no obligation to disclose his identity should be imposed upon a bidder.*

(e) Financing transactions

109. Section 54 provides that, with certain exceptions, a company shall not give financial assistance in connection with a purchase made or to be made of its own shares or those of its holding company. There are many transactions perfectly proper in themselves which might be held to be illegal under the present section. For example, in many groups of companies finance is quite properly centralised in the parent company, which acts as bankers to the group. When a company with liquid resources is acquired, those resources are taken over by the parent company which it could be argued had thereby recouped itself part of the purchase price of the shares and thus received financial assistance in connection with the purchase.

110. *The Council recommend that section 54 should be revised so as to make it clear that the kind of transaction to which reference is made in paragraph 109 is permitted.*

(f) Disclosure of directors' interests

111. The Council have two amendments to suggest both of which are matters of drafting only.

112. The Council recommend—

- (1) that section 191 and section 192 (1) be amended by the addition of the words " in general meeting " at the end of that section and that subsection respectively;*
- (2) that a subsection similar to section 192 (2) be added to section 191.*

(g) Compulsory acquisition of shares

113. The Council can see no reason why a transferee company should have to wait four months after the making of an offer before it can acquire the shares of dissenting shareholders. Indeed they feel that such a delay is totally unnecessary.

114. The Council believe that the operation of the Act would be improved by the amendments in drafting suggested in paragraph 116 (2) and (3).

115. The Council feel that there is no longer any purpose in the requirement in section 209 (1) (b) that three-fourths in number of the shareholders as well as the holders of nine-tenths in value of the shares shall approve a scheme.

116. The Council recommend—

- (1) that the words " after the expiration of the said four months " in section 209 (1) be deleted, and that the words " after the offer has been so approved " be substituted therefor;*
- (2) that it should be made clear that the percentages mentioned in section 209 refer to each individual class of shares;*
- (3) that section 209 (2) should commence with the words " Unless a notice is given under section 209 (1) . . . ";*
- (4) that section 209 (1) (b) be repealed.*

17. Prospectuses—Statements in Lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

(a) Adequacy of protection

117. In general, the Council are of the opinion that the relevant sections of the Act afford adequate protection both in the case of companies whose shares are quoted on a Stock Exchange, and in the case of companies whose shares are not so quoted. The additional regulations of the London and provincial Stock Exchanges are a safeguard in the case of companies whose shares are quoted on a Stock Exchange. The proposals of the Council are, therefore, confined to matters of detail.

(b) Usefulness and necessity

118. In the experience of the Council, none of the existing provisions has been shown to be either useless or unnecessary.

119. *The Council recommend that the present provisions should continue in force without alteration or amendment.*

(c) Certificates of exemption

120. At present, by section 39, a Stock Exchange to which an application for quotation is made, is empowered to grant a certificate of exemption from the provisions of section 38. The Council understand that exemption is normally granted where the expense or inconvenience of collating the necessary information is much greater than the value to the public of the information disclosed. Disproportionate expense, however, may also be incurred in complying with the provisions of section 38 in cases in which there is no intention to apply for a quotation. The Council, therefore, believe that a similar power should be granted to the Board of Trade to provide for these circumstances.

121. *The Council recommend that the Board of Trade should be empowered to grant a certificate of exemption from the provisions of section 38 in cases in which no quotation from a Stock Exchange is sought.*

122. Section 50 provides, in short, that no allotment is to be made within three days after the issue of the prospectus and that during that period no applications may be withdrawn. This section does not, however, apply in a case where under section 39 a certificate of exemption has been given relaxing the strict information requirements of Schedule IV. The Council do not understand the reason for this, and believe that unless there is some good reason, section 50 (7) should be repealed.

123. *The Council recommend that section 50 (7) be repealed.*

18. Control over Business of Dealing in Securities

124. In the view of the Council, the control exercised by the Board of Trade and the Stock Exchanges is working satisfactorily, and (with some reservations) they welcome the Licensed Dealers (Conduct of Business) Rules, 1960, as drafted, referred to in paragraph 96. They recognise that any alternative to the existing control would be some statutory body subject to rigidly defined rules on the lines of the American Securities and Exchange Commission, and they regard the present system as far more acceptable.

19. Unit Trusts and "Open-end Mutual Funds"*(a) Unit trusts*

125. The first unit trust in the United Kingdom (known as a fixed trust) was established in April, 1931. In spite of the fact that for many years the expansion of the movement was severely restricted by the Control of Borrowing Order, the amount of money invested in unit trusts has according to a recent report of the Unit Trusts Association, reached the substantial sum of £208,119,000, the number of individual holdings being 610,200. Progress such as this in the relatively short period of 29 years is phenomenal.

126. The Prevention of Fraud (Investments) Act, 1939, was brought into force in 1944, and since that time unit trusts have been governed by that Act, and its successor the Prevention of Fraud (Investments) Act, 1958.

127. The Act confers on the Board of Trade wide powers of authorising (or refusing to authorise) unit trust schemes, and of revoking authorisations. The scope of these powers was well illustrated in the decision of Danckwerts, J., in *re Electrical and Industrial Development Trust; Allied Investors Trusts Limited v. Board of Trade* [1956] 1 All E.R. 162.

128. Because the powers of the Board of Trade are undefined (or perhaps because the Insurance and Companies Department is under-staffed), delays in obtaining the authorisation of schemes and even the approval of supplemental deeds effecting minor modifications to existing schemes, have occurred. The Council have been informed of two cases, in one of which the approval of a new trust deed for an existing authorised trust took 11 weeks, and in the other of which the approval of a draft supplemental deed, making a very minor modification to an existing trust deed took almost four weeks. In the latter case the modification in question was the increase of the number of investments which might be held in the trust at any one time from 100 to 125.

129. The Council believe that generally speaking, the present rules regarding unit trusts have worked well. It is noteworthy that in the 29 years during which unit trusts have been in existence, there have been no cases involving a unit trust in which investors have suffered a loss through the dishonesty of the managers of the trust. Indeed the Council are not aware that any unit trust has been involved in Court proceedings other than applications for construction either of the trust deed or of an Act of Parliament.

130. The Council have considered whether the discretionary powers of the Board of Trade should be replaced by statutory provisions. They have come to the conclusion that both the future of unit trusts and the interests of investors and of the general public would be better served by a continuation of the present system whose value has already been proved.

131. *The Council recommend—*

- (1) *that the present law and practice regarding unit trusts should remain basically unchanged;*
- (2) *that steps should be taken to reduce the present delays in obtaining the authorisation and modification of schemes by the Board of Trade.*

132. Section 17 (1) (b) Prevention of Fraud (Investments) Act, 1958, provides that a scheme shall be such that the effective control over the managers of the trust shall be exercised independently of the trustees. If, therefore, the managers go out of business or retire (either voluntarily or compulsorily) from the management of the trust, and the trustees cannot immediately find new managers, the trust automatically ceases to be an authorised trust. The trustees must then terminate the trust, sell the investments, and distribute the proceeds. The trustees may be forced to sell the assets of the trust when the market is unfavourable; and in any case the selling of large blocks of shares at the same time is bound in itself to depress the market. The Council believe that this could be remedied by an amendment to the proviso to section 17 (1) Prevention of Fraud (Investments) Act, 1958, inserting a reference to paragraph (b) of the subsection in addition to paragraph (c) with consequential amendments.

133. *The Council recommend that a trust should not automatically cease to be an authorised trust when the managers retire and that section 17 (1) Prevention of Fraud (Investments) Act, 1958, should accordingly be amended, inserting a reference to paragraph (b) of the subsection in addition to paragraph (c) with consequential amendments.*

(b) *Open-end mutual funds*

134. The Council understand that an open-end mutual fund is a form of investment similar to that of a unit trust since it is a means of investing in a large number of securities at the same time. It differs from a unit trust because no trust is established and the public invests in shares of a company. In this respect it is similar to an investment trust company. In its operation, however, it is like a unit trust because its share capital can be increased or reduced at will in accordance with the requirements of the public. Because of the ability to reduce capital, no company constituting an open-end fund can be incorporated under the Companies Act. In fact all such companies have been incorporated under the laws of some other country, in particular

Canada, and certain states of the United States. The Council do not make any recommendations on this subject.

20. Reduction of Capital and Purchase by a Company of its Own Shares

(a) *Reduction of capital*

135. The Council have received many complaints that the machinery for the reduction of capital under section 66 is complicated and expensive. It is essential, however, that the interests of creditors should be protected, and the Court would appear to afford the best protection.

136. Reference should be made to paragraphs 109 and 110.

(b) *Purchase by a company of its own shares*

137. By section 54 (1) (c) a company may lend money to its employees to enable them to purchase its shares, but it may not so lend money to employees who are also directors. The Council can see no reason for the prohibition of loans to "working" directors. Reference should also be made in this connection to paragraphs 55 and 56.

138. The Council can see no force in the words "by trustees" in section 54 (1) (b).

139. *The Council recommend—*

(1) *that companies should be allowed to make loans to "working" directors to enable them to purchase shares;*

(2) *that the words "by trustees" in section 54 (1) (b) should be deleted.*

21. Accounts

General

140. As the Departmental Committee are no doubt aware, when the accounting provisions of the Act came into force, there were many difficulties and questions to be resolved. In the view of the Council, however, these provisions are now fairly well understood and do not give rise to any major problems. Any radical changes would almost certainly involve further difficulties for a time, and it is not considered that there is any justification for such changes.

141. *The Council recommend that the present regulations requiring the disclosure of information about the financial position of a company should remain basically unchanged.*

(a) *Revaluation of assets*

142. Where the value of assets is written up, then, subject to a review of the value of the other assets, the surplus is at present allowed to be used for a capitalisation issue. The Council can see no objection to this practice.

143. It also appears to be lawful for a company to distribute in cash or specie an unrealised surplus arising on revaluation. The Council believe that the cases in which this is justifiable are rare and that the heavy responsibility resting upon directors and their advisers is an effective check on any tendency to abuse.

144. *The Council recommend that where the value of assets is written up, a company should continue to be allowed to use the surplus for a capitalisation issue or distribution in cash or specie.*

(b) and (c) *Share premium account and pre-acquisition profits*

145. The principle that where a company issues shares for a consideration other than cash, and the actual value of such consideration exceeds the nominal value of the shares issued, a share premium account should be formed, has been generally accepted as having been established in the case of *Henry Head & Co. v. Ropner Holdings* [1952]

Ch. 124, although the precise effect of the decision is disputed. If share premium accounts are deemed to be capital, this principle appears to be logical although it may be subject to criticism from a financial point of view.

146. There are differences of opinion as to the effect of Schedule VIII, paragraph 15 (5). It is unfortunate that a matter of such importance should be dealt with in a paragraph in the Accounts Schedule, which applies to cases where group accounts are not submitted, rather than in a substantive part of the Act. The present law appears to be that where a company expends capital money in buying undistributed profits, it cannot use such profits for revenue purposes. It is considered that this principle should not apply in the case of *bona fide* reconstructions and amalgamations which might be defined as being those which are effected by an exchange of shares within the scope of section 55, Finance Act, 1927.

147. *The Council recommend—*

- (1) *that the principles outlined in paragraphs 145 and 146 should apply;*
- (2) *that the principle outlined in paragraph 146 should be expressed in a substantive part of the Act;*
- (3) *that as regards the application of both principles, an exception should be made in the case of bona fide reconstructions and amalgamations defined as above.*

but

(d) *Reserves*

148. There have in the past been numerous questions as to what constitutes a reserve or a provision within the meaning of Schedule VIII, paragraph 27, particularly with relation to future taxation. A fairly clear practice has, however, now been established. The Council therefore do not recommend that there should be any alteration in the law relating to reserves.

(e) *Profits*

149. The present rules defining profits have not caused any real difficulty. One ground for criticism of the accounts of certain companies is the failure to distinguish between different sources of profit. Profit may be shown, for example, under a general head such as "profit including rents". Alternatively, a composite figure may include sources of income from newly acquired businesses entirely different in type from that previously carried on, without any indication of the contribution made by the new undertakings. In the opinion of the Council, however, it is not practicable or desirable to exercise further control over such matters by legislation.

150. *The Council recommend that the burden of determining what is necessary "to give a true and fair view of the profit or loss of the company" should remain with the directors as provided in section 149 and with the auditors as provided in section 162.*

(f) *Exemption of banks, etc.*

151. The Council are of the opinion that this is a matter rather of national interest than of revision of Company Law. They do not, therefore, propose to express any views on it.

Miscellaneous

152. At present the power of the Board of Trade to extend the period for presenting accounts under section 148 (1) sometimes gives rise to practical difficulties, because the Board have no complementary power to extend the time for holding the annual general meeting under section 131.

153. It is understood that at present the Board of Trade take a restricted view of their powers under section 149 (4). As an example of this, they assume that they have no power to dispense with corresponding figures under Schedule VIII, paragraph 11 (1);

although they indicate that they would not themselves object in certain cases to these figures being omitted. Owing to the increasing tendency for mergers or take-overs, corresponding figures sometimes become not only useless, but actually misleading. It is desirable that the Board of Trade should be enabled to exercise this power.

154. *The Council recommend—*

- (1) *that the Board of Trade, if they extend the period for presenting accounts, should also have power to make any necessary extension in the time for holding the annual general meeting under section 131, at any rate so far as accounts are concerned;*
- (2) *that the Board of Trade should be enabled to adopt a more liberal view of their powers under section 149 (4).*

22. Audit

(a) *Appointment of auditors*

155. The Council believe that there is some obscurity in the present provisions relating to the appointment and removal of auditors. It is not, for example, clear when, if at all, an auditor may retire or be removed. Section 159 (6) envisages a casual vacancy but does not indicate how a casual vacancy may arise. Presumably it must arise on death, and perhaps also on retirement, but the view has been taken that auditors cannot resign between annual general meetings. If this view is correct a result is that on a take-over the company being taken over is compelled to retain its old auditors notwithstanding that they are prepared to resign and that it is manifestly more convenient that there should be only one auditor for the group. There is also no provision for removal for lunacy or any other incapacity, misconduct or fraud, bankruptcy or even disqualification by ceasing to satisfy the conditions set out in section 161.

156. The Council believe that the recommendations below would simplify the position without interfering with the principle of the independence of auditors.

157. The Council have no observations to make regarding the qualifications required for the office of auditor.

158. *The Council recommend that in order to clarify the procedure of appointment and resignation of auditors, the following express provisions should be made in the Companies Act—*

- (1) *The first auditors shall be appointed by the directors.*
- (2) *Subsequent auditors shall be appointed by the company in general meeting, except that the directors shall appoint auditors to fill casual vacancies to act until the next annual general meeting.*
- (3) *All auditors except those appointed to fill casual vacancies shall however appointed hold office until they resign or are removed or become disqualified.*
- (4) *Auditors shall be permitted to resign with the consent of the board of the company at any time or on due notice without such consent at the conclusion of any annual general meeting.*
- (5) *Auditors shall be removed automatically at any time on specified grounds, that is to say, bankruptcy, conviction for fraud, unsoundness of mind, or disqualification under section 161.*

(b) *Duties and responsibilities*

159. The Council have no observations to make on this subject.

(c) *Exempt private companies and section 161*

160. There seems to the Council to be no valid reason why the provisions designed to secure that an auditor is independent or properly qualified should not apply to an

exempt private company. It is often these companies which carry on their affairs without any regard to the provisions of the Act, or to the recognised principles of accountancy. The exemption which was perpetuated in the Act was not in accordance with the recommendations of the Cohen Committee, contained in paragraph 110 of their report. The Council believe that the benefits of limited liability ought only to be given to bodies the affairs of which are subject to proper supervision.

161. *The Council recommend that the exemption of exempt private companies from section 161 should be withdrawn.*

23. Provisions as to Returns

Declaration of compliance

162. The declaration of compliance (required to be made under section 15 (2)) as set out in form No. 41 takes the form of a positive statement that all the requirements of the Act have been complied with. In fact, however, matters which could affect the declaration (for example, the infancy of one of the subscribers) may have been concealed from the deponent.

163. *The Council recommend that the declaration should be expressed to be "to the best of the deponent's knowledge and belief".*

Allotment of shares

164. If the recommendations of the Gedge Committee as regards the issue of shares of no par value are adopted, capital duty will be payable in respect of the issue of capital and not on the creation of capital. The return of allotments could, therefore, be the instrument on which the duty is impressed.

165. The Council are of the opinion that in every case the terms and conditions upon which shares are issued should be recorded at the Companies Registry. The terms of issue may be contained in some document (such as a resolution of the board of directors) which ordinarily does not require to be filed. The Council believe that the fact that any resolution contains such terms should render the filing of it compulsory.

166. The Council consider that the company form entitled "Return of Allotments" should be made a document in which are to be entered the names of those persons whose names were first entered in the register as the holders of the shares being issued, instead of a document recording the names of those persons to whom renounceable allotment letters or renounceable provisional allotment letters in respect of such shares are issued.

167. *The Council recommend—*

- (1) *that capital duty should be payable on the return of allotments;*
- (2) *that a copy of any document or resolution attaching rights to shares, if not otherwise filed as being part of the articles of association or a special or extraordinary resolution, be filed with the Registrar of Companies;*
- (3) *that the company form "Return of Allotments" should be revised as suggested above.*

Return of allotments

168. The Council believe that the descriptions now required by section 52 to be included in the return of allotments serve no more purpose than the occupations previously required to be stated in the annual return. The requirement regarding occupations was criticised by the Cohen Committee and was omitted from the Act.

169. *The Council recommend that descriptions in the return of allotments be no longer required.*

Notice of consolidation

170. At present no form of return is required in respect of either a classification of unclassified shares or a conversion of shares of one class into shares of another class.

171. *The Council recommend that notice of such a classification or conversion should be required on the return filed under section 62.*

Increase of capital

172. The Council believe that there should be no necessity to file a statement of increase of nominal capital under the Stamp Act, 1891, section 112, in addition to a separate notice of increase under section 63.

173. *The Council recommend that a single form should be adopted for this purpose.*

Printing of resolutions

174. The Council believe that the printing of copy resolutions for filing should not be required. Typed copies are accepted under section 143.

175. *The Council recommend that a requirement that copy resolutions should be legible and durable should be substituted for the requirement that copy resolutions should be printed.*

24. Company and Business Names

176. The Council believe that the absolute discretion conferred on the Board of Trade by section 17 as to allowing or disallowing registration of a company under any particular name, according to whether in the opinion of the Board the proposed name is "undesirable" should be continued. The Registrar of Companies has issued guidance notes giving information about the kind of names which will not, or will not ordinarily, be allowed. These notes are clear and reasonably comprehensive and the Council, not being aware of any abuses or difficulties which have arisen in practice, do not recommend any substantive alteration save that the discretion should be extended to a power to the Registrar, upon the request of a company vacating a name, whether on dissolution or change of name, to put such name on a new and separate register which would preclude the use of that name or any colourable imitation of that name for any other company. At present the only means of preventing the use of a vacated name or any colourable imitation is to register a "name" company which is not intended to be a trading company and whose only function is to preserve the name. This involves much unnecessary expense and trouble and is an undesirable but at present necessary practice and must account for a large number of companies incorporated each year.

177. Section 201 requires specified particulars concerning directors to be stated in all trade catalogues, trade circulars, show cards and business letters on or in which the name of the company appears. These particulars comprise:—

- (a) The present surname and Christian name or the initials thereof;
- (b) Any former names;
- (c) Nationality, if not British.

These requirements correspond with those in section 145 Companies Act, 1929, and section 2 (2) Companies (Particulars as to Directors) Act, 1917. The latter enactment was a first world war measure connected with national security and the Council do not, therefore, wish to express any view as to the considerations of policy which might be relevant in regard to preserving the effect of that enactment under modern company legislation. There is an exception in respect of companies registered before 23rd November, 1916, but the Council consider that this is anomalous. The Council understand that especially in the case of trade catalogues, trade circulars and show cards, the requirements of the section have become widely disregarded.

178. The relevant provisions of the Registration of Business Names Act are:—

- (i) Section 1 (*d*) (which was added to the section by the Companies Act, 1947), which extends to companies carrying on any business under a business name other than their own, the requirement already applicable to firms registering under the Act.
- (ii) Section 14 which (as amended by section 116 Companies Act, 1947), confers on the Registrar of Business Names the same complete discretion regarding "undesirable" names for firms as is exercisable by the Registrar of Companies in regard to company names.

By virtue of this amendment of section 14, the jurisdictions concerning company and firm names are assimilated. This appears to be satisfactory and the Council have no recommendation regarding the amendment of the Registration of Business Names Act to put forward.

179. *The Council recommend—*

- (1) *that the absolute discretion conferred on the Board of Trade by section 17 be continued and be extended as recommended in paragraph 176;*
- (2) *that section 201 be amended so as to exclude trade catalogues, trade circulars and show cards;*
- (3) *that the relevant provisions of the Registration of Business Names Act, 1916, be similarly amended.*

180. Section 18 (2) empowers the Board of Trade, when a company has been registered with (or has changed its name to) a name which in the opinion of the Board is too like the name of a company already registered, to require the former company to change its name. This power is, however, exercisable only within six months of the incorporation of the former company (or of its change of name).

181. The lapsing of the rights of the Board of Trade at the end of this fixed six months' period can and has been known to give rise to hardship. Examples of this kind may not be numerous, but the "six months rule" encourages the unscrupulous to incorporate a new company under a name similar to that of an established company, and to refrain from publicity for six months. Admittedly once the new concern began to exploit its name in a manner identifying its activities with those of the previously existing company, the latter would have its common law rights but, as is well known, the enforcement of these may be an uncertain, difficult and expensive matter. The Council are, therefore, of the view that the retention of the six months' rule is unnecessary and that the powers of the Board of Trade could, subject to due safeguards, which should include a right of appeal, be made exercisable without limitation in point of time.

182. It is to be noted that the power under section 18 (2) is limited to the case where the name of the new company is "too like" that of the existing company. In other words, the power does not extend to other grounds of undesirability which the Board could take into account in its general discretion under section 17. The Council do not consider that an extension of the jurisdiction under section 18 (2) is called for in this respect.

183. To summarise, the Council believe that the unfettered power of the Board of Trade as it stands under section 18 to act at its absolute discretion during the six months' period should remain as a primary power. There should, however, be added a secondary and continuing jurisdiction, exercisable at any time after the six months' period. This jurisdiction would empower the Board, on application being made by the existing company, to direct, subject to such terms and conditions as the Board may prescribe, that the new company shall change its name within such period as the

direction may require. The Board would have regard to the circumstances, including hardship, the *bona fides* of the new company, and any acquiescence or culpable inaction on the part of the existing one.

184. *The Council recommend—*

- (1) *the establishment of such a secondary jurisdiction;*
- (2) *that there should be a right of appeal from any decision of the Board under this secondary jurisdiction by a company against which such a decision has been given.*

25. Foreign Companies

185. In the view of the Council, the provisions of Part X, which deals with companies incorporated outside Great Britain, have worked satisfactorily. The few comments and recommendations which follow do not arise out of any matters of substance or of principle, but are concerned with matters of technical detail such as the removal of certain anomalies and inconsistencies and the remedying of minor technical defects. It is true that Buckley on the Companies Acts, voices criticisms of several of the sections in Part X (13th Edition, pages 742 to 755), but while these or some of them might call for legislative attention, the Council, lacking evidence of difficulties actually arising in practice do not feel called upon to put forward specific recommendations other than those submitted below. The Council do not recommend any major revision of the provisions of Part X.

186. The interworking of section 406, section 407 and section 408 can at present place a real difficulty in the way of a foreign company seeking to comply with the requirements of Part X. The difficulty arises in this way: section 406 applies Part X to foreign companies which "establish a place of business" here; section 407 requires foreign companies "which establish a place of business" here to deliver the prescribed documents to the Registrar of Companies; and section 408 empowers a foreign company which "has delivered" the prescribed documents to hold lands in the United Kingdom. Thus unless the foreign company has delivered the prescribed documents it cannot hold lands, at least without having obtained a licence in mortmain. Consequently, unless a foreign company is able to establish a place of business by some means falling short of "holding lands", as perhaps by becoming a bare licensee to occupy premises, it would seem that it is not properly in a position to comply with the requirement of delivering the prescribed documents to the Registrar because the delivery of the documents presupposes the establishment of the place of business. Conversely, unless it has complied with the requirement of delivering the documents, it has no power to do the very thing which that requirement seems to presuppose it will have done, namely, that it will already have established a place of business. Thus a foreign company proceeding normally to set itself up in business in this country is in a real dilemma for which at present there is no evident solution. The Council believe that the situation can best be remedied by an amendment of section 408.

187. *The Council recommend that section 408 be amended by the addition of a proviso to the effect that an oversea company which within one month of first holding any lands in the United Kingdom shall have delivered to the Registrar of Companies the prescribed documents, shall be deemed from the time of first holding those lands to have had power to hold lands in the United Kingdom.*

188. Section 407 requires, *inter alia*, notification by a foreign company to the Registrar of Companies of the name and address of a resident authorised to accept service on its behalf. It appears from an Appeal Court decision (*Employers' Liability Assurance Corporation Limited v. Sedgwick, Collins and Company Limited* [1927] A.C. 95 (H.L.)) which was decided on the corresponding provision under the Companies (Consolidation) Act, 1908, that there is no means by which a person having been so authorised can effectively end his authority even though he might properly in fact have

ceased to exercise it. Accordingly it appears that service on such a person even in such circumstances, amounts to good service. Halsbury doubts whether this is still good law and this fiction seems in any case unnecessary since process would in most circumstances be capable of effective service either with the leave of the Court on the foreign company at its head office abroad under Order XI or by leaving the document at any place of business of the foreign company in Great Britain under the proviso to section 412.

189. The Council consider it to be anomalous that service should be capable of being effected in virtue of such an artificiality and that since the duty of appointing an authorised person for acceptance of service is a duty imposed on the foreign company itself, the duty of maintaining that authorisation effectively in being should be a continuing obligation of the foreign company.

190. *The Council recommend that section 407 be amended by the imposition of a continuing obligation on a foreign company to appoint an authorised person for the acceptance of service, and by making provision for such an authorised person, in proper circumstances, to give notice to the Registrar of Companies cancelling his authorisation.*

191. The Council wish to draw attention to another difficulty which arises under section 408, which deals with the power of foreign companies to hold lands in the United Kingdom. Broadly, a foreign company which has complied with the foreign company requirements of the Act has the same land holding power as a United Kingdom company. Decisions of the Courts in 1955 and since have illustrated the difficulties in which a foreign company which has not established a place of business here and accordingly has not complied with these requirements, may find itself in regard to holding lands here.

192. The Council, while recognising that the legal position would doubtless be capable of clarification by amending legislation do not feel called upon to put forward any recommendation for amendment which would apply only to companies falling within this limited category.

193. The Council believe that there is no reason of policy why foreign companies should be treated in a manner different from those registered in the United Kingdom. In practice however foreign companies receive treatment different in two respects.

194. Section 417 (3) precludes the issue to any person in Great Britain of an application form for shares or debentures of a foreign company unless accompanied by a prospectus complying with Part X. There is no relaxation of this rule similar to that contained in section 38 (3), proviso (b), with regard to United Kingdom companies where the application form is issued in relation to shares or debentures which are not offered to the public.

195. Section 423 (2) provides that an offer of shares or debentures of a foreign company to any person whose ordinary business it is to buy or sell shares, whether as principal or agent, shall not be deemed an offer to the public and so under the definition of "prospectus" in section 455 such offer is not a "prospectus". There is no corresponding provision in relation to United Kingdom companies.

196. *The Council recommend—*

- (1) *that there be included in Part X relating to foreign companies a provision similar to that contained in section 38 (3), proviso (b), permitting the issue of application forms in cases where there is no offer to the public;*

and either

- (2) *that a provision similar to that contained in section 423 (2) regarding foreign companies be enacted in regard to United Kingdom companies;*

or

- (3) *that section 423 (2) be repealed;*

- (4) *that the certification under section 420 of the copy of a prospectus of a foreign company to be filed with the Registrar of Companies should be by all the directors or if more than three in number by any three of them, instead of by the chairman and two other directors.*

26. Internal Management and Administration

Requisition of meeting

197. Under section 132, directors may defeat the objects of a requisitionist by convening a meeting within the permitted period but on unduly long notice.

198. In sections 133 and 141 there is some duplication of the provisions as regards convening a meeting by short notice. This would seem to be unnecessary.

199. The Council cannot see why the percentages required for agreement to the holding of meetings on short notice are different in the case of some meetings from others.

200. The Council recommend—

- (1) *that it should be provided that maximum notice of, say, thirty days should be given of any meeting convened by the directors pursuant to section 132 (1);*
- (2) *that all the provisions in sections 133 and 141 regarding convening a meeting by short notice be amalgamated into one section;*
- (3) *that the same percentage of voting rights be required for agreement to the holding of all meetings called on short notice and that this be 95 per cent.*

Statutory meeting and report

201. The Council can see no useful purpose served by retention of the provisions regarding the statutory meeting and the statutory report.

202. The Council recommend that section 130 be repealed.

(a) Annual general meeting

203. The annual general meeting is held mainly for the purpose of considering the report and accounts relating to the financial period of the company. Nevertheless the regulations for holding it are related very largely to the calendar year, a feature which makes a change in the date difficult. The Council do not, however, wish to disturb the present rule that an annual general meeting must be held within 15 months after the preceding meeting, but suggest that the Board of Trade should be given power to extend the statutory period. The attention of the Departmental Committee is also directed to paragraph 154.

204. The Council recommend that the holding of annual general meetings should be related to the financial year of the company rather than to the calendar year, and that the Board of Trade should be given power to extend the statutory period between annual general meetings.

Proxy votes

205. The Council see no reason why a member of a private company should not be entitled to appoint more than one proxy to attend on the same occasion if he so wishes.

206. The Council recommend that a member of a private company should be entitled to appoint as many proxies as he wishes.

Quorum

207. The Council can see no merit in the provision that if the articles do not otherwise provide, the quorum in the case of a public company is to be three members.

208. *The Council recommend that the statutory quorum in respect of all companies should be two.*

(b) Extraordinary resolutions

209. Since confirmatory meetings to pass a special resolution became no longer necessary, there is no substantial difference between an extraordinary and a special resolution. The Council feel that all matters required at the moment to be passed by extraordinary resolution should be required in future to be passed by special resolution.

210. *The Council recommend that the extraordinary resolution be abolished.*

Signed consents

211. Some doubt exists as to the effect of a document signed by all those who, if a meeting had been called, would have been entitled to attend and vote upon the subject matter of the document, no meeting having in fact been held.

212. *The Council recommend that a document so signed shall have the same effect as a resolution duly passed at a meeting properly held and that it should be reckoned, as the case may be, as the equivalent of a special resolution, an ordinary resolution or a class resolution.*

(c) Disclosure in circulars

213. Any attempt to regulate by statute the information to be contained in a circular to be accompanied by forms of proxy, the subject matter of which circular may relate to any commercial problem or any branch of company practice from a non-contentious alteration of articles of association to the most contentious take-over bid, would in the opinion of the Council only tend to render company practice overburdensome with no real advantage to the shareholders. In the opinion of the Council there is adequate protection for the shareholders under the existing law, in that apart from any application of the provisions of criminal law or of the law of defamation, the real sanction is the risk of the resolution being set aside by reason of non-disclosure or misrepresentation of relevant facts.

(d) Exercise of voting rights in cases of interlocking shareholdings etc.

214. It is conceded that the voting powers conferred by interlocking shareholdings and the holdings of pension fund, etc., trustees are capable of misuse by or of subjection to undesirable influence from boards of directors seeking their own advantage, e.g., their own re-election. In the opinion of the Council this is one of the cases where at first glance an injustice or impropriety which has occurred in some particular case would have been avoided if there had been some special legislative protection, such as the disfranchisement of the shares concerned. Nevertheless the Council believe that any general disfranchisement of all such holdings (even if it were practicable to define them satisfactorily) could undoubtedly create injustice in some cases and, accordingly, that no attempt should be made to legislate for or regulate the very diverse circumstances involved.

215. So far as holdings by unit trusts are concerned, the Council are of the opinion that disfranchisement would be as unjust (and as unjustifiable) as would disfranchisement in the case of any other holding, such as that of an investment trust or an insurance company.

216. *The Council recommend that no legislation as to the exercise of voting rights in the cases mentioned, or in analogous cases, is desirable.*

Section 142 (Clarification)

217. *The Council recommend that, in the penultimate line, section 142 should be corrected by substituting the word "section" for the word "subsection".*

Numbering of shares

218. Practical difficulties arise in the case of issues of new shares when the existing shares are unnumbered and it is desired that the new shares should not rank for the next dividend, but thereafter will be uniform in all respects. To comply with the present requirements of the Act, it is strictly necessary to number both the new and the existing shares. It is suggested that there is no advantage in doing this for a purely temporary purpose.

219. *The Council recommend that section 74 be amended so that when existing shares are not numbered and new shares are to be issued which will be uniform in all respects with the existing shares within (say) one year of issue, neither the existing shares nor the new shares need be numbered but the share certificate of the new shares should be appropriately worded or enfaced.*

27. Winding up

220. It has been judicially stated in *Re H. L. Bolton Engineering Company* [1956] Ch. 577 that the words "or have devolved on him through a death of a former holder" in section 224 (1) (a) (ii) confer express power on a personal representative to present a petition. If this is right, the words "or bankruptcy" after "death" would be sufficient to give the same power to a trustee in bankruptcy. Nevertheless to avoid ambiguity the Council believe that the power should be expressly given to trustees in bankruptcy.

221. *The Council recommend that a trustee in bankruptcy should be expressly empowered under section 224 to present a winding up petition in the same way as a personal representative of a deceased shareholder can so do.*

222. By section 213 the term "contributory" means "every person liable to contribute to the assets of a company in the event of its being wound up." It has been judicially held that the term "contributory" includes a fully paid shareholder, but this seems an inappropriate description of a person who can in no circumstances be called upon to contribute. The Council believe that the term, if it is to be retained, should be re-defined.

223. *The Council recommend that the term "contributory" should be re-defined in the light of the above remarks.*

224. In *Re Miles Aircraft Limited* [1948] Ch. 188, the Court held that section 173, Companies Act, 1929 (reproduced as section 227), did not give the Court jurisdiction to validate a disposition of property in the period between a winding up petition being presented and a winding-up order being made.

225. *The Council recommend that the power of the Court under section 227 should be extended so as to enable it to sanction a disposition of the property of the company between the date of the winding-up petition and the date of the winding up order.*

226. The provisions in the Act dealing with "B" list contributories are not altogether clear. The present position is set out in Buckley on the Companies Acts, 13th Edition, pages 434 and 435, under I to VII. This seems to be satisfactory and there would appear to be no good grounds for extending the liability of "B" list contributories any further.

227. There does not appear to be any case in which a "B" list contributory has been called upon to contribute towards repaying share capital or towards adjusting the rights of "A" list contributories amongst themselves, and on the present state of the authorities it would appear to be impossible to sustain any such claim. On the other hand, apart from authority, section 212 would be open to the construction that a "B" list contributory is liable (whether or not all debts contracted before they ceased to be members had been discharged) to contribute to the extent—

(1) necessary to pay the costs of the winding up;

- (2) necessary to provide a fund sufficient to adjust the rights of existing shareholders in the company.

228. The Council also believe that doubts expressed in *Re Apex Film Distributors Limited* [1959] 2 All E.R. 479 should be resolved.

229. *The Council recommend that section 212 (f) (b) should be amended so that the liability of a "B" list contributory to contribute should be limited to the aggregate of—*

- (a) *any debt or liability of the company contracted before he ceased to be a member to the extent that such debt or liability is not discharged either before or at any time during the winding up; and*
(b) *to such costs, charges and expenses of the winding up as are occasioned by his being called upon to contribute.*

230. Under the present provisions the creditors' meeting must be held on the day of or day after the meeting of the company to wind up. Since there does not appear to be any legal reason why the meeting of the company should not be held at short notice, the creditors' right to effective notice may be lost.

231. *The Council recommend that it should be expressly provided under section 293 either that a meeting of the members of the company in the case of a Creditors' Voluntary Winding up should not be called at short notice or that in any event a certain minimum notice is required in the case of the creditors' meeting.*

232. At present a trustee in bankruptcy of a member is allowed to set-off debts owing to the member by the company against calls on the member's shares. There seems to be no logical reason why the liquidator of a corporate shareholder should not have the same rights (thus reversing *Re Auriferous Properties Limited* [1898] 1 Ch. 691).

233. *The Council recommend that the right of set-off of a liquidator of a corporate shareholder should be assimilated to the right of set-off of a trustee in bankruptcy.*

28. Problems of Administration and Enforcement of the Law

234. The maximum fee for copies of memoranda and articles of association prescribed by section 24 is 1s. The maximum fee under section 113 for copies of the register of members, and under section 87 for copies of the register of debenture holders is 6d. per one hundred words. The maximum fee under section 87 for copies of trust deeds is 1s. These fees were fixed in 1862, and since that time the cost of supplying copies has risen enormously. The effect of the rise is that companies supplying copies do so at a considerable loss to themselves. The Council believe that the cost should be borne by the persons making application.

235. *The Council recommend—*

- (1) *that the maximum fee for copies of memoranda and articles of association should be increased to 2s. 6d. per copy or such higher fee as may be prescribed by the Board of Trade;*
(2) *that the maximum fee for copies of the registers of members and debenture holders should be increased to 2s. 6d. per one hundred words or such higher fee as may be prescribed by the Board of Trade;*
(3) *that the fee for copies of trust deeds should be increased to 2s. 6d. or such higher fee as may be prescribed by the Board of Trade.*

236. Under section 45 (3) (b) a contract for allotment of shares must itself be available for inspection. The Council believe that it should be sufficient for a copy only to be available. The rule would then correspond with the provisions as to contracts filed with prospectuses and the Stock Exchange new issue rules.

237. Under section 52, a company must register with the Registrar within one month a contract in writing (or particulars of the contract if it is not in writing) showing the title of the shareholder and the consideration he gave for the shares. The Council believe similarly that it should be sufficient for a copy only to be registered.

238. *The Council recommend—*

- (1) *that under section 45 (3) (b) a copy only of a contract for allotment of shares or debentures should be made available for inspection;*
- (2) *that under section 52 it should be sufficient to file a copy of a contract in writing subject to satisfying the Registrar as to due execution and to stamping.*

239. Section 113 (2) prescribes that copies of the register of members shall be sent to applicants within 10 days of the day next after the day of application. In the case of large companies, this section is not easy to interpret since a copy of the register is likely to be already out of date by the time it is transcribed and dispatched.

240. *The Council recommend—*

- (1) *that copies should be made as on a particular day by reference to the date of the receipt of the application;*
- (2) *that the statutory period should be extended to 21 days.*

241. The Council believe that the privilege provided by section 176 of a public company to have only one director if it was formed before the 1st November, 1929, is anomalous and no longer reasonable.

242. *The Council recommend that the privilege should be abolished.*

243. The provisions of the Act relating to winding up comprise about one-third of the Act. They are unfortunately extremely tautologous (largely owing to the varying types of liquidation) and complex and if it is possible to shorten them by deleting portions which have become obsolete it seems desirable to do so. It is believed that the provisions for winding up under supervision have been rarely used for many years past, and that the relevant sections could be eliminated without any prejudicial effect.

244. *The Council recommend that sections 311 to 315, Schedule XI, and other references to winding up under supervision should be deleted.*

245. The duplication of expenses involved in advertising the appointment of a liquidator both under section 305 and section 279 is unnecessary.

246. *The Council recommend that the publication of the notice of the appointment of a liquidator provided by section 305 should be limited to cases where the appointment has not already been advertised.*

247. At present the Companies Registry operates a voluntary service under which searches are made at the request of persons living outside London, but the facilities are not open to London solicitors. The value of these searches is in any case vitiated by the use of the following disclaimer:—

"While every effort has been made to ensure that the foregoing information is accurate, I cannot accept any liability for loss or damage suffered by any person in consequence of such information being inaccurate or incomplete."

Such a disclaimer would appear to be necessitated only by the absence of any statutory duty as to such searches.

248. *The Council recommend that statutory effect should be given to postal searches at the Companies Registry and that such searches should be made available to all applicants.*

249. As the law stands, a Dominion register can be established only in those parts of the Commonwealth in which the company carries on business, and is available only for entry of members resident in that part.

250. *The Council recommend that owing to the growing complexity of the Commonwealth and its break-up into small component parts often geographically contiguous section 119 be made more flexible.*

29. Any other Matters within the Terms of Reference

251. The Council are of the opinion that no matter what safeguards may be incorporated in a statute the State must always rely largely upon critical publicity to protect the investing public. At the present time, the Press are hindered from making their vital contribution to this end, in so far as they are not given an adequate measure of protection under the law of libel.

252. Section 7, Defamation Act, 1952, and Part II of the Schedule to that Act, give newspapers a special qualified privilege for fair and accurate reports of proceedings at general meetings of a public company, though they give newspapers no statutory right to be represented at such meetings. The privilege does not extend to reports and accounts or to circulars sent out by directors or others to shareholders. The result is that comment on such reports, accounts or circulars may either be stifled altogether or may have to follow on after the vote has been taken at a meeting and possible harm done.

253. The Council consider that if the privilege recommended below had been available at the time of the case of *Hide & Co. Limited* (*The Times*, 7th October, 1958, page 14) comments on the reports and accounts issued in connection with that case would almost certainly have been more effective.

254. *The Council recommend that qualified privilege under section 7, Defamation Act, 1952, should be extended to newspapers reporting on the reports and accounts of public companies (including representations by auditors under section 160) and circulars sent out, whether by the board or others, to shareholders of public companies, subject to the safeguards conferred by section 7 (2) and (3), Defamation Act, 1952.*

August, 1960.

Supplementary Memorandum by the Law Society

1. Exempt Private Companies (Companies Act, 1948, Seventh Schedule)

Certain circumstances have been brought to notice in which private companies have lost their status of exemption through the strict interpretation of the provisions of paragraph 3 (1) of the Seventh Schedule to the Companies Act, 1948, although it must have been the legislature's intention to allow private companies to retain in these circumstances the benefits conferred by section 129.

First, the amalgamation of a number of exempt private companies by the formation of a further private company which, in exchange for shares of its own, acquired the whole of the issued share capitals of the original companies, resulted in exemption being lost due to the existence as shareholders in the original companies of executors or trustees complying with the exception in paragraph 3 (1). The apparent reason for this loss of exemption, which both Counsel and Board of Trade have confirmed, is that the shares of the new company, received by the executors or trustees in exchange for their shares in the original companies, are not "shares or debentures held by trustees on the trusts of a will or family settlement disposing of the shares or debentures."

Secondly, grave concern has been expressed as to the effect on exempt private companies of the decision on 21st October last of Mr. Justice Cross in *re: Prens's Settlement: Truvox Engineering Co. Ltd. v. Board of Trade* (1960) 3 A.E.R. 564.

The Council have already put forward to the Permanent Secretary of the Board of Trade their views on the possible consequences of this decision to exempt private companies and a copy of their letter containing details of the representations made is attached at Annex A.

2. Dominion Registers (Companies Act, 1948, sections 119-123)

The subject of Dominion Registers has been further considered following additional evidence being forthcoming on the difficulties concerned in the establishment of such registers in certain Commonwealth territories with particular reference to the Federation of Malaya.

Under section 119 (1) a company having a share capital whose objects comprise the transaction of business in any part of Her Majesty's dominions outside Great Britain, the Channel Isles or the Isle of Man, may cause to be kept in any such part of Her Majesty's dominions, in which it transacts business, a branch register of members resident in that part (called a "Dominion Register"). For the purposes of this section the phrase "Her Majesty's dominions" is not defined; although for the purpose of section 123 (making provision for branch registers of dominion companies to be kept in the United Kingdom) the expression is defined in subsection (2) to include "any territory which is under Her Majesty's protection or in respect of which a mandate under the League of Nations has been accepted by Her Majesty." It may be observed that this subsection is a re-enactment of a corresponding subsection in section 107 of the Companies Act, 1929, and an identical definition was enacted in section 17 (4) of the Finance Act, 1930.

Both the last-mentioned statutes pre-dated the Statute of Westminster, 1931, in which section 1 created a special significance for the countries named therein described as "Dominions" with a capital letter as opposed to the generic term spelt without a capital. Halsbury's *Laws of England* (3rd edition) volume 5 contains a definition of "Her Majesty's dominions" on page 433 as "all the territories under the sovereignty of the Crown and the territorial waters adjacent thereto." In the absence of a definition of the expression in section 119 the possibility exists that the definitions in section 123 (2) of the Companies Act, 1948, and in the edition of Halsbury referred to are synonymous.

The question now arises whether any of the independent Commonwealth countries can be considered to be under the "sovereignty" or "protection" of the Crown, and this doubt creates dangers regarding the validity of the maintenance of Dominion Registers. The position may be illustrated by the way in which the Federation of Malaya is apparently affected.

Prior to the passing of the Federation of Malaya Independence Act, 1957, the Malay States (Johore, Pahang, Negri Sembilan, Selangor, Kedah, Perlis, Kelantan, Trengganu and Perak) and the Malay Settlements (Penang and Malacca) were part of Her Majesty's dominions, and if a United Kingdom company complied with the provisions of the Companies Act, 1948, in other respects it was at liberty to establish a Dominion Register anywhere in Malaya. Section 1 (1) of the Federation of Malaya Independence Act, 1957, authorised the execution of an Agreement between the Crown and the Rulers of the Malay States in order to bring about the granting of independence to a new Federation of Malaya. Clause 3 of this Agreement, when executed, and the terms of which are set out in the Annex to the Federation of Malaya Order in Council, 1957 (S.L. 1957, No. 1533), provided as follows:—

"3. As from 31st August, 1957, the Malay States (which are defined as Johore, Pahang, Negri Sembilan, Selangor, Kedah, Perlis, Kelantan, Trengganu and Perak) and the Settlements (Penang and Malacca) shall be formed into a new Federation of States by the name of Persekutuan Tanah Melayu or in English

the Federation of Malaya under the Federal Statute set out in the First Schedule of this Agreement; and thereupon the said Settlements shall cease to form part of Her Majesty's dominions and Her Majesty shall cease to exercise sovereignty over them, and all power and jurisdiction of Her Majesty or of the Parliament of the United Kingdom in or in respect of the Settlements or the Malay States or the Federation as a whole shall come to an end."

It would appear that by the terms of this Agreement, taken together with the provisions of the Federation of Malaya Independence Act, 1957, the Crown renounced all sovereignty over the Malay States. Certain companies have been advised by Counsel that since the granting of independence on 31st August, 1957, a United Kingdom company is no longer able to establish a Dominion Register in the Malay States.

However, a surprising anomaly can arise in that it may still be permissible for a United Kingdom company to establish such a register in the Malay Settlements. It is understood that this conclusion is reached through the construction of section 2 (1) of the Federation of Malaya Independence Act, 1957, which provides:—

"On and after the appointed day, all existing law to which this Section applies shall, until otherwise provided by the authority having power to amend or repeal that law, continue to apply in relation to the Federation or any part thereof, and to persons and things in any way belonging thereto or connected therewith, in all respects as if no such Agreement as is referred to in Sub-Section (1) of Section 1 of this Act had been concluded."

An interpretation has been placed upon this subsection to the effect that it preserves as applicable all existing law in relation to the Federation or any part thereof in all respects as if the Agreement between the Crown and the Rulers of the Malay States had not been concluded, i.e. as if the Settlements of Penang and Malacca had not ceased to form part of Her Majesty's dominions. The existing law to which section 2 applies is to be found in subsection (4); it includes the Act. Thus, the conclusion has been drawn that section 119 of the Companies Act, 1948, still applies in relation to these two Settlements.

It should be mentioned that the importance to United Kingdom companies of the establishment of Dominion Registers is threefold:—

- (1) The saving of time and expense in the case of transfers between two persons in the same country by the registration work being carried out in that country.
- (2) The Stamp Duty payable on such transfers (particularly in the case of Malaya) is considerably less than the 2 per cent. *ad valorem* duty payable in the United Kingdom.
- (3) Estate Duty would become payable in respect of stocks and shares that had to be registered in a register kept in the United Kingdom (in the event of the invalidity of a company's dominion register) since the shares would be liable to duty without reference to the question whether the title is British or foreign.

The Council consider that, for the purposes of clarification, an explanation should be given of the reasons which led to the restricted recommendation in paragraph 250 of the Council's memorandum that section 119 should be made more flexible. This recommendation was based on the evidence that, particularly in the case of Singapore and the Federation of Malaya, neighbouring Commonwealth territories can have different constitutional bases which do not permit a register to be established in one part of the "dominions" enabling persons resident in an adjacent or nearby part of the "dominions" to be placed upon that register.

The Council therefore stress the apparent urgency of consideration being given to a new definition of "Her Majesty's dominions" in section 119 (1) to place beyond doubt the position of Dominion Registers kept in countries of the Commonwealth granted independence and over which the Crown has renounced sovereignty.

3. Company Names (Companies Act, 1948, Section 18 (2))

It is the practice of the Registrar, when replying to an enquiry regarding the availability of a name desired for a new company, to require the promoters or the persons acting for them, in submitting the documents leading to the formation of the company, to provide "trade mark clearance" in respect of that word. This "clearance" takes the form of a letter to the effect that a search has been made in the Trade Marks Registry and that the word in question does not represent or resemble a registered trade mark and also is not the subject of an application for such registration in respect of any goods in which the company proposes to deal. If such "clearance" cannot be given, there must be produced the consent in writing of the owner of the trade mark, to the use of the word in the name of the proposed company, or an assurance in writing that the proposed company will be controlled by the owner of the trade mark.

When a company is registered under a name containing a word representing, or resembling, a registered trade mark, belonging to a person who neither consents to the use of the word nor controls the company in question, it appears that no power exists whereby the company can be compelled to change its name. Such a company can proceed to deal in goods under its own name by virtue of section 8 (a) of the Trade Marks Act, 1938, notwithstanding its similarity to the other party's trade mark. Under section 18 (2) of the Companies Act, 1948, the Board of Trade can compel a company to change its name, but this power is only exercisable if the name in question is too like the name by which an existing company is previously registered. It is not, therefore, available to meet a case of the nature mentioned.

It is the Council's opinion that the situation is unsatisfactory; although the precautions taken by the Registrar of Companies partly reduce the risk, they fall short of perfection for the following reasons:—

- (1) Whereas in the case of a registered trade mark the "clearance" must state that the word does not represent or resemble the mark, in the case of an application for registration of a trade mark it need only state that the word is not the subject of such application. In the latter case it is possible for a clearance properly to be given in respect of a word which differs slightly from a word that is the subject of the application, even if it is so nearly identical as to be virtually indistinguishable to the public.
- (2) As regards registered trade marks, the question whether or not a word "resembles" a mark is one on which opinions, particularly those of company promoters and the owners of the mark, may differ. It is quite possible that the promoters or their agents may give a clearance in good faith in respect of a word which to the mind of the owner of the trade mark is capable of confusion with his mark.
- (3) There is the possibility of human error in that the person carrying out the search may overlook a mark appearing in the Register of Trade Marks, or applications therefor.
- (4) An unscrupulous person may deliberately give false "clearance" and no penalty will be incurred.

It may be desirable to extend section 18 (2) to empower the Board of Trade to enforce a change of name in both the circumstances now permitted and where a word in the name of a company is too like a registered trade mark in existence at the date of the company's formation or change of name, or is too like a word which is the subject of an application for registration of a trade mark made before that date.

Although no extension of the jurisdiction in section 18 (2) was suggested in the Council's memorandum, it was recommended in paragraph 184 that a secondary jurisdiction should be established which would be exercisable at any time after the six months' period. This recommendation was restricted to the more general grounds on which a company name may be found undesirable. It is the Council's view that

no extension is called for in respect of these more general grounds, since their existence or potentiality must be discernable when a proposed name is initially put forward. However, it is also believed that consideration should be given to seeking a solution to the difficulty caused by the conflict of a proposed company name with a trade mark (and possibly even a business name).

15th February, 1961.

ANNEX A

The Law Society's Hall,
Chancery Lane,
London, W.C.2.

19th December, 1960

Dear Sir Richard,

I have been asked by the Council to express their concern as to the effect on exempt private companies of the decision on the 21st October last, of Mr. Justice Cross in *re: Prenn's Settlement: Truvox Engineering Co. Ltd. v. Board of Trade*.

The question raised by the Summons in that case was, you will remember, whether a Company lost its status as an exempt private company under section 129 of the Companies Act, 1948, as the result of a transaction in which the settlor, who was the majority shareholder, allotted to the trustees of a settlement, in return for a cash payment, shares which were being distributed on a capitalisation of undivided profits. It was necessary to consider the wording of paragraph 3 (1) of the Seventh Schedule to the Companies Act, 1948, which provides that the basic conditions (mentioned in paragraph 1) shall be subject to exceptions for—“(b) any shares or debentures held by trustees on the trusts of a will or family settlement disposing of the shares or debentures”. Mr. Justice Cross construed these words to mean the trusts of a will or settlement where the shares form part of the estate of the testator, or were settled by the settlement itself, with the result that they would not include cases where the shares came to form part of the will fund or the settlement fund by a simple change of investment. Accordingly, it was declared that the company had lost its status as an exempt private company.

Following the enactment of the provisions contained in section 129, to give certain benefits to genuine family companies, provided that they satisfied the conditions found in the Seventh Schedule, and particularly in this respect paragraph 3 (1) (b), it has been widely believed by solicitors and others that these benefits include the right of trustees to hold the shares of a private company on the trusts of a family settlement, irrespective of whether such shares were acquired by the trustees on the execution of the settlement, or at a later date. It may be observed that paragraph 5 enables trustees to hold shares or debentures for the purposes of a scheme maintained for the benefit of employees of the company, but does not appear to specify that the shares must be transferred on the creation of the scheme.

It is feared that, as the result of the decision in the case mentioned, private companies will lose their status of exemption in at least two common cases, viz.—(i) where the property originally settled by the family settlement (within the meaning of paragraph 3 (2) (b)) consisted of cash, which was subsequently used for the purchase of shares in a private company, and (ii) where the property that was originally settled consisted of shares, but there have been additions in the form of bonus shares since the date of settlement. The first proposition follows from the decision itself. The second was argued before Mr. Justice Cross, as is apparent from the judgment, though he did not find it necessary to deal with it. It is thought, however, that the contention which he accepted was that the shares must be owned by the settlor at the date of the settlement, and settled by him; while the right to bonus shares would accrue to the trustees at a date subsequent to that of the settlement.

A private company may suffer a number of inconveniences, including the possibility of hardship being caused, if the result of this decision is a loss of the status of exemption. Hardship might particularly arise where a company, in reliance upon its assumed status as an exempt private company, has made a substantial loan to a director following the provisions of section 190 (1). Further, a company will discover that when making its annual return it is not exempt from the provisions of section 129, and it will be required to annex a copy of the last balance sheet (including profit and loss account, and auditors' report).

This would be contrary to the expressed intention of the Cohen Committee "to exempt from the obligation to file accounts what can roughly be called the small family business incorporated as a company" on grounds of competition with partnerships.

The Council appreciate that an appeal may be lodged from the decision, and also that the subject of exempt private companies is one of those under consideration at the present time by the Departmental Committee on Company Law Amendment, under the Chairmanship of Lord Jenkins. Whatever conclusions are reached by this Committee, however, when their Report is finally published, considerable time must presumably elapse before there is the likelihood of new company legislation of a comprehensive nature. Also, if an appeal is lodged, I would not expect that, in normal circumstances, it would be heard for some months.

In the meantime, those solicitors and company secretaries who are alert enough to have become acquainted with the decision in *re: Truvox Engineering Company* case will have caused the companies for which they are responsible to suffer the inconvenience or hardship referred to above, while company secretaries whose attention has not been drawn to the case will go on signing annual returns containing certificates which, in the light of that case, are untrue.

Accordingly, I have been asked to express the hope of the Council that consideration may be given by the Board of Trade to the desirability of introducing legislation during the current Parliamentary Session, which would restore the position, to what it was thought by the profession to be before the decision of Mr. Justice Cross. Such legislation might be to the effect that where trustees acquire for consideration, or through acceptance of a bonus issue, the shares of a private company subsequent to the date of execution of a family settlement, the privileged status of the company as an exempt private company will not be lost even though it may happen that the shares were never held by the settlor, or testator, himself.

Yours sincerely,

(Signed) T. G. LUND

Secretary.

Sir Richard Powell, K.B.E., C.B., C.M.G.,
Permanent Secretary,
The Board of Trade,
Horseguards Avenue, S.W.1.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
SIXTEENTH DAY

Thursday, 2nd March, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

MR. W. H. LAWSON, C.B.E.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. I. H. SHEARER and MR. J. P. H. MACKAY *called and examined*

5628. *Chairman:* Gentlemen, we are very much obliged to you for coming here to help us this afternoon, and before we begin I would like to say, on behalf of myself and my colleagues, how very pleased we are to have this opportunity of holding one or two of our meetings in Scotland. It will enable us to see how these matters appear to practitioners on both sides of the Border. I do not think there is much divergence of interest, except on the question of floating charges, which I understand is being dealt with elsewhere at the moment.—*Mr. Shearer:* Yes.

5629. Just to keep our record in order—*Mr. Shearer*, you are one of Her Majesty's Counsel, and Convener of the Faculty's Committee on Common Law?—That is so.

5630. And you, *Mr. Mackay*, are a member of the Faculty?—*Mr. Mackay:* Yes.

5631. Now, to take in order some of the points that have occurred to us on your valuable memorandum, you begin with the vexed question of *ultra vires*, and you share the opinion of the Cohen Committee that the rule should be abolished and that, as between a company

and third parties, a company is to be considered as having all the powers of a natural person?—*Mr. Shearer:* That is precisely so.

5632. This view is shared, I think, by a number of witnesses, all of them feeling that it is fraught with certain difficulties: and the kind of difficulty they put forward is this—how is the third party to stand if he actually knows that what is being done, that is the transaction on which he is embarking with the company, is beyond the powers of the company as set out in the memorandum?—I think that would have to be treated as a special case; it could be covered by protecting the third party only when he was acting in good faith. I should have thought if the third party in fact knew the company was entering into a contract which was *ultra vires* it would scarcely be proper that such a third party could claim protection.

5633. So the third party must be acting in good faith to be absolved from notice of the contents of the memorandum of association?—That would be my view.

5634. That of course would not be an entirely certain solution of the problem, would it? You still would have the

question of whether this or that transaction between the third party and the company was in good faith, and so forth?—That would have to arise, I would agree, Sir. That would be the circumstances of any given case.

5635. You recommend, in conjunction with your view about the *ultra vires* rule, the adoption of the "main objects" rule; that is to say you would take out of the totality of objects those which are really the material and primary objects of the company, and say the company's powers are to be limited by these?—Yes.

5636. How does the introduction of the "main objects" rule fit in with your proposal that the company should have all the powers of a natural person *vis-à-vis* the third party? The main objects would be set out in the memorandum, as I understand it?—I was not looking at the relationship through the eyes of the company; I was looking at it through the eyes of the third party. As I understand the views of the Committee of the Faculty, the person to protect is the third party, not the company. If the company acts *ultra vires*, that obviously may raise questions within the company. I do not, with respect, quite see how the two points overlap. We were saying, as an addendum which suggested itself to us when we considered the *ultra vires* rule and its application, that we did think, rightly or wrongly, that the existence of that rule had led to the complicated memoranda which most people deplore. If the rule was going, from the point of view of the third party and business and commerce, there seemed no reason to continue to permit complicated memoranda which, as you know, have been frowned upon and led to a debate in the House of Lords. We had in view the Cotman case in 1918.

5637. So your objects clause, recast so as to be a main objects clause, would be preserved; but it would be fair to put it that it would be preserved merely as a piece of domestic machinery, operating between the shareholders and the company?—That is what we were trying to say.

5638. We have had many proposals put to us about this and about the degree to which the third party should be

protected; and it has seemed to some of us that this is a difficult problem. Can you help me about this? These cases of *ultra vires* are a comparatively rare occurrence nowadays, are they not?—Yes, certainly here, within one's knowledge.

5639. One goes to *Jon Beauforte (London) Ltd.*, which has been cited to us as having been decided since the new Act came into force in 1948. I am not saying there have not been other cases, but obviously they are not common.—I agree.

5640. And would you agree they generally occur in the winding up of a company?—Within my own experience, yes.

Mr. Mackay: Yes, I would agree.

5641. Do you think there would be any merit in this suggestion—it is not a very artistic one—leave the *ultra vires* rule as it stands, but give the Court a dispensing power in appropriate cases where the person dealing with the company has done so in good faith, so that the Court could, in its discretion, validate the transaction subject to the third party performing his part of the contract?—*Mr. Shearer:* I confess I think our view would have gone a little further than that. Although I appreciate the difficulties, we would rather have recommended the total abolition which we suggest, in preference to leaving it to a Court's discretion. Our view simply was, as we tried to say, we did not really see why the third party should, in dealing with a company, be put to the extra and rather peculiar conditions which at present he is under. But if it were thought the difficulties were such that it should be rather a matter of the Court's discretion, then one would not—certainly strongly—object to that. Would you agree, Mr. Mackay?

Mr. Mackay: I was wondering at whose instance the application might be made.

5642. It would arise almost always on a rejection of proof by a liquidator. If there were a claim for fuel supplied, and the liquidator rejected the proof on the ground that the transaction was *ultra vires*, for instance; I would say practically all the cases which are likely to arise would arise in that context, that is to say,

winding up and rejection of proof.—I suppose the difference between that suggestion and the Faculty's is really one of onus: whether the rule should be in the ordinary case that such a contract is a good contract and binding on the company and on the third party, or whether the rule should be that in the ordinary case it would be a bad contract but capable of being validated. The Faculty took the view that the ordinary rule should be the former.

5643. What I had in mind was a power to the Court to validate an *ultra vires* transaction where they were satisfied that by doing so the substantial justice of the case would best be met—something like that. It is perhaps a little unfair on the Court, but that is the thought.—Mr. Shearer: Yes.

5644. Then perhaps we can pass from that. Returning to the "main objects" principle, you say that if the *ultra vires* rule goes you consider it would be in the interests of the investing public to have in the memorandum a compulsory and definitive main objects clause clearly identifiable as such and distinct from ancillary powers clauses. What would the status of your main objects clause be in those circumstances? *Ex hypothesi*, it would not bind the third party, would it?—No.

5645. And if it did not bind the third party, how could it protect the members?—I am sorry; I think plainly we have expressed this rather badly. We were not considering the adoption or intensification, if one wishes, of the main objects rule from the point of view of third parties. As I tried to explain, while thinking of the *ultra vires* rule it occurred to us the two were, in point of fact, linked, because rightly or wrongly we think the form of objects clause we find so frequently now was one dictated or encouraged by the existence of the *ultra vires* rule. If that were removed, we believe the way would then be open to prohibit—I agree it would be very difficult—the multiple objects clause; and that really would be more in the interests of the shareholder than anything else.

5646. You would leave the main objects clause in the memorandum?—Yes.

5647. Would you make that a domestic provision only?—That, in effect, would be so; subject to the *bona fides* of the third party.

5648. I see: so that the company in all its external affairs would have universal powers, but it would have behind those, albeit in the memorandum, a domestic provision laying down in a more circumscribed fashion than at present the things the directors could do?—That is so.

5649. The comment I would make on that is that you are likely to get back into the old difficulty of *ultra vires*, though not in the true sense. It is clear the board of directors would want to know what was covered by their main objects clauses?—Yes, that indeed is so; though it is a difficult matter from the point of view of draftsmanship we had really hoped to provide in some way for objects clauses which would tell the shareholders or anyone who looked at them what precisely the company did.

5650. That was what was hoped for and intended in 1862.—I quite agree; and I thought this might be a chance to try once more.

5651. And one of the things this Committee can do is to consider what can be done to improve the position as regards the company's objects; and, given universal objects, how to arrange matters so as to give adequate protection to the shareholders. That, I am afraid, is about as far as we can take that point. Passing to heading 5—exercise of powers of companies by directors and degree of control retained by shareholders—you deal there with fundamental changes in a company's activities and the disposal of its undertaking and assets. Your general view is that it would be on the whole an advantage that the company, in general meeting, should have a greater degree of control over the directors than it has at present as regards certain important matters, such as fundamental changes in the company's activities and disposal of the company's undertaking and assets?—Yes.

5652. You make, if I may say so, a useful suggestion to the effect that this might be achieved by making it a statutory requisite that the articles of association

should contain a clause delineating the powers of the directors to dispose of the undertaking and assets; this clause to be subject to alteration by special resolution with powers to apply to the Court as under section 72. This is a minor point, but could you clarify the reference to section 72 which, as I understand it, only applies where class rights are concerned?

—Yes. I think that is badly phrased, Sir. What was in the minds of the committee, as I recall it and, I think, accurately, was that there should be power to the minority—I think in section 72 it is 15 per cent. of the shareholders—who thought the majority should be restrained, to apply to the Court.

5653. It is analogous to the procedure on a proposed variation of class rights. There would be a resolution passed by the company in general meeting, and even in those circumstances you say that those who are out-voted at the meeting should be invited to renew their attack in the Court?—Yes, subject of course to a special value in quantity or number—15 per cent. or something like that.

5654. Then, to pursue this same topic, you perfectly well appreciate if you put the restrictive power in the articles that power can be altered or abrogated by the alteration of the articles.—Yes, I appreciate that.

5655. Would you say there was any merit in the suggestion that restrictions on the directors' powers, such as you propose, should be inserted in all articles with reference to the sale of the undertaking and assets; and, furthermore, that these compulsory articles so to speak should be capable of alteration like any other article, with the qualification that they should not be altered before the expiry of a specified time after the formation of the company? That would prevent the restrictions being chucked out on sight or at a stage so early that the people who ultimately become shareholders would have had no opportunity of considering the matter. Do you think that might be worth examining?—Yes, Sir, undoubtedly.

5656. Then under the other branch of the same topic, as to the control of fundamental changes in the activities of the company, you say in your opinion

such control would be achieved by the application of the main objects rule, as suggested in your remarks on the *ultra vires* rule.—Yes.

5657. What I want to put to you on that is this: as I understand it, the directors would be bound by the same objects, concisely and intelligibly expressed. They would be bound by those, but questions would inevitably arise, as they have arisen in the past, as to whether a particular transaction was within the main objects.—Yes.

5658. Would that not lead to something very like the process of widening the objects clauses which has gone on since 1862, with the result that the objects clause is now almost universal?—I suppose, Sir, that would be largely a matter of circumstances. The ideal is if one would have an objects clause which, if you looked at it, you could see exactly what a company did. It must always perhaps be a matter of degree, but I would have thought that, with anything approaching an objects clause in the restricted sense in which we desire to see it, the question of whether or not a particular act is within that power would present less difficulty. I take your point, Sir, precisely, but I think we are just coming back to the same point.

5659. You cannot expect the directors to conduct a company's business with litigation hanging over their heads, and if they enter upon a transaction, believing that the company has power to do it and then something goes wrong, they surely want to know they cannot be struck at for exceeding their powers.—But would that not arise today, or could it not arise in every instance?

5660. But we do not have the main objects clause at the moment: we are not applying that principle, so you have the universal objects clause which, on the face of it, enables the company to do anything it chooses.—Yes. It is possible we may be rather rigidly minded, but I think the view of the Faculty would be that they would prefer to worry the directors rather than have a blanket clause enabling a company to do anything it chose: because we feel that stultifies the whole purpose.

5661. But then a blanket clause may be a very comforting thing, and under

its protection the directors may be able to do all sorts of things which are very much to the advantage of the company?

—Yes, but that I take to be merely a matter of weighing one against the other. I may be entirely wrong. I think it is not regarded as legal to float a company with an objects clause saying it can do anything which any company may be entitled to do.

5662. The argument thus goes back in a circle, because we are back on *ultra vires* then.—That is true.

5663. So far we have not succeeded in wrapping this into a tidy parcel: you subdue one end and the other escapes. So perhaps we cannot really carry that very much further. The next topic is heading 5 (c), the issue of shares; and under that heading you say, "In our view all unissued shares should be issued by public issue or by rights issue *pro rata*, or as approved by the company in general meeting." As to that, why should one put a public issue in the forefront if the money can be collected by means of a rights issue offered to the shareholders in the first instance?—I should immediately agree, Sir. I would not put the public issue in the forefront at all.

5664. And if you did, I suppose it would be possible to give existing holders some preferential right of subscribing on a pink form?—Certainly. I am sorry, Sir: it was not intended that should be the primary purpose. It is bad draftsmanship.

5665. Then your case would probably be met if it were provided that all shares issued for cash should be offered to shareholders *pro rata*, unless the company in general meeting decided otherwise?—Yes.

5666. It would be reasonable, as I think you recognise, in connection with that to leave to the directors' discretion the issue of small parcels of shares not exceeding a certain specified amount: the instances of benefiting employees, pension funds, and the like, are given in your memorandum.—Yes.

5667. You agree that would be a reasonable exception to the general rule?—I think so, Sir, yes. As we say, what we had in mind here—and this is a matter

largely dictated by one's own experience in these things—is the prevention of manipulation which has happened, as we all know, where there is no check on the issue of unissued share capital by directors.

5668. And unscrupulous directors might allot them to themselves or their friends, at a great advantage which might be denied to the shareholders?—Precisely, and from the point of view also of manipulating control.

5669. Yes, I think we have your points there. Now there is the case in which shares were on their creation expressed to be at the disposal of the directors at their discretion. That would commonly be the case, I suppose, under ordinary articles of association as regards the initial authorised capital, and it might be so also as regards subsequent increases in capital.—Yes.

5670. The directors might succeed in getting power from the company by resolution to the effect that the shares would be at the disposal of the directors. Would you think it right to allow the shareholders' *prima facie* right to have a *pro rata* distribution displaced by an omnibus general resolution of that kind?—I do not suppose one could object to that if it were in relation to any particular shares outstanding where the matter had arisen. After all, if shareholders in general meeting, or in meeting to consider it, decided they did not wish to exercise *pro rata* rights but preferred it should be left to the discretion of the directors, then it is a matter entirely for themselves. We would not wish to see the creation, let us say, of new capital with the power entrusted solely to directors over it, I think.

Mr. Mackay: I think not.

5671. Do you think it would be feasible to legislate so as to prohibit that in all cases?—Mr. Shearer: I do not say such provision should not be left to the company in meeting; in other words we consider that such power should only be conferred upon directors by general meeting in relation to a specific group, class or creation of shares.

5672. Mr. Brown: Do you mean shareholders' approval should be specific for each issue?—Yes, I would put it like that. I am obliged to you, Sir.

5673. And you would do away with this general provision, which is now commonplace?—Yes, I agree entirely. I may say our feeling on this matter has been inspired by certain cases which we have come across in Scotland over the last few years.

5674. *Mr. Scott*: Did you have in mind issues of equity shares for cash only, or did you have in mind any issue of shares—for example the acquisition of another company for shares and not for cash?—We had in mind, I confess, issues for cash.

5675. And presumably equity shares and possibly debentures with conversion rights into equity?—Yes.

5676. Any issue, in other words, which affects the equity interest and is for cash?—That is so.

5677. *Mr. Mackinnon*: Of course, the issues of shares for a consideration other than cash could give rise to manipulation as well as the cash issues, could they not?—That is perfectly true.

5678. I ask that because you are putting it on the grounds of prevention of manipulation.—That is perfectly true: of course it could.

5679. *Chairman*: It may be said that the position is different according to whether the shares in question form part of the original capital or are created by an increase of capital. In the former case the directors have such power over the shares as the promoters of the company choose to put into the original articles.—Yes.

5680. But in the latter case there has to be a resolution and the shareholders have to be asked to cast their votes on the question whether the capital is to be increased; and the probability is that the members would want to be satisfied as to the purpose for which the shares were being created, as to whether they were going to be issued to the shareholders or not, and if not, why not? They would have the opportunity of ventilating the whole thing if they were able to use that opportunity.—Yes.

5681. So there is that degree of protection, it may be said.—That is true. Of course, it might well be that in year 1

it would prove to be perfectly proper to leave the control, time and manner of the issue to the directors, but in year 2 the climate may have so changed that it would be rather a different matter. That is what we have in mind.

5682. *Mr. Lumsden*: Would you perhaps put some time limit within which the authority must be exercised? At the moment, I think, when an increase is authorised the directors are normally authorised to issue the shares in such a manner as they think fit.—Yes.

5683. Would there be any advantage in extending that by adding the words "either by public issue or rights issue or in any other way"? I am doubtful whether it would be clear, but supposing the directors were given adequate authority would you say that authority should be exercised within the next 12 months, otherwise a new authority would be required?—That might be one of the ways of meeting the problem. If authority were given in year 1 and renewable each year, it would give the company in meeting the opportunity of reviewing the situation. I do not know whether we are overstressing this matter. It is merely the climate of opinion of the last year or two which was rather brought to our notice at the Bar at any event, where the directors are unfettered. That, of course, may be just an unfortunate experience.

5684. *Chairman*: For reasons which I have endeavoured to state, it might be the case when one works it out that this danger to shareholders only arises as regards any surplus of the original capital remaining after the needs of formation have been met, because in every other case there has to be a resolution to increase capital.—Yes, I do accept that, subject to the possible caution that if you have new capital, of which some remains unissued, the climate of the company or of your boardroom or of your personal relations can change from time to time.

5685. *Mr. Bingen*: Could I ask what problem it is which is worrying Mr. Shearer? He says he has come across cases where boards have issued shares without consulting shareholders in circumstances which give rise to some alarm. Is it because they have issued shares at an under-valuation or bought businesses at

an over-valuation?—The problem worrying those of us who deal with this aspect of it has been almost entirely—in fact I think I can say entirely, within my experience—the immediate question of control. That can obviously lead to many other things: that is, directors have manipulated control of a company on a question of voting by their unlimited power of issue of unissued capital.

5686. But not in circumstances which would give rise to misfeasance action?—No, they were perfectly within their powers.

5687. They have collected the full consideration for the shares they have issued?—Yes.

5688. *Chairman:* Do you think this is a case like the sale of the undertaking and assets, which might conceivably be dealt with by way of special articles, possibly with some restriction on the date before which those articles could be abrogated?—I think it could, Sir, yes. I am afraid we are not being terribly helpful. It is the evil—if that is not too strong a word—which one has come across, which one is trying to stop; and it is much easier to define it than to stop it. But I see no reason why it should not be done by article or, as Mr. Lumsden suggested, by putting a time limit on a discretionary right and requiring renewal of such rights, which I suppose could be quite easily done.

5689. The difficulty is that one is trying all the time to supplement the protection of shareholders as regards attendance at meetings and control of affairs.—That is true.

5690. *Mr. Brown:* With that in mind, is it really met by a provision in the articles; they could be altered so as to remove this restrictive power at any time?—I think Lord Jenkins suggested it might be a form of entrenched or protected article; but again I think we would have to bow to that. If the articles can be changed at any time—as they can—and if the company wishes to change its articles and if the company, having considered the matter, wishes to give the directors full discretion, apart from a time limit, it is very difficult to see why they should not. After all, it is their business and not mine, so to speak.

5691. *Chairman:* We have your general view on that subject, and I think it is shared by many; but it is a difficult one when one attempts to work it out with any degree of precision. The end to be achieved is perhaps not so controversial as the means for achieving it.—I agree entirely, Sir.

5692. Could we pass from that to the topic of directors' and officers' dealings in their own companies' shares, section 195 of the Act: and you express your conclusion on that in these words:—

“In our view the provisions of section 195 while going far to provide for publication could be strengthened, with advantage, by making disclosure of directors' dealings throughout the year part of the information to be put before the shareholders prior to the annual general meeting.”

That suggestion has been made by other witnesses, but others again, I think, have inclined to the view that it would be unnecessarily imposing too much of a burden on directors if they were required in general meeting to supply a summary of dealings as well as keeping the register. There is already the obligation to keep the register under section 195?—Yes.

5693. Do you think that protection would be to any substantial effect increased if, in addition to entries in the register, there were a circular summarising the effect of the transactions?—Yes. Again, I suppose it might be that we are attempting to legislate for the idle shareholder in a sense, because he can of course go and look at the register when he wishes: he can do the inspection, I think it is 14 days before the meeting. What we had in mind was that it would merely be an additional check on dealings by directors which would, or might, be promoted by use of knowledge which we feel should not lead them to the market.

5694. I think many people share your view, and I should have added that most people who say the existing register is sufficient protection pre-suppose, I think, that an alteration will be made in the law as regards the period of time over which the register is open. They would be in favour of a provision to the effect that this register of share dealings should be open

ideally as one would wish to deal with such people, we could not quite conceive how one could do it by legislation. That, of course, might be an argument in favour of an extended power, as your Lordship suggested and as has been suggested elsewhere, in the Board of Trade to hold an inquiry in a given situation.

5708. *Chairman*: Yes, and whether that would be effective or not would depend on the manpower available in the department and on the number of transactions which might occur in any given year. It would be useless to have powers which were strong on paper without at the same time having the manpower in the department to enforce them.—Yes.

5709. *Mr. Althaus*: And some difficulties may arise through initial buying as part of the acquisition operation?—Yes.

5710. And therefore one might have some inquiries instituted which had no foundation or justification at all?—Yes, that is so.

5711. *Chairman*: I do not know if we can carry that much further at the moment. The next heading I had noted was heading 6 (d) (ii). You deal there with the disclosure of directors' interests. As I understand it, your point is one which has been taken by a number of other witnesses, that disclosure of directors' interests at present is made to the board and only to the board; and I gather your view to be that any matter with respect to which a director has made disclosure during the year under review should be particularised in the documents laid before the company in general meeting?—That is so.

5712. Do you think that is really a necessary precaution?—I should think in 99·9 per cent. of cases, no; but again it is merely the very rare bad case, which possibly postulates a bad board in any event.

Chairman: It does mean another bit of paper, which is something else for shareholders to pick upon, where directors really have acted perfectly honestly; and so many of these discussions end in putting some further obligation on the directors. One wonders whether such proposals ought not to be investigated fairly closely.

5713. *Mr. Lawson*: Would it not be sufficient if these particulars were given in

the same register as the directors' share dealings, for example, so that they were open for inspection if someone took the trouble to look?—Yes.

Mr. Brown: We use a standard practice for the directors' notices to the board. We are a big investing company. Our directors are directors of other companies having share interests. They may hold 500 shares in L.C.I., and if the board decide to buy shares in L.C.I., are they to take notice of all directors on the register?

5714. *Mr. Scott*: Would you not say that was a matter which could be left to the directors? If the directors know from one of their number that he is interested in a company, they are able to say: "Thank you for telling us that; we note it, and you should not vote on it, but we will make up our minds as to whether it is to the benefit of the company to go ahead without having your vote on this project." Is it really necessary for them to tell the shareholders afterwards that had happened at a board meeting? Would it help the shareholders if they knew it? There would have to be a footnote to the effect that "it did not really matter, as we were satisfied his holding did not affect or influence our decision in dealing with the contract". The point of telling the directors is that it is all above-board.—This is not a point which I personally feel strongly on. I believe it was promoted by the experience of certain other members of the committee.

5715. If one bad case is allowed to dictate a policy which covers so many, so to speak, *bona fide* and innocent cases, it probably would not be a very good thing, I think.—*Mr. Mackay*: I suppose the main thing the committee had in mind was the small family business with a very small board of directors, and perhaps a number of shareholders who were connected with the family but did not know the directors' affairs. If the directors were very close together it might be possible for them to run the company so as to benefit the concerns in which they had an interest, unknown to the other shareholders.

Mr. Shearer: It is the private company we had mainly in mind.

5716. *Mr. Lawson*: Another type of case that has been raised is the case where

a director of a company is also a director or perhaps a partner in a firm which is responsible for some part of the management of that company, for which that firm is receiving substantial fees. One wonders whether in that kind of case, perfectly proper as it is, it is not a matter which shareholders should know about at the time when they are appointing or re-appointing that person to the board.

—That is generally what was in view, Sir. That is an instance of the sort of thing which was felt it would be better to take beyond the confines of the board room: but I appreciate immediately there is a lot to be said on the other side—that this might lead to an elaboration which would not serve any good purpose.

5717. *Chairman*: You may also have a director of a company which is responsible for letting a number of retail boot shops, and he is also a director of a company which is concerned with renting similar premises for the purpose of carrying on a retail trade in boots. Then it might be said that director had a foot in both camps and was permanently fixed in a position in which his duty and his interests conflicted?—That is so, and that is a thing which, as Mr. Lawson has suggested, shareholders might well wish to take into account when the time came to consider his continuing as director. I think it is true as far as my recollection goes that the instances cited to us by those who were anxious about this were all small private family companies, to all intents and purposes. I think that is so, is it not?

Mr. Mackay: Yes.

5718. And then you get fraud on the minority, and that kind of consideration.

—*Mr. Shearer*: The border-line sometimes would be very difficult to draw.

Mr. Mackay: I think our idea would be satisfied by any method in which intimations given to the board were accessible to the shareholder, if that could be devised.

5719. *Mr. Bingen*: Well after the transaction had been completed?—*Mr. Shearer*: Yes, we cannot contemplate holding up a transaction.

Mr. Mackay: I think we felt it was most likely to arise in continuing cases.

Mr. Lawson: I think there may be a big difference between the kind of case Mr. Scott mentioned and the type of continuing case, of which there are a great many even with public companies, in which the whole arrangement is very confidential to both sides. There is no objection, but is it not something which should be somewhere on record and which shareholders can know about if they take the trouble to go and look? I think that is the point.

Mr. Bingen: Would it meet Mr. Lawson's point if a company had to disclose in its list of directorships what other directorships those directors held?

Mr. Watson: I would not have thought that would cover this particular case. You will be aware that many plantation companies in particular, and perhaps investment trust companies, have directors who are appointed by firms who are the managing agents, secretaries, and so forth of those companies; and their remuneration is of course fixed by the directors. Should the partners of those managing agents predominate on the directorate of the company it is possible that the terms upon which the agents were engaged might not be quite satisfactory. There is no suggestion that that happens, so far as my knowledge goes; but obviously the possibility is there, and if it were made compulsory, as Mr. Bingen suggested, that other directorships should be shown, it would also be necessary to cover this point; I think partnerships would also have to be included.

Mr. Bingen: I merely threw it out as a suggestion but, of course, Indian companies deal specifically with the problem of managing agents. There are all sorts of restrictions on managing agents under recent Indian legislation.

5720. *Mr. Althaus*: If it were thought necessary to have some public declaration of directors' interests, could it be confined perhaps to such cases where the directors, after consideration, had found the interests to be material? There must be many cases where it is a very important factor and many cases where it is a negligible factor, and the directors could easily decide which were the important cases. Supposing it was thought desirable to have that, would it be a helpful

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way of approaching the problem?—*Mr. Shearer*: Yes, I suppose that would do it: it would not meet the case of the bad directorate, of course. I wonder whether there would really be much difficulty about our proposal. I do not think it would be difficult to keep a register of disclosures or make a submission to the annual meeting because after all it is merely an excerpt from each directors' meeting—just a few lines from each meeting, which would be open to inspection in the same way as a registered dealing.

Mr. Lawson: You could combine that with Mr. Althaus' point; as Mr. Brown has said there is not much point in listing a whole number of shareholdings of directors. A whole lot of information would then be included which was not material at all.

5721. *Mr. Mackinnon*: If section 199 were amended to refer to "material interests" and not "every interest", then that would fit in with what Mr. Althaus said. It would eliminate the absurdity of recording the interests of people who have a few shares in a multitude of large companies.—That is perfectly true.

5722. *Chairman*: Then the upshot is that the point is one which merits consideration, but it looks as though the scope of transactions in respect of which disclosure is now necessary under the existing Law should be reviewed to see whether their scope can be limited in any way, so as to make this piece of legislation, if it were adopted, not unnecessarily burdensome on the directors?—I would agree with you, Sir.

5723. Now the next topic is whether bodies corporate should be allowed to act as directors. The view of the Faculty is that they should not, and if I may say so, there are a good many people who sympathise with that view: but actually, as no doubt you are aware, the Act as it stands does clearly contemplate that corporate bodies should be allowed so to act—for example, section 200 (2) (b).—Yes, Sir.

5724. You would amend the Act to give effect to your view that bodies corporate should not be directors?—That is so, Sir.

5725. An exception has been suggested to us as regards directors of wholly-owned subsidiaries. Where you have a sole shareholder, or as near that as you can get, the natural thing would seem to be to allow the holding company to act as director. I do not say it is right, but that obviously has something to be said for it.—I do not think one would be entitled to object to that: that was not what we had in mind when we were objecting to the idea of a body corporate being a director—it was really the concealed and possibly uncontrollable director in the ordinary company.

5726. Yes, I follow that, I think. Then the next topic is voteless shares, a matter which has attracted a good deal of controversy in the press. You set out your views very fully and clearly, if I may say so, and the upshot of your deliberations is that in your view these shares should not be made illegal but that the position of the holder of such shares should be strengthened in certain respects, and those you set out in your memorandum. The first is one which has occurred to everybody, I think—it should be required that "all such shares be described and quoted in a manner which would expressly disclose their lack of voting rights or the fact that the voting rights attached to them are restricted". I do not think that is a view probably with which many people would quarrel. And your second one is "requiring information of all business to be discussed at meetings of the voting shareholders to be communicated, in the same manner and contemporaneously with communication to voting shareholders, to those equity shareholders who have no voting rights or whose voting rights are restricted". That would give voteless shareholders the right to receive notices of meetings and the business to be transacted throughout, though they would not be entitled to vote at the meeting?—Yes.

5727. And finally, "permitting the latter category of shareholders to attend and speak at the meetings of voting shareholders; and perhaps, in defined circumstances, empowering the less favoured equity shareholders to submit resolutions to be voted upon by the voting shareholders". So that would improve the voteless shareholders' position in

some respects without going back on the terms of their contract to the effect that they would not be allowed to vote?—That is so: there was some difference of opinion and one school of thought said, "If you buy voteless shares it is your own look-out"; and the other school, which won the day, put forward the views expressed here—that is, at least give the man more information about his company and possibly allow him to put forward his views to be voted on by those who have votes.

5728. Would you go further and suggest that on certain matters these voteless shareholders should be entitled to vote notwithstanding their contract, the matters in mind being analogous to those on which preference shareholders with restricted rights are now entitled to vote—for example, a resolution to wind up the company, that kind of thing?—The upshot of this matter was discussed and our view at the end of it, for what it is worth, is that if that were done we thought it was going a little too far. If you take the situation of a purchaser who is going to have it made quite clear to him that he is buying a non-voting share; he would be given the information and we thought that there the line should be drawn. We thought if one went into the next category where you had what one might call class rights, you would really be creating an entirely different type of share.

5729. I follow that. It is obviously a perfectly tenable position, and if the line is not to be drawn there it is difficult to see where to draw it, short of giving complete protection of class.—That is what we had in mind.

5730. *Mr. Lumsden*: May I raise one small point? If your proposals were adopted that non-voting shareholders should be entitled to attend and possibly also speak at meetings, I suppose it would follow that in order to hold a meeting at short notice you would require the consent of the non-voting shareholders entitled to attend as well as the voting shareholders whose consent alone is required at present?—Possibly with the standing proposal it would be so. It would not have been in my mind, I confess.

5731. I was envisaging the voting shareholders might be a dozen people whose consent could be obtained round the

table, and you might have a large number, perhaps five thousand non-voting "A" shareholders who would be entitled under your proposal to attend and speak. Presumably that would follow?—That would undoubtedly follow. I rather shied back from the impossibility of a true emergency meeting being held there. But in the ordinary instance certainly that would follow and I think it would have to follow, but I do not quite see how one could so define "emergency" to brush it aside.

5732. *Chairman*: Passing from that, the next matter I have noted is heading 8, protection of minorities. You go into that in some detail, but is it your view that section 210, which is the material section here, should be capable of being worked effectively if what has been called in our discussions "the winding up criterion" were repealed?—That is so, Sir, yes.

5733. If the dissatisfied shareholder could obtain relief from the Court without first having to prove that the case was one in which a winding up order might be made, then you agree his position would be greatly strengthened and the section might operate more effectively than it has at present?—I think we were very strongly of the opinion, Sir, that that would be so.

5734. Then the next one is the protection of special classes of shares. There you have raised the difficulty that clause 4 of Table A about separate class meetings does not make adequate provision as to the necessary quorum in all circumstances, with the result that a perfectly proper class modification necessary in order to put through some scheme of reduction or something of that kind is held up indefinitely. That I think is your criticism under this head, and I see no reason why it should not as a matter of legislation be satisfactorily dealt with either by modifying the form of clause 4 of Table A or by extending section 135. What is required is something in the way of an amendment to Table A under which, as in the case of a general meeting of the company, if the quorum is not present at the time fixed for holding the meeting or within a specified time thereafter, the meeting shall be adjourned for a specified period and at the adjourned meeting the members

actually present shall constitute a quorum. That really is your suggestion here, is it not?—Yes, that is so, Sir.

5735. Then there is the question which sometimes arises where you have more than one class of shares, but for some reason or another no modification clause has been put into the articles or into the memorandum. What would be your view on the suggestion that in such cases the articles of association should be deemed to contain the appropriate modification machinery, overriding the memorandum so far as is necessary?—I do not think one could object to that, Sir. I think that would be acceptable.

5736. Of course it would be technically altering rights, but it would be altering them by putting in provisions which are invariably or almost invariably contained in modern articles of association.—That is so, and I take it the purchaser who would be buying on that basis of contract would be deemed to have knowledge of that, he would not be having his purchase lessened in value necessarily.

5737. But there is the contrary argument that where there are no provisions for modification of class rights by means of separate consents or separate meetings, then the whole thing can be done by special resolution of the company without consulting the class at all. The next matter is the matter you raise under the heading of the Board of Trade powers to appoint inspectors, and there you point out, I think, a difference between section 167 (3) and 167 (4). Perhaps I had better refer to the section; I think one can begin at subsection (2):—

“(2) An inspector may examine on oath the officers and agents of the company or other body corporate in relation to its business, and may administer an oath accordingly.

“(3) If any officer or agent of the company or other body corporate refuses to produce to the inspectors any book or document which it is his duty under this section so to produce, or refuses to answer any question which is put to him by the inspectors with respect to the affairs of the company or other body corporate, as the case may be, the inspectors may certify the refusal under their hand to the Court,

and the Court may thereupon inquire into the case, and after hearing any witnesses who may be produced against or on behalf of the alleged offender and after hearing any statement which may be offered in defence, punish the offender in like manner as if he had been guilty of contempt of the Court.”

That relates to officers or agents of the company, and it is followed by subsection (4):—

“(4) If an inspector thinks it necessary for the purpose of his investigation that a person whom he has no power to examine on oath should be so examined, he may apply to the Court and the Court may if it sees fit order that person to attend and be examined on oath before it on any matter relevant to the investigation, and on any such examination—

“(a) the inspector may take part therein either personally or by solicitor or counsel;

“(b) the Court may put such questions to the person examined as the Court thinks fit;

“(c) the person examined shall answer all such questions as the Court may put or allow to be put to him, but may at his own cost employ a solicitor with or without counsel, who shall be at liberty to put to him such questions as the Court may deem just for the purpose of enabling him to explain or qualify any answers given by him.”

Your view, as I understand it, is that subsection (3) is unduly hard on the officer or agent, because it denies to him certain facilities which the other person mentioned in subsection (4) enjoys, in particular, being represented by solicitor and counsel.—That is so.

5738. The point you take in your memorandum is in relation to the examination of officers of the company as defined; there seems to be no right of the person being examined to be represented by solicitor or counsel?—Yes.

5739. You also point out that it seems that the person under examination may not refuse to answer any question on the ground that it may incriminate him.—I think that may be debatable, but I do feel it is so.

5740. Your view really is that section 167 (3) and (4) should be assimilated to a greater extent so that the rights of the accused person may be the same whether he is an officer or agent or some other person under subsection (4)?—That is so, Sir, yes.

5741. That is a matter which must be looked into obviously with some care in relation to the other germane provisions of the Act. I do not think it would be possible to form a view upon these two subsections in isolation. Those are the points you have raised upon that; but as we are discussing the Board of Trade powers of inspection, have you or the Faculty any criticism to make of the procedure and machinery for inspection and the way it has worked in practice?—No, Sir.

5742. We can pass from that, and the next matter concerns disclosure of ownership and control, with particular reference to nominee shareholders and directors. As to nominee shareholders, you are in favour of disclosure, are you not?—Yes.

5743. If I may use the term, you are whole hog supporters of disclosure and would favour a register setting out the beneficial owners; or do you not go quite so far as that?—Yes, I think we are whole hog on this matter.

5744. The difficulty is that anything in the nature of a register of beneficial interest would, one is told and one can well understand, involve a very great deal of work. The amount of work that would have to be done as regards the current position, let alone the pre-existing position, would be likely to be enormous; and supposing that was considered a ground for not accepting your whole hog view, various other suggestions of a less extreme character have been made, and I do not know whether you would care to give your views upon some of them. The first I would mention is that the registered holder must disclose whether he holds as beneficial owner or not. The next one is that the beneficial owner of more than, say, 10 per cent. of the equity should be placed under an obligation to disclose, the onus would be on him. Then it has been suggested that the directors should have power to require any shareholder to

disclose the identity of any person other than himself who is beneficially interested in any of the shares he holds. That empowers the directors to call for a statement of beneficial interest if they think the circumstances of a particular case warrant that course. As an alternative to that it is suggested that the directors should have power to require the Board of Trade to investigate under the existing machinery, *mutatis mutandis*, the beneficial ownership of any shares which they have reason to suspect to be beneficially owned by any person other than the registered holder. That differs from the previous suggestion in that it would be for the Board of Trade and not for the directors to carry out the investigation. And it also differs from the existing provisions of the Act about an investigation of the ownership of shares, in that the Board of Trade could be set in motion at the instance of the board of directors instead of by a resolution of the company which is made necessary at present. I do not know if you have any views upon the first one, which I might recapitulate as placing an obligation on the registered holder to say whether he holds as beneficial owner or not.—One would certainly accept that, Sir, because that is the first step.

5745. What would you say to the suggestion that the beneficial owner of more than 10 per cent. of the equity must disclose? That puts it on his own conscience to do it whether anybody tells him to do so or not.—I could not object to that, Sir. It is again a step in the direction in which we wish to turn.

5746. And as regards the others, a discretionary power on the directors to demand information themselves or to set the Board of Trade in motion.—I would accept that, Sir.

5747. Which would you like to have if you could have some only of these rather lame alternatives?—I would certainly like the disclosure of the fact whether a person is the beneficial owner. I should like all three, but if I cannot get all three I would certainly wish for the first one, and possibly the last, the power of the directors to institute an inquiry through the Board of Trade.

Mr. Bingen: The first one would not take you very far, it would simply tell

you that the registered holder was a nominee.

Chairman: It might tell the directors that there was a situation building up which meant that the time would shortly be ripe, if indeed it was not already ripe, for them or the Board of Trade at their instigation to investigate.

5748. *Mr. Lawson:* What is the real reason behind your suggestion? Why is it that fundamentally you think it is necessary that beneficial interests should be disclosed?—I think our last sentence rather tried to put it, I am afraid, rather vaguely. It again is within the conception which I understand the Faculty holds, possibly an old-fashioned one nowadays, that we think a person who is going to invest or has invested or who thinks of increasing his investment should be in a position, by looking at the documents of the company, to have some clear idea of those with whom he is associating and of those who control the company in which he is a shareholder. What we do feel is that the tendency nowadays in very many companies is that the ordinary person who comes along just has not the slightest idea.

5749. *Mr. Bingen:* Does it help him to know, provided the management is good and the record is good, who his fellow-shareholders are?—That is perfectly true. I suppose in one view of it, if he is relying on a management in year 1 he might have a better idea, if he knew whom his fellows really were, whether that management would still be there in year 2. But the whole thing is fraught with difficulties, I appreciate. We instance the *Meyer* case, a rather outstanding and again possibly peculiar case. But we do feel that the modern tendencies are necessarily, I think, to cloak true holding. Would you agree, Mr. Mackay?

Mr. Mackay: Yes. We felt that the provisions with regard to the Seventh Schedule of the 1948 Act with regard to exempt private companies were good provisions and should be extended so far as practicable, although I should say we appreciate there are great practical difficulties. But we do feel it is in the interests of the shareholders generally to know who their fellows are, because if a situation developed where even although

the management had been good, questions were arising about it, it might be very much easier for a shareholder to decide what was wrong with the management or whether it was wrong if he knew who was in control.

Mr. Shearer: As Mr. Mackay says, we instance the Seventh Schedule as showing the sort of things one would not require notice of, normal dealings, security dealings, death, incapacity, these sort of things listed there in relation to the exempt company.

5750. *Mr. Althaus:* Your point is that this is in the interests of the shareholders; many of these proposed changes are put to us, I think, on the basis that they are helpful to the directorate of the company. —That is so; this is a shareholders' point, I would put it that way.

5751. *Mr. Brown:* Is it implicit in your view on this that you would object in principle to the return of bearer shares? —I suppose it must be so.

5752. And the growing practice of American deposit receipts?—I suppose it must be so. May I say this, if you will permit me before we pass from that? We are certainly concerned; we have been talking so far I think about the shareholder's point of view, from the point of view of the nominee shareholder; but the nominee director is a thing which did concern us even more. Of course we know there is provision under section 195 for certain disclosures by directors of the nature and extent of their rights in the shares they hold, but we would like to see a compulsitor on that—at the moment there is not a compulsitor. We think the fact that a director is a nominee of another person or body should be known.

5753. *Chairman:* That would be a matter for inclusion in the register of directors?—Yes; we do feel that a nominee director should disclose his principal and that information should be given to shareholders and should be disclosed when there is an election or co-option.

5754. *Mr. Lumsden:* How would you define a nominee director? It is a clear case where, under the articles, a particular body has power to appoint directors, they are obviously nominee directors; but

from your memorandum I gather you envisage this as being someone in fact elected by the shareholders in the ordinary way. How would you define such a nominee director?—We merely used the phrase used in the questionnaire put to us. But what I envisaged was that you have a man who holds his qualifying shares, whatever they may be, 500 perhaps, and he is put up for election and elected to the board; what we had in view was that that man is holding his 500 shares as agent or to the dictation of somebody else.

5755. That is purely as regards his qualification shares, it is not the fact that he represents a particular interest that you are getting at?—I see you are taking me one step further. I had not split these in my mind; I should not have thought that they would have split.

5756. If I may put it this way; it is now becoming the practice in public companies to have no share qualification. Where they have no share qualification can you have a nominee director within the meaning you ascribe to it?—In an instance of that kind you still could have. I appreciate the case where a man does not need to hold shares at all and he becomes a director. But if that man is merely the mouthpiece of someone else, who is not a member of the company, to my mind he is a nominee. 'Nominee' may be an unfortunate word, but it is plain what we are trying to get at. We want those who elect the board to know if any director is acting not wholeheartedly in the interests of the company and not independently in the interests of the company, but on behalf of someone else, or to the dictation of someone else.

5757. *Mr. Bingen:* If I may put the question differently; you get a nominee director where, for instance, you have got two groups, A and B, which control the company and each appoints half the board—perhaps it is laid down by the articles, perhaps it is by agreement, but it is known; it is probably a private company. Occasionally they represent the debenture holders, that is one case, and then I think you have got Government representatives on the board of British Petroleum. Beyond that I cannot conceive of any cases in which directors are not really in the first place nominated

by the existing board and then their appointments are confirmed in the ordinary way at the next annual general meeting of the shareholders. I am a little exercised in my mind to know where this problem arises.—I think, and I speak subject to what his Lordship may say on this matter, that this has been largely prompted by reading what was said by the House of Lords in the *Meyer* case which we instance. I speak with diffidence, but I think in our reading of it it indicates that the duties of directors in interlocked companies may extend very much further than possibly was at one time thought, before this case was discussed in the House of Lords, in regard to their disclosure of interests in one company to another, and the ambit of their duties towards their various companies. That prompts the reflection that it would be right, rather than to leave that to what one might call current Law, to try and have some method whereby the interests of directors should be disclosed. I am afraid that is putting it rather badly. It is this word 'nominee' which is a difficult one to get over. How would you put it, Mr. Mackay?

Mr. Mackay: I think our basic idea was that a 'nominee director' was a person who becomes a director of a company and is amenable in his capacity as director of that company to some form of external control, either because he holds that position having been nominated by someone outside that company and has relations with that person which might be enforceable in law, or is in some situation of that kind.

Chairman: You may get the common case of a reconstruction where the debenture holders stipulate that they shall have a director on the board, and of course the whole purpose of that is that he should watch over the interests of the debenture holders, although there might be no agreement in writing between him and his principals on anything beyond the terms of the reconstruction scheme.

5758. *Mr. Althaus:* Really your point is that certain people are candidates for the board of a company who would not be candidates but for the existence somewhere else of a large interest. It is those kind of people you are trying to

bring under control?—I think that is putting it very fairly.

5759. *Mr. Bingen*: In the sense of publicly stating what they are?—Yes.

Chairman: There is this point; section 200 (9) (a) of the Act reads:

“a person in accordance with whose directions or instructions the directors of a company are accustomed to act shall be deemed to be a director and officer of the company.”.

So you get the curious position that the nominee and his nominator will both be directors. I do not know what flows from that, but it seems to have a curious result.

Mr. Mackinnon: Section 195 (10) (a) picks this up as well; it uses the same definition.

5760. *Mr. Lumsden*: Both refer to “any person in accordance with whose directions or instructions the directors of the company . . .”. That is surely the whole body of directors and not an individual director?—This might be used to give a definition of a nominee director, when applied to the individual director.

Mr. Shearer: Section 195 (3) does suggest that it was envisaged that a director could indicate his interest or right in any shares, but leaves it entirely to him to do so, as I read it.

Mr. Althaus: That is only in relation to shares in his own name.

5761. *Chairman*: Might we pass from that topic. The next point concerns the professional qualifications required of an auditor under section 161 (1) in special reference to the exempt private company. Your view, as I understand it, is that the auditor who audits the accounts of an exempt private company ought to be just as well qualified as the auditor of the accounts of any other company, so that you would remove the existing privilege in this respect of exempt private companies?—Yes.

5762. I do not know if you are prepared to deal with this, but would you be able to express any view on behalf of the Faculty as to the desirability or otherwise of continuing the special status of exempt private company—the main matter at issue

being the obligation to file accounts from which they are relieved under section 129?

—I do not think, Sir, I can express a Faculty view on that. I gather there is some difference of opinion on that matter.

5763. Are you prepared to give your own personal views—I am sure we would value them?—I think I would ask permission to leave that one.

5764. *Mr. Lumsden*: I would like to ask about the very last point in your memorandum, which I want to ventilate because it is one of the few points where the Law of Scotland is different, and that is this point on section 32 (4) on the execution of deeds. You suggest that in 32 (4) the words “in accordance with the provisions of this Act” should be omitted and it should read that “a deed to which a company is a party shall be held to be valid according to the Law of Scotland on behalf of the company if it is sealed with the common seal and subscribed by two directors or a director and secretary and the witnesses shall not be required.”. I am just wondering if that would lead to difficulties, and I confess I have considerable doubt in my own mind as to the meaning of the word “deed”; but, for instance, could a share certificate be held to be a deed? You know this new practice now of permitting an issue of share certificates under seal without any signatures. If we omit these words “if it is executed in accordance with the provisions of this Act”, which would authorise the articles to say that a share certificate need not be signed, are we going to run into difficulties in cases of that kind?—The case which we draw attention to, I think I am right in saying, was in fact a share certificate case, and a share certificate would in Scotland be looked on as a deed. What we were really after here was clarity. We do not care as conveyancers how it is dealt with so long as the matter is made more clear; it is purely for clarification. The clarification which suggested itself to us was to restrict it to the seal with the director and secretary or two directors; but we have no strong views on that whatsoever, so long as there could be some clear definition.

5765. Instead of the words “executed in accordance with the provisions of this Act” one might put in “executed in accordance with the provisions in the

memorandum and articles of association of the company."—We were rather against, as we indicate, the idea of any company adopting its own method of authenticating deeds. That, in one view of it, means you have a limitless number of ways of so doing, and in any given transaction you might never quite know whether you were dealing with a formally executed deed or not without, of course, reference to the articles. But again I repeat it is purely for clarification and nothing else. We are not otherwise critical of it and I do not care what formula is adopted, subject to this, that we are rather against the idea of any company selecting its own method of authenticating formal documents.

5766. *Mr. Lawson:* A rather difficult situation occasionally arises with interlocking shareholdings. If company A owns 30 per cent. of company B and company B owns 30 per cent. of company A and the other shares are fairly widely distributed, you can get into a situation when it is almost impossible for shareholders to control the board of either company. I do not know if you have come across that; it does occasionally arise. Have you any views on that as to how it would be possible to meet that situation?—No, frankly, I have not, I am sorry.

5767. The other question I wanted to ask is about your comment about accounts:

"While it is no part of an auditor's duty to conduct a detailed valuation of a company's assets it is desirable that auditors should be made aware that their duty to state the true financial position of a company extends to cases not only of over-valuation but of under-valuation." I suppose that since the 1948 Act, it has been equally important not to understate the profits as not to overstate them, and of course the same applies with regard to current assets, you should not understate current assets nor overstate liabilities; that is already clear, is it not?—Yes.

5768. I think what you are referring to here is the much more difficult subject of fixed assets, broadly the assets which are not for sale but are used in the business, and those assets of course, not being for sale, it is not customary as a rule to show

their value in a balance sheet. Is there any particular merit in telling shareholders that a thing would have a value today of £x if it were for sale, knowing full well you have no intention whatever of selling? That is one difficulty. The other difficulty is to assess a value, which is a thing that may change from day to day.—As I think we indicate, we do realise that the precise duty or responsibility of an auditor in that situation is an extremely difficult question. But I think we all know now that the fixed assets which in one view the company does not intend to sell may be precisely the bait which may make the company such an attraction in the market. What we felt was that since the shareholder should have the true financial position of the company before him, that would be affected by the valuation of the fixed assets as well as by the valuation of current assets, profits, stock-in-trade, and so on. I do not pretend for a second that that is an easy matter, and I do not know how far it trenches or extends the present duty of auditors.

5769. A great many assets are so tied up with the business that it is impossible to value them apart from the profit-earning capacity of the business. That is, I suppose, true of the majority. I take it the kind of case you have in mind is perhaps the more exceptional case, perhaps a very valuable freehold of some sort, which is perhaps property that is being used for one purpose but which, if used for another, would make that a very much more valuable property. Is it that type of case?—It is that type of case. With respect I would not look upon that as a very exceptional case.

5770. But it is confined broadly to certain classes of business. We have had evidence on it and it is surprising how often examples of public houses crop up. It is fairly common in certain specific trades.—Undoubtedly in some trades rather than others.

5771. Do you think the position would be met if it were practicable to require companies to give more information about these properties rather than a valuation? Supposing you have property of that kind and get a valuation; the valuer probably says it is worth £x if you can get planning permission to do this, that and the other thing, and it is only worth £y if you cannot.

Then after he has given a valuation on one basis, next year perhaps there has been some different planning arrangement so that the value gets altered. It is pretty tricky. You would not think the onus should be on the board of directors and not on the auditors? It is difficult for an auditor to put a value on such assets is it not?—The matter might well be met by information, but what we had in mind was, I repeat, an effort to give the shareholder as far as is possible a true picture. That was really all that was behind it. Here we have settled it on the auditor up to a point, which I personally rather suspect is going too far from the point of view of the unfortunate auditor. But I am sure one would willingly accept any other method whereby possibly more information was given than in some cases is given, and I do not think it is in exceptional cases.

5772. *Mr. Watson*: What would be the object? Is this to prevent an existing shareholder selling his shares at a price and then finding they would have been worth very much more if he had kept them?—That is an illustration, Sir, of what we had in mind. We merely had in view the generality that a man should be in a position, looking at the audited accounts, to form some idea of what his shares are really worth.

5773. *Mr. Bingen*: Based largely on the asset value rather than the profit earned?—But in some cases, as we all know, we find the asset value becomes a matter of importance.

5774. *Mr. Scott*: If you were to take a steel company where its big fixed assets are steelworks, the only basis of valuation really must be what in fact they will bring in in the way of revenue to a steel-making company. They could possibly be sold at site value, if the company ceased to carry on business and they were in an area zoned for another purpose at a considerable profit. Similarly a big West End store having a large shop might be able to sell its premises at substantially more than they appear in the company's balance sheet. But, as Mr. Lawson has said, this is a case in which there would be no intention of selling, and even if it did sell, unless it went into liquidation, the company would have the obligation

of finding some other premises. The question is whether, if you are setting out the valuation on this basis, you can have any other basis of valuation than that which in fact shows the return which those assets produce when they are operating in the business. A chain of public houses, for example, might appear in the company's balance sheet at, say, £5 million, and the valuer might go round in any one year and say they are worth £10 million, but that probably only means collectively worth that if they are sold. So far as the company is concerned they do not bring in any more revenue. It is a question of whether the shareholder would not get a more misleading impression from being told they were worth £10 million than having the historical cost and assessing himself what they were worth in view of the profits they earned.—Yes, I entirely appreciate that, Sir. That is the battle between historical costs and the only other method of approaching it. I do not pretend it is not fraught with difficulties. It is merely an attempt to try to get more information, but I take that point perfectly, that in any given case you might find it misleading. What we had in mind is the case you get possibly in small companies fairly frequently, where you have a balance sheet in which fixed assets appear plainly on any accountancy basis at a ridiculous figure, and we do not really think an auditor should just pass that.

5775. *Mr. Lawson*: On the present understanding it is not really the purpose of a balance sheet to show a statement of value. You could argue, I suppose, that it should be, but I do not think any accountant would agree that is really the purpose of a balance sheet, because you have to look at the business as a whole, and in particular its earning capacity and the way it is using its assets. You do not contemplate in making a balance sheet that the company will be liquidated or that its business will be transformed into something entirely different.—Of course I readily accept that from you, but I must say from one's personal experience of fairly heavy litigation, one finds in fact that the reverse happens; when a sale does take place then there is a row by the shareholders. There was this recent case dealing with a shipyard in which the point at issue very largely turned upon the value

of the fixed assets, the question of historical costs and the rest was thrashed out in lengthy detail, and the only people who suffered as far as I could make out were the shareholders, who had never known the potential value of their shares. That is the sort of thing one has in mind.

5776. *Mr. Brown*: If it were felt that information should be provided, should not any obligation be put on the company and the directors? If the information is not given by the company or the directors why do you think it proper to imply that the auditor is responsible, who cannot have as much information as the directors about the value of the property?—I appreciate that. What we had indicated was the watchdog and bloodhound definition of what an auditor's duties are. I think it would be fairer to put the obligation on the board, as it has been suggested, if it were thought that this was a proper solution.

Mr. Mackay: I think our view basically was that it was only in a very extreme case that the auditors would require to do anything very much about it, but it might be as well if the auditors should realise that in extreme cases of undervaluation of fixed assets there might be some duty on them to bring that fact to the attention of the shareholders.

5777. *Mr. Lawson*: There is one example which has been brought to our attention by a number of witnesses which could be dealt with in one way or another, that is the case of investments in an associated company, where at present very little information is given, and the accounts of the holding company will show only the dividend which comes in from that investment, which may in the extreme case be only quite a small part of the profits of that company, while much larger profits are building up. That kind of case might be dealt with much more easily by giving a picture of the earnings of trading investments. It is the kind of property which has a value in itself but which nobody has any intention of selling.—Yes.

5778. *Mr. Bingen*: With regard to take-over bids there was a suggestion made recently whether some proportion of the consideration should be paid in cash

rather than in shares of the offeror company. Have you considered that at all, and do you see any merit in a proposal of that kind?—That was discussed, I regret to say, in no great detail. I could not give a Faculty view on the merit of that.

5779. If you were paying for a company by issuing shares, presumably those shares would be marketable investments; and could you not attain the same result by making a rights issue to your own shareholders and with the cash resulting from it pay cash? It comes to the same thing in the end.—Off the cuff I would not feel strongly about it at all.

5780. The only other question I would like to ask arises on paragraph 20 of the Faculty's memorandum, and that is the question of the possible purchase by a company of its own shares. You say in your paper that that is open to abuse and even if limited to the use of reserve funds for such a purpose could be fraught with danger to the financial stability of the company. We know that, except in the case of a reduction of capital sanctioned by the Court, you cannot tamper with the capital account of a company in that way in this country, but we have had some evidence from American lawyers who came before this Committee that the practice was in their view a beneficial one and that American companies regularly purchased their own stock on the market for two main purposes: (1) to issue shares to employees in pursuance of bonus plans and (2) to use them for the issue of new capital to purchase other companies on occasion. They thought it was a convenient arrangement. Would you like to comment on that and also to say why you consider it open to abuse and dangerous to the financial stability of the company?—I suppose the two American usages which you have suggested do not in effect reduce capital at all; they merely put it into different hands. Am I right?

5781. They put it into the company's treasury for the time being; it may be re-issued later on or it may be purchased for cancellation.—I can only say the Faculty view would be against any reduction by purchase purely in accordance with long-established law. The general approach of the lawyer to it, as I understand it, is that the person dealing with a

company is entitled to rely on the capital outstanding unless proper application is made to reduce it. Insofar as the criticism made by the Faculty of possible abuse is concerned, I do not quite recall what point was in mind there.

Mr. Mackay: I think the idea was that the shares purchased by the company would be then in the control of the directors and if they carried ordinary voting rights the directors would thereby increase their voting power, and that, I think, is the reason that we suggest in the next paragraph that in certain limited cases, where its own shares are held in trust for a company, they should carry neither vote nor right to dividend. There were these two aspects in mind, the aspect of financial stability and the aspect of voting control.

5782. You would not necessarily take the same view if shares purchased by directors with the company's funds were held in the company's treasury for the time being and while in the treasury had no voting rights?—So far as abuse is concerned, that might certainly disappear; the financial stability question might still remain.

5783. *Mr. Lawson:* Do you think they should be bought *pro rata* from shareholders, or would you not think there might be some abuse if the company was entitled to buy shares in the market or buy the shares from one particular shareholder without asking for them *pro rata*?—*Mr. Shearer:* I suppose that could arise if the company's funds were devoted to one shareholder or group of shareholders, it might anticipate the market and deplete the company's funds against a false market value.

5784. *Mr. Althaus:* Would not abuse arise if purchases were made for the effect of hoisting the price?—Indeed that is also quite true.

Mr. Althaus: I do not think it is a point which has been raised. But purchases might be made to hoist the price for a special purpose, for the directors personally or to enable somebody to create a fictitious value.

Mr. Bingen: The evidence from our American friends did not show that that had happened at all.

Mr. Althaus: I accept that. Nevertheless, we have to legislate for the less virtuous as well as the virtuous, and it could happen unless you had safeguards.

5785. *Mr. Mackinnon:* I would like to go back to the *ultra vires* point. You say the *ultra vires* rule should not operate against third parties acting in good faith. What troubles me is that this sort of approach would involve the Court in awkward decisions about *bona fides*. May I put an example and see how you would envisage it being tackled? Supposing one large company is negotiating with another large company a very large deal in a particular field of industry. Would it be in your view *bona fide* in that case if the directors of neither company looked at the other's memorandum?—I think that would be inexcusable ignorance. I am not quite clear whether that is covered by the phrase *bona fide* or not, but I think it would not be in good faith in the sense which we would use the term. I think inexcusable ignorance is a phrase used which I think would not qualify for good faith.

5786. The difficulty then, if you have the rule you are suggesting, is that, except in what you might term day-to-day dealings of the type that arose in *Jon Beauforte*, it does bring back the *ultra vires* rule through the back door, does it not?—That is true, yes. Subject to this, I suppose, that whenever you turn to *bona fides*, immediately are you not getting into the realm of fact? Everything would have to be looked at and the ultimate test in any given situation might come back to that.

5787. You would agree perhaps that, faced with that situation, you would normally advise your clients to have a look at the memorandum?—Undoubtedly.

5788. Except when they were making ordinary day-to-day contracts?—Yes.

5789. The other question I wanted to ask is on paragraph 26 (d):

"We consider that any trust, whose vote can be controlled by the directors in their capacity as such, should not be permitted to vote in respect of any shares in the company or any subsidiary held by such trust."

I was wondering what precisely you had in mind by the phrase "in their capacity as such".—That is as directors; that is badly expressed. What we really had in mind is in the case of a pension fund, welfare fund, that kind of thing, where the trustees were the directors for the time being of the company.

5790. *Mr. Bingen*: So you would dis-enfranchise those shares?—If they were director controlled, yes.

5791. *Mr. Scott*: I am sorry to return again to *ultra vires*. I think you recommend that so far as the third party is concerned the doctrine should be abolished.—Yes.

5792. As Mr. Mackinnon has said, if the third party is to be affected by what is contained in the memorandum of association, you inevitably bring back the doctrine.—I think that must be so, subject to the test of *bona fides*.

5793. Yes. I do not think when the Cohen Committee made their recommendation that they made any exception for *bona fides*. I think they just thought the third party should be entitled to deal with the company on the basis that it had complete power to do anything. I wonder whether you would see any objection to a law providing that the memorandum of association could specify certain things beyond which the directors could not go without the authority of the shareholders, but that there would be an express power that no third party, whether himself a shareholder or not, would be in any way affected by or concerned with any restriction in the memorandum? If that was spelt out as part of the law would you see any objection to that?—No; I see no objection to it at all.

5794. The question of *bona fides* then would not arise. He might have seen the memorandum or might not have seen it.—That is quite true. Our recommendation as it stands is of course the same as that in the Cohen Report.

5795. The first part is, but I think the introduction of *bona fides* goes back on that.—*Mr. Mackay*: I do not think that is intended, whatever may appear from the face of the memorandum. I think the first paragraph is really intended to define our view with regard to third parties, and

what follows is intended as a corollary—if that is adopted, something that must be done. What follows after the first paragraph is intended to replace the existing system in the event of the first recommendation being accepted.

Mr. Shearer: My reference to good faith was really prompted by what Lord Jenkins put to me at the outset, where he suggested you might temper the flat rule by putting cases at the disposal of the Court, one might appeal to the Court and say, "I am technically wrong, I have lost my way; I have come across an *ultra vires* provision but I wish dispensing power." That was what really prompted it. But our opening paragraph expresses the Faculty position, that is, abolish the rule altogether.

5796. If the Court had a validating power and had to rely on it, we might get back to the same position we are in today; in order to avoid having to go to the Court the draftsmen might construct their imaginative clauses giving all sorts of powers.—That I should have thought was a danger.

5797. I have one question on a company buying its own shares. As Mr. Bingen said, the American witnesses were rather surprised at the view taken by the British Courts on the question of a company not being allowed to buy its own shares, and they never have any trouble. They made it clear that any such purchases could only be made out of surplus, and while it is true it could be open to abuse, I do not think they thought the purchase of shares any more likely to be open to abuse than any other thing a director might do in running a company's day-to-day affairs. It could have advantages, particularly in the case of a private company where, say, it is desired to buy out a deceased's interest; both the continuing shareholders want to do it and the executors want to be bought out; but the continuing members have not got the funds themselves to do it. It would be quite convenient if the company's funds could be used to an extent to buy out that interest out of surplus for the benefit of both parties, provided the capital were not thereby reduced. Would you see any objection to that? It would be rather like a partnership where on a retirement the partnership assets are available to buy out

a deceased partner's shares; a private company frequently is virtually a partnership.—I do not think we would object to that; it does not involve reduction, one keeps the shares alive—or are you suggesting a reduction?

5798. I would go further and say you ought in such a case to be able to cancel the shares, provided that you have not reduced the amount originally available as stated share capital—in other words, the purchase was only made out of surplus. Would you see any objection to that, even if it did involve cancelling shares? I think that is almost a secondary consideration.—I wonder if you could make it a little more concrete.

5799. The remaining capital would continue as the share capital of the company and the shares that you had bought from the deceased member would be treasury shares, kept as unissued available for issue in the future. The point would be that the company would have applied its own funds in buying its own shares, which at present of course it cannot do.—I can only answer by saying that the Faculty view would be against that, even in the instance which you put forward.

5800. *Mr. Lawson:* Is not the position this, that the real difficulty which arises in the kind of case Mr. Scott has in mind arises from the surtax position, not from the Companies Act. If it were not for the possibility of surtax assessment you could achieve the same result either by distributing your profits or by going into liquidation and winding up. If Mr. Scott's suggestion were adopted you would automatically certainly get a surtax assessment on the company, I should have thought, which would do away with the advantages.—I think that would be correct.

Mr. Scott: The assets could be sold to produce the cash to do it.

Mr. Lawson: The whole reason why the Inland Revenue do not assess private companies for surtax is that those profits are retained in the business and are needed for the purposes of the business.

The more you advance the argument that they are not needed in the business or that money can be provided to use those profits for another purpose, I should have thought you were bound to affect that view and attract the attention of the Inland Revenue.

Mr. Scott: That is one of the factors to take into account, but to suggest that the Companies Act should not be amended because of the surtax implications is not quite the answer we are looking for.

Mr. Lawson: The point I am trying to make is this. Could you not achieve the same result by winding up the old company and forming a new one?

Mr. Mackinnon: There is some point in retaining continuity. Take a small company where surtax would not enter into the picture at all; in that type of company it would be a real facility in that case.

Mr. Lawson: What I am really afraid of is whether this type of change in the company could not bring about corresponding adverse changes in the tax position; we would then re-open the whole question of surtax assessment.

Mr. Scott: I am not suggesting it would have to be done, but that companies might be given the facility to buy their own shares.

5801. *Chairman:* We seem to have come to the end of our questions, and it only remains for me to thank you once again for coming here this afternoon and being so helpful.—May I have your permission to draw attention to one small point. Our comments under paragraph 28 (1) of our memorandum are no longer valid; it was a request for clarification, and on the same day almost when this report was lodged the Law Reform Committee announced that they were investigating the question of security and moveables. The fact is the Faculty have expressed no objection whatsoever to a change in that Law; the only point was that assuming the Law of Scotland stood, we wished to clarify that point.

(The witnesses withdrew)

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
SEVENTEENTH DAY

Friday, 3rd March, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. J. SUTHERLAND, MR. W. A. COOK, MR. G. K. V. CLARKE and MR. R. B. LAURIE
called and examined

5802. *Chairman*: Good morning, Gentlemen. We are very much obliged to you for coming here to help us this morning and also for the useful memorandum which you have submitted for our assistance. Mr. Sutherland, you are a member of the Council of the Law Society of Scotland and convener of its Company Law Committee; Mr. Cook is vice-president of the Law Society of Scotland; Mr. Clarke is Writer to the Signet and a member of the Society's company law committee; and Mr. R. B. Laurie is Secretary of the Law Society?—*Mr. Sutherland*: That is so.

5803. If we might now refer to some of the points you make in your memorandum. The first one is to the effect that where a private company is the wholly-owned subsidiary of another company, one member should be sufficient as distinct from the two ordinarily required in the case of private companies. That is the suggestion you make, as I understand it. You would not go further and say that one man could incorporate a company in any circumstances, or would you go as far as that?—*Mr. Cook*: We felt that people had become accustomed to two members and it had worked quite well,

and the only circumstances in which there was a case for not having two members was the one you have indicated, where it was rather unreal to have two, involving somebody holding shares as a nominee.

5804. It has been suggested in some quarters that while it may be right to allow a wholly-owned subsidiary to have only one member, the relationship is so close and would involve such identity between the sole shareholder and the company that it would be reasonable to say that while that state of affairs subsisted the holding company should be liable without limit for the debts of the subsidiary. If you are not prepared to deal with that we will pass on, but it has been a suggestion that has been made, and from the logical point of view there is perhaps something to be said for it.—I can see the force of that, but it is not a point which we have previously considered.

5805. Then we can pass from that. The next point you take concerns what is known as the ready-made company. You think the ready-made company is an abuse and should be put a stop to?—I think we ought to say we have perhaps

got a professional interest here and it is possibly difficult to know how far that may have influenced our views on this question. But that in fact is our view, and I think our justification for it is that we do not think it is desirable that people should form a business into a company merely in response to an advertisement indicating that they can do it cheaply; and it is desirable before they do that that they should take proper professional advice, and also that the constitution of the company should be tailored to fit their requirements.

5806. On the other hand it is suggested that this provides a useful service.—There is no doubt it is cheaper and that is an advantage to certain people, one cannot deny that; but that has got to be weighed up against the fact that there is a prospect of people forming a business into a company when, if they took proper advice, they would continue to run it as a partnership or an individual proprietor.

5807. You get the company registration agent who knows his way round the company registration procedure but perhaps is not so very much good as a lawyer, and probably no draftsman of anything special in the way of articles of association. That is the kind of objection?—Yes, together with the objection that advice ought to be taken as to whether a company is desirable at all.

5808. The abuse, if one can call it such, without prejudice, is perhaps analogous to the practice of keeping in type ready-made wills which people can buy and fill in for themselves, so avoiding legal charges. It is that type of thing?—Yes.

5809. One might add that the congestion on the Registrar of Companies file is *pro tanto* increased by these ready-made companies, and that administrative reason might possibly be an additional one for scrutinising them with some care?—I agree, but I think that is not so much a matter for us.

5810. That is a secondary matter; if it is a legitimate proceeding the Registrar must cope with it as best he can?—Yes.

5811. *Professor Gower*: Your English opposite numbers have suggested that

solicitors have at times found it convenient to be able to go and buy a ready-made company when they wanted to form one rapidly and there was not time to go through the normal procedure.—I can only say we never do.

Mr. Clarke: I think during the printing strike that was so; there was a convenience then but not in normal circumstances.

Mr. Scott: Is it not sometimes the fact that solicitors themselves offer these companies for sale; there is one advertised in *The Times* today.

5812. *Chairman*: You can sell them on all sorts of grounds; one is that they have never made a profit during the whole of their career. Your suggestion to remedy this is really to require the Registrar to scrutinise more strictly the real objects for which the company is incorporated?—*Mr. Cook*: It was to require a statutory declaration to the effect that the subscribers were associated for the purposes set out in the memorandum.

5813. That there was a *bona fide* intention to pursue those objects—that kind of thing?—Yes.

5814. *Professor Gower*: Such a requirement would surely interfere with the normal way in which solicitors do it, by their clerks?—If that were adopted I think the practice of clerks in solicitors' offices signing memoranda would have to cease.

Professor Gower: And probably that would be a very good thing.

5815. *Mr. Lumsden*: It would also interfere with the registration of a company purely to protect a name. Where, for instance, a company with a certain name is going out of existence in an amalgamation, it is quite common to form a company with a nominal capital under the same name to prevent anybody else using it.—It depends on the memorandum, I suppose—I do not know whether you can put that as an object.

5816. *Chairman*: I do not know if we can carry that very much further. Allied to it is the question of the ease of incorporation. As you point out, the privilege of incorporation can at present be obtained by a company with a share capital,

however small, and your suggested remedy is that there should be a requirement that no company could be incorporated without a capital paid up in cash of at least £100. The difficulty I feel about that is that there is something arbitrary about it. £100 might be derisory in one case and more than sufficient in another?—Yes, of course it is arbitrary, but that suggestion was partly also directed to this question of the registration of ready-made companies, and it was suggested to us by what I believe is the practice in Germany, Switzerland, France and certain States in the United States, where there is a requirement for a minimum subscription in cash when a company is incorporated.

5817. We had some witnesses from the United States the other day, and the effect of their evidence was, I think, that this expedient of having a minimum capital was not in their experience very satisfactory. It could be got over in one way or another, and I do not think they thought it served any very useful purpose.—Perhaps we did not know enough about it, but I have indicated the reasons which induced us to put forward that suggestion.

5818. Another suggestion has been made that instead of a requirement that a fixed minimum sum should be paid up on incorporation, one should have something analogous to the minimum subscription clause you find in a statement in lieu of prospectus or perhaps I should say a prospectus—that is to say, some statement in a simplified form showing that after purchasing any business or property the company has sufficient working capital in order to carry on its business.—I suppose it would depend on how far they followed the requirements of the statement in lieu of prospectus; it might throw a very heavy burden on a private company.

5819. That might be beyond their capacity?—There might be considerable work. Perhaps it is not so necessary, seeing that being a private company the people putting up the money know about it, and it is not the same as asking for subscriptions from the public.

5820. Reverting to the minimum paid up capital; if it was done in the simplest way, which would be requiring signatories to the memorandum to subscribe for 100

shares each instead of one share each, that might be all right so far as it went. But if one reflects that signatories are very often nominees, would you agree that difficulties might arise?—Yes, but of course if our suggestion were adopted that there had to be a declaration that the subscribers were associated for the purposes of the memorandum, I do not think the subscribers could be nominees, they would have to be principals.

5821. I think I have your view about that. Another suggestion is that the best remedy against unsound companies is to require full disclosure in the matter of accounts. What would you say to that?—I think we later on suggest that practically all private companies should be treated as exempt, so that in view of that we would not favour the requirement of full disclosure of accounts.

5822. That would follow certainly as your view from what you say about making all private companies exempt private companies, but I was only putting to you a suggestion that has been made the other way by those who seem inclined to the view that the exempt private companies' exemption from the obligation to publish accounts ought to be done away with. You would not agree to that?—We do not agree to that.

5823. So we can pass from that point. There is one other matter; it is suggested that an annual registration fee should be imposed, no very large sum, which had to be paid by every company annually for the privilege of remaining on the register. It is suggested that if such a registration fee were instituted that would discourage the formation of companies for frivolous or undesirable reasons.—We have not considered that, but there would seem to be a case for at any rate a reasonable charge of that kind.

5824. You think that might be worth looking into?—I do personally, but that is not a point which the Society has considered at all.

5825. Then we come to the doctrine of *ultra vires* which has been giving the Committee a good deal of trouble. You are in favour of the Cohen Committee's recommendation, I think, are you not,

which would give a company, *vis-à-vis* a third party all the powers of a natural person?—Yes.

5826. I do not know how far you have gone into all the difficulties of notice which can arise with regard to the position of the third party with whom the company deals. How far can he be given absolute protection from liability where he embarks on a transaction with a company which is *ultra vires* the company?—I would say that in the absence of fraud it should not matter whether he had notice or not.

5827. If he has got notice then that is on the threshold of fraud, is it not, in a sense?—By that I meant if the directors arranged with somebody who was aware of the restriction to enter into a contract which was *ultra vires* and did that deliberately to defraud the shareholders, that is the kind of thing for which of course there should be a remedy. But I do not really see why a company should not, as regards third parties, have full power to contract, with restrictions in the memorandum to regulate the position between the members and the directors.

5828. The third party would have protection to the extent, I suppose, that he would be entitled to assume, unless he had some express notice to the contrary, that the particular transaction had been authorised by the directors acting within their powers?—Yes.

5829. *Omnia praesumuntur rite esse acta*: there would be a presumption that everything had been done in accordance with the law?—Yes.

5830. In fact the position of the third party would not greatly differ from the position of the ordinary customer when no question of fraud arises. He would be entitled to assume that the directors were duly authorised to do what they were doing?—Yes.

5831. It is a topic which one can go on discussing almost indefinitely, and it comes round in a circle. There is a case for giving the corporation all the powers of a natural person, but there certainly are difficulties as well in working out the precise implications as regards notice, and so forth, and I do not propose to elaborate further on that; if my colleagues later on

wish to add anything on this vexed question I will leave it to them to do so. The next point concerns the alteration of the company's objects, and you point out in effect that section 5 (1) only allows the memorandum to be altered with respect to the objects for certain limited purposes, which are in the lettered sub-paragraphs (a) to (g). The point you make, as I understand it, is that as often as not a company may vote in favour of an alteration to objects which is not within those lettered sub-paragraphs, but nevertheless in such case the alteration stands as valid unless proceedings have been taken to have the alteration cancelled within the period of 21 days. If I read your memorandum on this point correctly, in paragraph 12, you say that is wrong, and if the alteration made was outside the power of alteration contained in section 5 (1) then it should be capable of being upset at any distance of time and not merely within 21 days.—That is our point, yes.

5832. Logically it seems sound, but from the practical point of view might it not be productive of great difficulty and uncertainty?—Yes, it might; because I suppose it would mean that it might be necessary for someone dealing with the company to consider not only what the memorandum was but what the memorandum had been and whether it had been competently altered. That would not matter so much if the doctrine of *ultra vires* was changed.

5833. Do you not think the simplest way of change would be to simplify section 5 (1) providing that the company may by a majority alter the provisions of its memorandum with respect to objects in any manner it thinks fit?—The difficulty arises then about the minority, because the company could by a 75 per cent. majority effect any alteration in terms of the section; but there may be a case, in the interests of the minority, for preventing a fundamental alteration of the objects.

5834. I would contemplate they would still have the right of recourse to the Court—that is to say the minority would have the right of objection on the merits. But I would be against preserving a technical objection giving anyone the

right, at any distance of time, of saying that the alteration was procedurally wrong because it was not within the limited terms of section 5 (1).—I think if the minority had an opportunity to object that might meet the difficulty. But we felt that the minority ought to be protected against a fundamental alteration in the company's objects carried out by a majority, and that therefore there is something to be said for the more restricted terms of section 5, which does not allow a fundamental change.

5835. I was wondering how much value do you think there is in limiting alterations to the specific matters mentioned in (a) to (g)?—There is not much value, as long as an alteration cannot be challenged after 21 days.

5836. But that is the objection to your scheme, that it leaves things in uncertainty for an indefinite period.—Yes, I see that.

5837. *Mr. Lumsden*: Do you feel quite satisfied with the 15 per cent. which is required for the minority to object—do you feel that is a satisfactory percentage?—*Mr. Sutherland*: We were not really agreed on that when we discussed this, but there certainly was a suggestion that 15 per cent. was too high a percentage. I do not think we came to any definite conclusion on that.

5838. *Mr. Mackinnon*: Why do you feel that 21 days for objecting under section 5 is inadequate? Why do you go from giving the minority 21 days to take action to allowing them an eternity to take action? I do not quite see, if they cannot do it within 21 days, why are you suggesting they should be able to come along at any time?—*Mr. Cook*: I think the truth is we took this point because we thought there was something wrong with the section. It seemed to be illogical and unreasonable that the section should allow only a limited alteration of the objects but that it should provide that no purported alteration to the objects can be challenged after 21 days, whether within the terms of the section or not, and I am afraid we were looking at it from that point of view rather than from the practical result of it.

5839. *Professor Gower*: You are quite happy about the provisions regarding

notice—those entitled to object will of course get notice of the resolution with notice of the meeting; but it does not provide that they should get any notice that the resolution has been passed. Theoretically a debenture holder might never know whether a resolution had gone through until after the 21 days was up. Do you think this is a point of sufficient importance to require any attention?—*Mr. Sutherland*: I should think so, Sir; if objection up to 21 days to a company's alteration of its objects is to be allowed, it is only proper that anyone who wishes to dissent should have note of the fact that it has been done, because otherwise 21 days protection is completely illusory.

Professor Gower: I suppose a wise person will assume that the resolution will be passed and will be thinking of what he is going to do as soon as he gets notice of the meeting. But on the face of it it is a little strange.

Mr. Mackinnon: If he has got any sense he will consult his solicitors as soon as he receives notice of the meeting.

5840. *Chairman*: Then you refer in paragraph 14 of your memorandum to the matter of shares of no par value. You have nothing to add to your memorandum; you were in favour of the Gedge Committee's recommendations, were you?—Yes.

5841. Did you share the view of those who said that preference shares should not be included?—*Mr. Cook*: We have not really discussed this at all. The Council decided that the original memorandum which was submitted by the society to the Gedge Committee represented their views.

5842. There was a difference of view, one school of thought saw no objection to preference shares of no par value and others were less enthusiastic about it.—*Mr. Sutherland*: The Council's suggestion was that it should be confined to ordinary or equity capital and should not apply to preference shares.

5843. That was the view which prevailed in the report, I think. You thought it was out of keeping with the concept of preference shares that they should not

have a definite par value for the purpose of payment on winding up.—Yes.

5844. Then we come to the classification of companies, and one has to consider that with particular reference to the question which has been much discussed in this Committee, on which we have already touched, whether the exemption of exempt private companies from the obligation to file their accounts ought to be preserved. Your view, I understand, is that it should be preserved?—*Mr. Cook*: Preserved and extended.

5845. Your qualification for private companies, apart from numbers and restrictions on share transfers and so on, is going to extend exemption to all cases, except where a public company is beneficial owner of any of the shares?—Yes.

5846. And that would very considerably enlarge the scope of the exemption, as compared with the complicated restrictions in the definition of the exempt private company contained in the 1948 Act?—That is so, yes.

5847. May I put some views the other way so that you can deal with them? One starts with the Cohen Committee's view, which I think seems to have been strongly held, that the general rule should be that every company should file its accounts and that an exemption from that was only justified in the case of small private businesses which found themselves in competition with partnership firms and other small companies, and it was thought that disclosure in that kind of case would be productive of hardship, because it would open the door to methods of obtaining information with a view to competition and so forth?—Yes, that is so. Undoubtedly in a very large number of private companies the directors and members believe, whether there is justification for it or not, that the disclosure of their accounts may be seriously injurious to them in giving information to large companies which are competing with them.

5848. Then if they feel like that about it, they have a very simple remedy; they can remain deaf to the persuasions of the peddler of limited companies and they can stick to the old-fashioned method of

carrying on business in partnership.—Yes, but the way we look at it is this. What ought to be the test? Should there be publication of accounts even when it is not in the interests of the members, or who is it that is to be considered? We think the test ought to be what is in the interests of the members. Then when you come to a public company it is in the interests of the members that the accounts should be published, because the public are potential buyers of their shares. That does not apply in the case of a private company. If there was any real demand on the part of creditors for this information that would have to be considered. But we do not think that that is so. We think the demand for publication comes from financial journalists and economists who have their own special reasons for wanting information, but we think their point of view should be overridden by the interests of the members. So far as we can judge creditors are not really interested in the publication of accounts. We think it is most unusual for tradesmen to inspect the company's file to see the accounts, and I do not know whether the Committee has received representations from people like Chambers of Commerce and so on, who might be taken to represent the creditors, as to the desirability of the publication of accounts, but in the absence of representations that it is prejudicial to creditors, we take the view that the overriding consideration should be the interests of the members. And as in our experience in many private companies the members think it would be injurious to have to publish their accounts, therefore we think private companies should be exempt from that requirement.

5849. The opposite view starts with the principle that disclosure is a *quid pro quo* for the benefit of limited liability.—Of course that is arguable.

5850. That is an arguable point. As regards the people who are interested in disclosure, we have had some evidence from trade protection societies and so on to the effect that it would be helpful to them in their business if the accounts were filed.—That I would regard as a relevant consideration telling against our view. But our experience is that creditors

are not really interested in this and that the members are very strongly opposed to publication.

5851. Then there is what one can only call the excessive complication of the Seventh Schedule which lays down the conditions of exemption. Do you think it is desirable that the exemption, whatever it may be worth, should depend on such extraordinarily elaborate considerations?—That is a very strong argument I think in favour of the much simplified suggestion we put forward, because the Seventh Schedule, even with all its elaborations, does sometimes result in what you might call deserving companies being excluded, and there are two recent cases which have drawn attention to particular points in regard to this—the decision in the case of the Prenn settlement, which decided that unless the shares of the company form part of the estate which was settled, the exemption is lost; and a very common case is where a man dies leaving a family business, which his trustees may form into a limited company, and that presumably would not be exempt; whereas that is a kind of case which we think ought to be exempt.

5852. Is it not the fact—I am not as well up on this schedule as perhaps I ought to be—that it is in the power of any shareholder by transferring his beneficial interest in one share to an outsider to take a company outside the ambit of exemption altogether?—That is so.

5853. That is a very unsatisfactory position, surely.—Yes.

5854. *Professor Gower*: Your solution would not wholly solve that. The exemption would be lost if one member transferred his beneficial interest to a company.—If that were a public company.

Professor Gower: Only a public one, yes.

5855. *Mr. Lawson*: Would it help to meet the point at all if only the balance sheet had to be filed and not the profit and loss account? Competitors would not get a great deal of help from the balance sheet; on the other hand it would be a help to the creditors.—If the

balance sheet were published every year it would give them perhaps the material figures of the profit and loss account, comparing one balance sheet with the next one.

5856. *Mr. Watson*: It would not disclose the remuneration paid to the directors?—That is so.

5857. And it appears there is some importance attached to publicity on that. Could I ask another question? How would you propose to deal with private companies that advertise for deposits from the public? Do you want to keep them exempt?—No, I think they should be treated as public companies. I was not aware until recently that that was possible. But I did see recently that apparently it is possible for private companies to do so. I do not think they should be allowed to do so.

5858. Have you as a Society considered that?—No.

5859. It is your personal view that they should lose their private status in these circumstances?—Yes.

Mr. Sutherland: We wish to amend the suggestion about the private company losing its exemption if a public company is a beneficial owner because it is of course a very common practice now in family businesses for estate duty purposes, to transfer shares to finance houses—and the recent case of *Qualter Hall & Co. v. Board of Trade*, 1961, All E.R. 210, decided that they will in certain of these circumstances lose exemption; so that we would wish to qualify our suggestion that the ownership of shares in a private company by a public company lost exemption, to take that type of case out.

5860. *Chairman*: That would be another addition to the schedule?—Yes.

Mr. Cook: It would be an amendment to clause 7 of the schedule which gives exemption only where the capital is subscribed for by bankers or finance houses. We would like it to cover also the transfer of shares by shareholders to a banking and finance house.

5861. For a similar purpose?—Yes. The kind of case which arises is that the

owner of a majority shareholding in a private company wants to provide for death duties and disposes of some of his shares to one of these finance companies; we think that ought also to be treated in the same way as if the finance company had put money into the coffers of the company.

5862. Then, I do not know if you agree, it does rather look as though the field of exemption opened up by the Cohen Committee's recommendation was a very much wider one than the Committee can well have contemplated when they recommended having the special category of exempt private company. The position is, we are told, that something of the order of 80 per cent. of all private companies claim and are allowed exemption.—Yes, I do not know what the figures are, but an enormous proportion of private companies must be very small.

5863. You would say this is accounted for by the fact that most of the companies in this particular category are small partnership businesses now carried on by companies?—I would think that, yes, but I have no exact information, that is only an impression.

5864. There is this other point. It may be difficult for small companies to keep themselves up to the mark in the matter of accounts; they may be prone to fail to keep up to the mark in that matter. Is there not something in the view that if they had to file their accounts once a year that would keep them up to the mark and ensure that the accounts were properly kept?—Yes, I think that is so.

5865. It is probably to the advantage of the small trader himself, because his accounts should be properly and regularly kept and brought once a year to a condition fit for filing.—It is desirable, in his interests, that his accounts should be properly kept.

5866. That is more likely to happen if he is under an obligation to file the finished accounts?—I wonder if that is the only way to arrive at that. If the company is required to have an auditor, if the auditor had to sign the annual returns saying that the company had

completed accounts, that would meet that point without the necessity of publishing the accounts.

5867. It has been suggested by others that some sort of certificate might take the place of filing the accounts, but the trade protection societies would prefer to see the actual accounts on the file.—Yes, but assuming that the exemption is to continue in some field, the very field in which it is likely to be continued is the one in which properly the protection societies should be the most interested. We would hope that the Committee would not favour doing away with the exemption altogether, and we would rather continue to face the complications of the Seventh Schedule than lose the exemption for the family business.

5868. *Mr. Brown:* If it be felt that this exemption should be limited to the small family company, would it be an appropriate amendment to reduce the number of members allowed from 50 to some other figure, say 20?—Yes, I think that is a point that might well be considered, because a smaller number would cover the majority of cases where it is most necessary.

Mr. Sutherland: On the question of disclosure and protection of creditors, I think it has been suggested by the English Institute of Chartered Accountants that in an exempt private company the directors should be obliged to lodge a declaration of solvency in lieu of accounts. While we have not discussed that, I personally feel that that is a better method, if there is to be a disclosure,—simply requiring the auditors to lodge the declaration, because in order to give a declaration of solvency without being reckless, the accounts would in fact have to be prepared.

5869. *Chairman:* That is true; but is it desirable to introduce the necessity for a declaration of solvency once a year?—I do not think it is desirable, but I personally feel if that were one of the conditions of exemption it would be better to have that than to lose exemption.

5870. The trouble is that people are not in the vast majority of cases deliberately dishonest. Where you have got

a form you have got to fill in every year, it is likely to degenerate into common form which may be signed without due consideration.—It should not be if it is a statutory declaration.

5871. I quite agree. Anyhow, that is another alternative suggestion which merits consideration. As regards the matter of the audit, I understand you are in favour of making the requirements as to the professional qualifications and so on of auditors the same in the case of an exempt private company as in the case of any other company.—*Mr. Cook*: We have not expressed any opinion on that.

5872. I am sorry, I was mistaken about that. Then can we deal with companies limited by guarantee. I think you are concerned with the curious position which arises in the case of a company limited by guarantee and having no share capital. While it is apparently allowed the privileges of a private company, it cannot actually comply with all the conditions; it has not got any share capital so it cannot restrict the transfer of its shares, and you have a proposal to have an amendment to make it clear that the qualification of the company limited by guarantee as a private company should be secured without reference to the provisions which are only appropriate in the case of a company limited by shares. That is your point?—Yes.

5873. This anomaly has been noticed by other people, and it does look like one which might with advantage be tidied up. Have you any view as to the company limited by guarantee and having a share capital; have you ever come across one?—Never.

5874. Do you think there is such a creature in existence?—I do not know; I can only say I have not come across it.

5875. There is a suggestion that it might be just as well to put an end to that particular form of company, or to say that no company of that variety could be formed after a future date?—As far as my own experience goes that would be justified. I can only say that whenever the question of forming a company by guarantee has arisen it has never been thought desirable to have shares. It has

always been a company without share capital, and I do not myself know the circumstances in which a company, limited by guarantee and having a share capital, would be desirable.

Professor Gower: I thought it was completely obsolete, but I understand two or three have been formed in the last couple of years; why, I have no idea.

Chairman: It has been put that there is a fairly recent case of, I think, a football team which formed a company limited by guarantee, and they have a share capital as a means of extracting subscriptions from the pockets of their members. In that particular case the adoption of share capital was thought possibly convenient.

Professor Gower: Why did they not form an ordinary company limited by shares? What is the point of the guarantee?

5876. *Chairman*: The common method used to be to form an ordinary company and then to issue debentures to the shareholders, which never got paid; that was the means of raising money there. Do you agree that might be worth looking into?—Yes. I have no reason to believe that it is serving any useful purpose.

5877. We can pass to another thing—shareholders' control over the exercise of the company's powers by directors. You discuss this in paragraph 24 of your memorandum. You say:

"It is undesirable to interfere more than is necessary with the discretion of the directors in managing the affairs of the company, but in our view there are certain decisions of so great importance to the future of the company that it is desirable that the directors should be required, on the analogy of section 191 and Regulation 79 of Table A, to give information in regard to them to the members and obtain the approval of the company in general meeting. In our view these included a substantial alteration in the nature of the company's assets and the abandonment of a main trading activity."

Similar views have been expressed by a number of witnesses, and we generally ask them what they would say a substantial alteration was, or what a main

trading activity was. Have you any contribution on that?—*Mr. Sutherland*: I do not know if we have any contribution. We discussed this at considerable length, and while we were agreed on these general terms we had great difficulty in coming to any definition. But I think what we had in mind by a substantial alteration in the nature of a company's assets was this; we started from the idea that the directors should not be allowed to sell the undertaking without obtaining the permission of the company in general meeting, and then went on from that to the point where a company might have a very large proportion of its assets in liquid funds and was either not putting them back into the company or investing them on short term but was proposing to invest them in different long-term investments in other types of business; we felt that was a substantial alteration in the nature of the company's assets not presumably envisaged by the shareholders in terms of the memorandum, and that that should go before the company. We had not defined it, but these are the two main points that we had in view with regard to substantial alteration. We discussed how much of the total would be "substantial" and felt that it was better not to try to define that as it would have to depend on circumstances.

5878. It would have to depend really on the directors doing the right and proper thing, rather than on legislation.—I think we felt there should be legislation, but that it was not possible—we could not, at least, say how—to arrive at a definition of the actual alteration by reference to a percentage of the assets.

5879. *Mr. Scott*: Could you envisage such an alteration taking place gradually, over a period of years; a company might discontinue slowly the manufacture of a certain product and increase gradually the manufacture of another product so that after, say, five years, you could see that the business had fundamentally changed, but at no particular stage in those five years could you say that this was where they had reached a substantial alteration?—*Mr. Cook*: It would have to be substantial at one time. It would be a sudden change as opposed to a gradual change.

5880. *Mr. Brown*: It does happen in practice that a company starts some purely ancillary business to produce some of its own requirements, and that is so successful that it sells to outsiders. It may take ten years before it is realised that the business of the company has changed, and at no point was there a substantial change, it just happened.—I think that must be left to the directors.

5881. *Professor Gower*: Presumably the directors will be aware of it, and in many cases they could give the shareholders an indication earlier of what is happening if the directors' report was fuller and franker than it tends to be at the moment.—If the process is gradual, the shareholders have an opportunity of raising it at annual meetings. What has to be guarded against is the sudden decision of the directors to make some very substantial change in the company's activities without giving any notice to the members.

5882. *Chairman*: Would there be any value, as regards these sudden changes, in having a provision of this character: that transactions of that sort should be disclosed to the shareholders if in the opinion of the directors it was reasonably practicable so to do in all the circumstances, but if they decided it was not reasonably practicable they should record a minute to that effect and state their reason, and they should, as soon as possible after the transaction had gone through, circulate to the shareholders a notice of the development which had happened and a short statement of the directors' reason for not consulting the shareholders in advance? Would there be any merit in that, or would it be simply a pious hope and clutter up the law with something that was never going to be observed at all?—*Mr. Sutherland*: We have not considered that, of course; but from one aspect it is an engaging thought, in that it would give effect to what I think is generally felt, that it is undesirable to interfere more than is proper with the directors' activities. There are so many circumstances where a change in the activities of the company is wanted, which the directors wish to do, but which would be impossible if they gave advance notice to the members. From that point of view it would be extremely attractive.

Not having considered this, my own personal difficulty is that I think it could be used perhaps to allow the directors to make the alteration in any circumstances; because at first sight I feel it is difficult to apply the test of what is reasonable and proper in the directors' thinking—of whether it is proper to do this rather than to advise the shareholders. I think insofar as oppression might be involved the shareholders comprising a minority should still have a remedy, but I feel that such a provision might simply allow the directors to do this by recording a minute, whether in fact it was what they generally ought to do or not.

5883. It might have that result. On the other hand it might have the merit of ensuring that the directors, if they were an honest body, would, before they proceeded with the matter, have applied their minds to the question whether this was not a proper matter for the shareholders to be informed about.—Yes.

Chairman: I agree it might become a formality, but you can say that of anything.

5884. *Professor Gower:* It would mean the shareholders would have to be told of it pretty soon afterwards, whereas at the moment they may never realise it.—Yes. And I think also the directors would have carefully to consider it, because presumably when recording such a minute they would have it in mind that they would have to justify their decision at a later date to the members, and they would not rashly engage in such a project if they had to record that and explain the reasons for their decision. We have not considered it, but it seems a good suggestion.

Chairman: Perhaps it is worth looking into.

5885. *Mr. Lawson:* How would you deal with the company which acquires a new type of business through a subsidiary company. There are so many holding companies which buy shares?—We did consider the question of companies which are formed and all they do is change their assets and engage in different trading activities—the type of trading investment companies—and we felt that probably the very constitution of such a company, in

its memorandum and its articles, would be such that the members by joining had in effect given approval to a continuous change of assets and of activities.

5886. So many companies are like that today. A big manufacturing company may also be a holding company as well, carrying on a whole lot of different enterprises in different companies. The two things so often go together. That is the type of case I had in mind rather than the company which starts out clearly as a holding company investing funds in various kinds of different enterprises.—It is very difficult to define whether there has been a substantial change in the assets or in the trading activities. It would depend on the circumstances of a particular group of companies.

Chairman: That is the most difficult case to fit into any legislation of the kind we are considering. As you say, it would be the function of the company, its *raison d'être*, the turning over of investments or properties or whatever it might be.

Mr. Althaus: The whole function of a company like that would be to have diversification, and therefore it would be unlikely that any transaction would in fact be one of such a major character that it would fundamentally alter the objects of the company.

5887. *Mr. Mackinnon:* The practical difficulty is if we make this alteration everybody will in fact turn themselves into a kind of holding company. I do not say that cantankerously, because in fact it is a common feature of companies that have large liquid assets to vary their constitution in that sort of way.—But on the other hand you have to get the requisite number of members to agree to that, and if the members do agree, then they have in advance agreed to the company doing this kind of thing all the time, and therefore they cannot object.

5888. Let us take a new company, every new company formed practically will evade such a provision by doing it. That is what troubles me—apart from the existing ones which will normally carry the 75 per cent. with them.—Again all I think I would say to that is that if a new company is formed and the public are

prepared to subscribe on those terms, they cannot take objection to that type of activity thereafter; they have gone into it with their eyes open.

Chairman: The modern trend is to believe that shareholders have not got any eyes, or if they have, they go about with them shut.

Mr. Lumsden: And the prospectus would not necessarily show all the ancillary objects which it was not intended to use at that particular time.

5889. *Chairman:* I do not know if we can pursue that much further. The next one is a matter of considerable moment, and I confess I was rather shocked, because your proposal appears to amount to laying hands on the Ark of the Covenant and upsetting the rule in *Foss v. Harbottle*. It is your view that this time-honoured rule is not all that its supporters claim for it.—*Mr. Cook:* That is so, Sir.

5890. The underlying advantage is to avoid multiplicity of actions?—*Mr. Sutherland:* We appreciate that, but I think it is true to say our view is that, with the rule as it stands, so far as we can see the difficulties and understand the facets of the rule, it is almost impossible to bring an action to a successful conclusion even in circumstances where one would think that there were grounds for a successful conclusion; and that it would be better to have a multiplicity of actions than in effect to bar actions altogether, which we feel is really what happens because of the rule in *Foss v. Harbottle*. I think as a corollary to that we also believe that if section 210 were extended the effect would be that the common law action would almost entirely disappear, except perhaps for cases where there were *ultra vires* actions or actions by the directors in breach of their duties, but the other common law actions which have taken place under the aegis of *Foss v. Harbottle* would largely disappear because section 210 would comprehend almost every possible other circumstance.

5891. The basic principle of *Foss v. Harbottle* is that the proper plaintiff to redress a wrong done to the company is the company itself. That is it, is it not?—Yes.

5892. Then it goes on to the effect that there may be cases where control within the company is such that the company is not going to assume its role of plaintiff in the matter. That is the second step in it.—Yes.

5893. That opens the door to a representative action provided that the action complained of amounts to a fraud on the minority?—Yes.

5894. Is the real difficulty definition of what amounts to a fraud on the minority?—That as we understand it is the difficulty. The rule in *Foss v. Harbottle* is quite clear, but in order to avoid the rule one has to establish a fraud on the minority, and we feel there is great difficulty in understanding the particular circumstances where the Courts have decided that there is a fraud on the minority.

5895. So it is your view that if oppression and so forth is effectively dealt with by section 210, that really gets over the difficulties attendant on the rule, because this new statutory remedy would really deprive the rule of much of its importance?—I think we would take it a little further for what remains of the scope of the fraud on the minority type of common law case. We think the problem should be attacked not from the aspect of fraud on the minority but from the other side, not the effect on the majority but the effect on the minority, and it would be more proper that the criterion should not be fraud on the minority but really what we have envisaged in section 210, that it is something which is prejudicial to the interests of the minority, not so wide as fraud.

5896. I follow that. Passing to section 210, would it be right to say that in your view the provisions of that section should be capable of being effectively used if what has been referred to as the winding up criterion were taken out of the section? At the moment the party aggrieved, in order to proceed, has to show that the case is one which in other circumstances might have afforded a good ground for a winding up petition. If that provision is taken out, would it be your view that the section should be workable?—Very definitely so.

5897. You take various other points in paragraphs 37 and 38 about the section, but I think that is your main point.—That is the main one. I think we felt that it was almost as important to extend section 210 to meet oppression of people not necessarily in their capacity as members; we refer to that in paragraph 39 (4); we were very concerned in private companies with the effect of the decision in *Elder v. Elder & Watsons, Ltd.*, which we of course respectfully agree with technically but think it is quite iniquitous from the equitable point of view. Our suggestion is that section 210 should be expanded to allow for oppression of members in their capacity other than members, such as employees or directors.

5898. The difficulty one feels about that is that it hinges on another field, that the relationship of master and servant would come in there.—That is so. What we are particularly concerned about are the private companies, the family type of business with a relationship which, while it may be in law that of master and servant, is really in practice that of partners in the business.

5899. It ought not to be possible for the people for the time being in control of the company to dismiss the opposite party to the dispute because he happens to hold office as director or manager as well as being a shareholder?—We are so very familiar in practice with the type of family company where the reward for the capital invested is taken out purely in directors' fees and management salary, as was the case in *Elder's* case, and where dismissal from office is tantamount to appropriation of the investment, unless it can be otherwise realised, which it usually cannot.

5900. I think we have that point. It would be a matter for consideration whether provisions dealing with that aspect of the matter could be incorporated in any new section 210.—Yes.

5901. *Professor Gower*: You would have to be a little careful about extending it to employees generally. You might get trade unions using it.—It was only proposed that it should be applied to employee shareholders, of course.

5902. I see: they have to be members, have they?—They must be members.

5903. *Mr. Brown*: If there are two employees, one of which holds 10 per cent. of the share capital and one holds 9 per cent., the one who holds 10 per cent. has a different remedy under your proposal from the one who holds 9 per cent. or nothing. I am not clear why that should be.—The employee who has 10 per cent. has no remedy as an employee under our proposal but only as a member of the company who has been deprived of the benefit of his investment. So far as the 10 per cent. and the 9 per cent. are concerned, the figure is of necessity arbitrary. It might be that it should be an employee having any share in the company; but we felt we had to show some substantial holding.

5904. *Chairman*: I would just like to refer to your interesting suggestion of a form of limited partnership that you dealt with in paragraphs 39 and 40, and you suggest a new form of company to give effect to these provisions. I want to ask you why should not your provisions, or substantially the whole of them, be grafted on the ordinary articles of association of a company under the Companies Act?—*Mr. Cook*: The reason is this: if you put in a provision in the articles that in the event of failure of other shareholders on a certain event to acquire shares, the company is to be wound up, the Court merely regards that as a factor to be taken into consideration and they may or may not decide to wind up. We want to have the position in an incorporated partnership where, if one of the partners dies or retires, he should be entitled to get his money out, and if he cannot get it out by other people buying his shares then he should be entitled as of right to have the company wound up. That could not be provided for in the memorandum or articles of a company. And the other thing is we think it might be appropriate in certain cases to enable the Court to allow the company to buy the shares of the retiring member. That also would require legislation. So I do not think the scheme which we have suggested in paragraphs 39 and 40 could be carried out within the framework of existing legislation.

5905. You could add to the circumstances in which a company could be wound up the happening of the event postulated by the new form of rights you are given by the articles.—Yes, but I think the Courts have held that is merely one of the things to be taken into consideration in deciding whether to wind up the company or not; and there is no certainty the Court would do so.

5906. But you could make it certain: you could do it by an appropriate amendment of the section which deals with the circumstances?—Yes, I beg your pardon: I thought you were enquiring within the framework of the existing Act; but I think it requires legislation.

5907. It requires a new kind of company, as I understand it?—At least it requires legislation: that may be all that is required. Why we suggested a new type of incorporated body was that this body should have new types of conditions, which could not be altered except by consent of all members. We do not want it to be something which can be altered by a three-quarters majority.

Chairman: I see. It is certainly very well worked out, and an ingenious suggestion. It is difficult to say how far it might be adopted, but as with so many of these things it is certainly a possibility worth considering.

Mr. Bingen: Would it not be possible to deal with the proposals in paragraph 40, by widening section 210, or adding a new section on the same lines, dealing specifically with private companies and giving the Court the powers set out in paragraph 40 of your memorandum?

5908. *Professor Gower:* Are you envisaging this partnership should have limited liability?—Yes, the reason we used the expression "incorporated partnership" was that the expression "limited partnership" had already been used in another context.

Mr. Bingen: But you could really provide for this without introducing a new type of company at all by just adding an enlargement to section 210 to cover all this.

5909. *Mr. Mackinnon:* I do not think you could, because the theory is the

article must be unalterable under the Act. The theory of this set-up is that it has to be in the articles, and the articles in this respect cannot be altered by special resolution; so there would be a double qualification of the existing legislation. One is to provide for an additional event in which a winding up takes place, and the second one is that in this one case you cannot alter your articles. Is that correct?—That is correct: and there is the third point that the company may, with the approval of the Court, purchase the shares.

5910. *Mr. Scott:* Is it necessary with regard to that point to say only with the approval of the Court? If the directors were to file a declaration of solvency and the purchase was made out of surplus, is there any need to go to the Court? Because it is recognising this company as a partnership, and it is recognised that the partnership has come to an end.—If it is going to have the benefit of limitation of liability, then anything which reduces the capital ought to have some supervising authority. I would have thought a declaration of solvency would not be adequate.

5911. *Professor Gower:* If it is purchased out of surplus it does not really reduce capital, does it? You could have a similar provision to that in the Act about redeemable preference shares, that when shares were purchased out of surplus, an equivalent amount should be transferred to Capital Redemption Reserve Fund.—If it could be provided that the company could only buy the shares out of surplus, leaving its capital intact, without requiring approval by the Court, that would improve the working of the scheme.

5912. *Mr. Scott:* That is what I had in mind. In other words, the purchase would merely be made out of surplus.—I would certainly accept that, and if it were possible I think it would be a great improvement on the scheme, because it would simplify it: it is intended to be for smaller businesses taking the place of a partnership.

5913. *Mr. Mackinnon:* It would not actually meet the point fully, because supposing there was no surplus, you

would still want the long stop of being able to go to the Court to reduce the capital.—*Mr. Sutherland*: That is one of the points we are concerned about; and also it impinges on section 54. In some circumstances you might very well get the type of company whose assets were such that they could easily borrow to repay; but this would be borrowing to purchase their own shares. We thought that should have the supervision and sanction of the Court.

5914. *Mr. Lawson*: I am not quite sure I follow the advantage of buying these shares if it can only be done out of surplus, because the surplus could be distributed to the shareholders who, in turn, could buy from the retiring shareholder. Is there any great advantage that it has to come out of surplus?—There would be considerable tax repercussions if the surplus could only be applied in the form of dividend and then used to purchase the shares.

5915. But the Inland Revenue would soon see to it that you would have exactly the same repercussions if you adopted this method.—I do not think there is any loss of tax in the company acquiring the shares.

5916. *Mr. Lumsden*: I am not quite clear what your intention is regarding the right of minorities to have this new form of company wound up. You speak of their right to apply to the Court to have it wound up, but did you envisage that if this special article were included the Court would be bound to order the company to be wound up, provided the creditors were not affected?—Yes.

5917. I was just wondering, in those circumstances, whether there would really be very much demand for a company of this kind, because surely—initially any way—all the shareholders go into a company, when they form a company, with the intention of making it a permanent body which will go on progressing and continue to trade; and would not the general body of shareholders, who would expect to be in the majority and wish to continue to trade, be very reluctant to include an article under which a very small shareholder might at any time bring the whole show to a complete end?

—This is intended for the case where a number of people carrying on business in partnership want to obtain the benefit of limited liability. At present, if they form the business into a company, the consequences which arise on death are fundamentally different from what they would be under a partnership, and often, I think, cause hardship. It may be hardship to the continuing members or it may be hardship to the retiring members, according to the circumstances. Therefore this is an attempt to enable people who want to do so to continue the same kind of arrangements as they have had previously.

5918. *Professor Gower*: Why do you place so much importance on the benefits of limited liability? Is it not rather the tax advantage and perpetual succession which are sought after? Would it not be possible to deal with the problem by amending the Partnership Act so as to make the partnership an incorporated body. I realise that in Scotland a partnership is regarded as a separate legal entity but you do not carry that to its logical conclusion and on the death of any partner the partnership is dissolved. What I suggest is that on registration of simple particulars of a partnership, it should become a fully incorporated body, not dissolved on the death of a partner, when arrangements exactly similar to those you suggest should apply. This, it seems to me, would mean you could have a very simple type of incorporation which would appeal to the small trader, which would not have the complications of limited liability and the complications of a possible division between ownership and control which you get in a normal company. It would give all the advantages, tax advantages and all the others, with the sole exception of limited liability—which, I frankly would have thought, in the case of a small concern is not a paramount consideration, bearing in mind they will not succeed in getting credit facilities from the banks and so on unless they give personal guarantees; so it is in a sense a sham—it trades with limited liability towards ordinary creditors but with unlimited liability to the banks and people who grant credit facilities.—That would undoubtedly meet many

of the cases, but I do not think this kind of body would be limited necessarily to only small businesses.

5919. Well, if it is a very large one, the complications of the Companies Act do not matter very much. I would have thought one of the great weaknesses of the present system is that the Companies Act is too elaborate for the small private company; and I think we all know some of the provisions are not in fact observed. It is in fact too complicated. Is there not a need for something which gives corporate entity and yet is very simple?—I still think that while the tax advantages, etc., are a material factor, the advantages of limited liability weigh quite heavily.

5920. Of course, you could get round that, I suppose, by allowing these kinds of companies to work on the limited partnership principle although some of the partners' liability is unlimited?—We did consider that question of limited partnership, and were attracted by the French idea in this respect, but we came down in favour of this type at the end of the day.

5921. Your solution would mean that all the complications of the Companies Act would apply to these so-called partnerships?—*Mr. Cook*: Yes, that is so.

Mr. Sutherland: I do not think that we quite properly put forward our idea in reply to Mr. Lumsden's question about going to the Court for liquidation. As I understand it, that is the final sanction after failure to agree to purchase the shares.

5922. *Mr. Scott*: Would that give an unfair advantage to an unreasonable shareholder to hold out for an unfair price, knowing that if he does not get his price he can force them to go into liquidation?—*Mr. Cook*: It would put him in exactly the same position as a partner is in today, and that was the intention, to try to make the consequences on death or retirement the same; and you must remember it also has advantage for the continuing members. In a successful partnership, if one partner dies his representatives get his share of capital

paid out, and any remaining profits accrue to the remaining partners. Whereas if the business were carried on by a company the representative of the retiring or deceased partner might get a share in the profits, which were really attributable to the efforts of the continuing partners. We wanted to have a limited company which would have consequences similar to those which arise from partnership at present.

Mr. Bingen: On Mr. Scott's point, our American friends gave evidence on the U.S. share appraisal procedure and said that it worked quite well. That might be the answer to the point he raised.

5923. *Mr. Watson*: Suppose the owner of 75 per cent. of the capital dies and his executors ask that his shares be bought by the company. The company's reply is "if we put up the money out of the company's resources to buy the shares, that will cripple it". In those circumstances the alternative is that his shares should be bought by the remaining members. They may not have the means at their command to buy the shares. What happens in that situation?—They would have to wind up if they cannot get the money from some other source.

5924. *Mr. Mackinnon*: But that was the fundamental arrangement between them in the beginning. It would have been a partnership but for the necessity to have corporate status?—Yes.

5925. *Mr. Bingen*: Would you be satisfied if some special section of the Act incorporating your ideas was brought in but limited to companies of not more than, say, ten members, so that it was clearly the small family business?—Yes, I would indeed.

5926. *Chairman*: As to limitation on the size or type of company to which this is going to apply, there you will get difficulty because, if some advantages are apprehended from having this arrangement and it was limited to a company with £x capital, would not enterprising people proceed to form a multiplicity of such companies?—I thought the limitation was to the number of members and not concerning the amount of capital.

Mr. Bingen: It was really the small family business.

5927. *Chairman*: I thought it was suggested that your scheme might be made applicable to companies of less than a certain size, in point of capital or number of members or whatever it may be?—I understood, my Lord, the suggestion was a limitation in the number of members; and that was a suggestion which I thought was reasonable. The point of limitation of the amount of capital had not been suggested.

5928. I was only thinking of the kind of thing which happens if the Treasury puts on a limit against borrowing £10,000 by any individual—that type of thing. Advantage can be taken of that by, say, forming ten companies, in order that each may borrow within the limit, you see. I do not say it is possible in this case, but where it comes to defining companies by reference to their size, whether it is by number of members or by issued shares or whatever it is, you can evade that by having two or more companies, each within the limit.—I would not favour limiting it by reference to share capital, but it might be reasonable to limit it by reference to number of members, because we are really providing something in lieu of a partnership.

Professor Gower: Some chartered accountants get round the present prohibition of more than 20 partners by interlocking partnerships. You can get round the limited number theoretically by doing the same thing?

5929. *Chairman*: Yes, that is so. I do not think that we can pursue this matter much further today. You have a point under protection of special classes of shares in paragraph 45, in which you deal with the question of variation of class rights. Put very broadly, I take your view to be that you are inclined to disagree with the principle laid down by clause 5 of Table A to the effect that the issue of shares of a given class, ranking *pari passu* with an existing class of shares, is not a variation?—I did not think we disagreed with that, my Lord.

5930. Then I have misapprehended. You say: "in this connection the position might be clarified if Regulation 5 of Table A were to be included as a section of the Act subject to the proviso that a company

should be entitled to make provision to the contrary in its articles of association." The present position is that clause 5 of Table A, where it is adopted, shows that creation of issues ranking *pari passu* with shares of an existing class is not a variation.—We also say in paragraph 45: "Where the rights of a class of shareholders are 'affected' to such an extent that their consent is required, it seems appropriate that the variation in the rights must be of a substantial nature and not simply affecting, albeit adversely, the value of the shares, nor simply reducing the relative voting strength of the shares concerned" and so on. So I do not think we were opposed to the principle.

5931. *Professor Gower*: What I thought you were saying was that clause 5 of Table A appears to assume that unless it is expressly so provided in the articles, an increase in one class would be a variation in the rights of another, whereas the cases appear to establish that it is not a variation. You think it should be expressly provided in the Act, so that everybody knows that it is not a variation unless the articles otherwise provide—is that not your point?—Yes.

5932. *Chairman*: I am much obliged. Then you refer to section 23, with special reference to the case of *Marshall Fleming*. In *Marshall Fleming's* case rights were attached to the shares by memorandum and the contemporaneous articles contained provisions for variations of those rights, but there was no reference in the memorandum to the articles registered therewith.—Yes.

5933. And the point you make there is that the English interpretation of the law ought to follow the Scottish interpretation, so that contemporaneous articles containing modification of class rights would suffice to make the rights attached by the memorandum capable of alteration?—That is exactly it, my Lord.

5934. I am not sure how the law stands with us at present. Of course, where there is a reference in the memorandum to the articles of association registered therewith, that suffices to incorporate any modification of rights clause in the memorandum; but what is not so clear with us is the position when the contemporaneous

articles, containing a modification clause, are not referred to in the memorandum. —Yes.

Chairman: That seems to be a point which might be conveniently clarified.

5935. *Mr. Lumsden:* I was not quite clear what you intended in paragraph 44 with regard to article 4 of Table A—the normal variation of rights article. I think the difficulty which arises, or can arise at present, is where there are shares with different rights, but there is no variation of rights article at all—is it your suggestion, as has been made by some other people, that a variation of rights clause on the lines of article 4 of Table A should be implied in such cases, and that you should only be able to alter the rights in accordance with the terms of such an article?—I think our intention is that if the conditions of the share capital are set out in the memorandum, with no power to alter and with no contemporaneous article entitling you to alter, then they should be unalterable. In other words it should still be possible to create unalterable rights in the memorandum.

5936. Yes, but I was going on to a slightly different point. The memorandum is silent on the question of rights, but under the articles there are both preference shares with certain rights and ordinary shares, but there is no variation of rights article. There is a body of opinion which says that in such cases these rights can be altered simply by a special resolution without the consent of any class meetings; I wondered whether you were making the suggestion that the variation of rights article should invariably be implied in articles where it was not inserted?—Yes, I think that is what it amounts to.

5937. *Chairman:* Then there were one or two points on take-over bids, on which you make your contribution in paragraphs 47 to 54 of the memorandum. I am not sure what your view is about the new Board of Trade regulations for licensed dealers issued under the Prevention of Fraud (Investments) Act. Do they, generally speaking, meet with your approval?—I would say yes, but perhaps Mr. Clarke might wish to add something.

Mr. Clarke: I really do not think we have had enough time to look at them

in practice to pass any comment, and at the stage this memorandum was being prepared, I think they were just in draft. We have no positive objection to them at all; we think they are very fair and very comprehensive.

5938. I see. Then certain proposals have been made about take-over bids, on which we should welcome your views. The first is that the bid leading to the ultimate acquisition of the dissentient one-tenth or less of the company—the bid must be for all the outstanding shares of a particular class of the company and not a bid limited to part only.—Of course, that is not a point we have considered, but when we were considering this whole section we went as far as we could to fundamental principles, and we thought there should be freedom of action as far as possible and there should not be any unnecessary restrictions of the right of property, either to accept an offer or to refuse it. As I say, we have not considered that particular point and perhaps it would be better not to discuss it at this stage.

Mr. Cook: If I can express my own personal opinion, I would agree with the suggestion as regards public companies, but I am not quite sure about private companies, because if a take-over bid is confined to a bid between, say, two other persons which will result in a take-over of the company, I am not sure it would be an appropriate thing in the case of a private company to require any such bid to be made to all the shareholders. In the case of a public company, I should have thought there was a case for requiring the offer to be made to all the shareholders.

5939. I see. Then it has been suggested that if a majority accepts the offer the minority should be entitled to demand to be bought out on the same terms: that is to say, if 51 per cent. accept the offer then the minority ought to be able to insist on being bought out on the same terms.—That would seem reasonable to follow from the first, in the same way; because I think the minority ought to have an opportunity to change its mind. If you start off by assuming the offer must be made to everybody and a minority refuses, I think perhaps they should be given the opportunity of changing their mind once

the control has passed; I would have thought there was a good deal to be said in favour of the suggestion.

5940. Then there has been a suggestion made that part of the consideration of a take-over bid should be in cash.—I do not think I would favour that. I do not see any reason why it should not be open to a person acquiring the shares to offer shares: it is a matter for contract between the two parties.

5941. *Mr. Brown:* Reference has been made previously, and there is an example in the Press this morning, to the case where a take-over bid has been declared unconditional without any indication of what proportion of the capital had been acquired and with a refusal to state how much of the capital had been acquired. Is it your view that the shareholders should still have an opportunity to accept and they ought to know how much has been acquired, at that point, when it is made unconditional?—*Mr. Clarke:* One must go back to the fundamental conditions of the offer. The offeror makes his offer and it is up to the shareholders individually to make up their minds, with all the advice they can get, to accept the offer or not. Whether at a later stage the offeror should be forced to do anything which is not in his original offer, I should think was rather a doubtful proposition.

5942. But the general approach to the subject is that proper information should be given, and it becomes pertinent to know when an offer is made unconditional whether control has been acquired or not.—But if the original offer does not treat as to any minimum percentage?

5943. Well, it is normal.—I understand it is usually made unconditional when one has more than 90 per cent.

5944. Ninety per cent. is the normal point at which it is made unconditional. But whether they get 90 per cent. or 20 per cent., is that not information which the shareholder of the offeree company is entitled to have, or that it would be better that he should have?—It is purely a point of contract.

Mr. Brown: But it is a question whether this should be made one of the rules as regards take-over bids.

5945. *Professor Gower:* Regarding Mr. Cook's suggestion, that pre-supposes you have to say what percentage you have got, otherwise it would be unworkable?—*Mr. Cook:* There would have to be a series of time limits, yes.

5946. *Mr. Lumsden:* And there is the question whether an acceptance should be irrevocable in such circumstances. I am thinking particularly of where control has not been achieved. As you say, the usual formula is to make an offer conditional upon 90 per cent. or some such lesser percentage as the purchaser may decide. That gives a one-way option to the purchaser, and he can declare that offer unconditional if he only gets, say, 20 per cent.?—Yes.

5947. That causes abuse, because if it is declared unconditional at 20 per cent. it may be that it enables that purchase to re-sell to a later bidder at a higher price?—Yes.

5948. You say, perfectly correctly, one does not want to interfere with the freedom of contract; but there is the possibility in such a case that the person who gets caught is not the experienced investor but the inexperienced investor, who accepts the first offer that is made; and would you agree there might be a case for protecting an inexperienced investor in such a case by making his acceptance revocable if control is not achieved?—Or a certain percentage possibly, yes.

5949. *Mr. Bingen:* Mr. Cook has said that he thought it would be right to impose an obligation on anybody who made an offer for shares in a company to make an offer for the whole of the shares.—A take-over offer, yes.

5950. What was the reason underlying your answer? What is the objection in principle to company A making an offer for 50 per cent. of the shares of company B, provided acceptances are taken *pro rata*? You can buy shares in the market so as to acquire over 50 per cent. of the shares: why should you not make a bid for 50 per cent.?—I think I might modify my earlier answer. What I had in mind was simply that the general body of shareholders ought to be treated alike.

5951. *Mr. Scott*: Would you make it unlawful to invite tenders, for the shareholders of company A to say to the shareholders of company B "we would like to buy up, say, 500,000 shares. If you wish to sell, would you like to tender? We are in the market". That would be in effect a partial bid. Would you say that should not be permitted? It is really arising out of what Mr. Bingen said.—I think it is really another aspect of a take-over bid: it is treating it in a different form.

5952. But it is in effect a partial bid. Would you say it should not be permitted?—Could that not be met by the provision that if everybody wanted to sell, the offeror would be bound to take them *pro rata*?

Mr. Scott: The question of price might arise.

5953. *Chairman*: But I thought there was really a drafting difficulty in section 209, which seems to say that I can make an offer for any shares, and not the whole of the shares of the company—those become the whole of the shares within the meaning of the section; and so it seems to say you can make an offer for 1,000 out of 2,000 shares, and having got 90 per cent. of the 1,000 you can compulsorily acquire the balance. It seems to me to be a flaw in the drafting of the section.—I had not realised that was what section 209 said.

5954. It does not make it very clear:—

"Where a scheme or contract involving the transfer of shares or any class of shares in a company . . . to another company . . . has within four months after the making of the offer . . . been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved."

It need not necessarily be an offer for the whole of the shares as far as I can see; and that is a point which looks as though it needs tidying up.—Yes, it should be tidied up.

5955. *Professor Gower*: What would happen where there are differing classes? Supposing there are A non-voting shares and B voting shares and an offer is made only for the voting shares; then the non-voting shareholders have no rights under section 209. Do you object to that?—No.

Chairman: Section 209 does not say all the shares, it just says "shares," and those are the shares which are involved. Still, there it is. So far as I am concerned, gentlemen, those are all the questions I have in mind to put. I will invite my colleagues to put any further questions which occur to them.

5956. *Mr. Scott*: On the question of issue of shares, paragraph 25 of your memorandum, you say: "We recommend that the approval of the company in general meeting should be required to the issue of shares otherwise than to the existing shareholders *pro rata* to their holdings". Would that apply to all classes of shares, or only equity shares; would it apply to preference shares, for example?—I think it really ought to apply to all classes, because you might have rights attached to preference shares which made them much more valuable than *par value*.

5957. You would need the consent of the shareholders to a company, say, placing a lien on preference shares with an institutional investor. You think that should be so?—Yes.

5958. And would you apply that requirement only to issues for cash?—No, to all issues.

5959. So they could not issue shares, say, to acquire a business without getting the consent of the shareholders?—That is so, but we contemplate that it might be competent for the company, by a resolution, to authorise issues of up to a certain amount within the next year.

5960. But the company normally, to-day, when it increases capital, authorises the directors to issue those shares as and when the board think fit. That is the normal practice, is it not?—Yes, but our suggestion is that the authority should be given at or about the time of issue.

5961. It cannot be given in advance to apply indefinitely?—It might be given in advance to apply for a period of not more than 12 months.

5962. So you would say that unless the directors hurry up and issue the shares in the next 12 months, they would have to come back again?—Yes.

5963. And that would apply to all classes of shares, whether for cash or otherwise?—Yes.

5964. And if they acted in breach of that, how long do you think it should be before an innocent allottee—if there is such a person—should have before he is dispossessed of his shares? What would be the effect on the company?—I do not think we had considered remedies for breach.

5965. Would you suggest it would give rise to an action for misfeasance against the directors?—Yes.

5966. *Mr. Watson*: I do not think your memorandum comments at all on non-voting shares?—*Mr. Sutherland*: No, Sir; we did not consider that question.

5967. Are we correct in assuming that you consider that they should continue to be allowed to be used where the situation seems to require them?—As we did not consider it, I cannot really speak for the Council; but I think we feel the situation is now well enough known for the public to be protected.

5968. And perhaps you might say that provided they carried their label very obviously, that was all that was required, provided they were shares of a public company?—I am only speaking personally, but I would agree with you.

5969. *Mr. Lawson*: Just one point on reduction of capital: there are two kinds of reduction of capital, one where money is returned to shareholders, and the other where the capital is reduced merely to write off capital which has in effect been lost, either by bad trading, or for some other reason. Do you think it should be necessary to go to the Court in the latter case, where there is no return of cash to the shareholders?—I think so, Sir, in that supervision and sanction of the Court is a creditor's protection.

5970. Of course, if the capital is lost and is certified to be lost by the directors and the auditors, it is really only something of a book entry, to adjust the amount of the share capital.—I appreciate one can accept the auditors' certificate on that, but I do not know whether one, without the sanction of the Court, should necessarily accept the directors' certificate on it.

5971. The present position, as I understand it, is that if a trade loss has been made, that is regarded as a loss of capital and you can pay dividends out of current earnings without making good that loss. That is so, as a matter of law, is it not? If that is the position, then the creditors would not seem to be protected if one took a chunk out of capital or, more easily, out of the share premium account, and wrote that off?—The creditors would be affected in this way: as regards a dividend out of capital profits, before declaring such a dividend you have to be satisfied that you have assets representing the share capital. If you reduce the share capital you might be able to declare a dividend out of realised capital profits which, if you have not reduced the capital, you would not be able to do.

5972. I think that is true. One might couple the suggestion I was making with the proviso that one should not distribute capital profits till one had made good the capital loss which had been written off or, if they wanted to distribute capital profits, they would have to go to the Court. This would be instead of going to the Court merely to adjust the value.—*Mr. Cook*: As far as I understand the point at the moment, that would seem to me to meet it.

Chairman: Where there is known to be £20,000 in notes in the safe, and the next morning the managing director does not turn up for work and the safe is opened and the money is gone—in a case like that I should have thought you could prove the loss, and the Court would only be concerned under the Act with the formal matter of finding the loss had been proved. Cases do vary in complexity or simplicity, and it seems to me there may be a fairly wide field of cases where application to the Court is really no more than a formality, provided that on the figures the loss is genuine. On the other hand it might involve questions of valuation, and so forth.

Mr. Mackinnon: On the example you have given, despite the £20,000 loss on one side, there might be a £20,000 surplus of assets; one can hardly say £20,000 is lost, and that I think is the real reason why the Court should keep control over this

matter. If it is left to the free will of the company you could get a freeing of capital assets for distribution under the present system.

Mr. Lawson: That is why I thought there should be the added proviso that you should not be allowed to distribute capital profits until the loss had been made good.

5973. *Mr. Mackinnon:* Then I would like to ask Mr. Cook whether such a complicated set-up would be necessary to meet every type of situation of loss reductions. Is the present procedure a great impediment to commerce?—I do not think so, no.

Chairman: You would get a simple reduction in the Companies Court in England quickly enough if you pressed for it. They could do it within a month. It is only a long procedure where there is to be a return of capital unless you pay all the creditors off.

Mr. Brown: Is not the present procedure more helpful to minorities who object to the scheme of writing off? They have a right to appear and object, otherwise they would have to initiate the machinery of objection.

Chairman: That makes another distinction: the case where there is one class only of shares, and the case where there are several classes.

5974. *Professor Gower:* I believe in Scotland you have a system whereby a Reporter is appointed by the Court?—That is so.

5975. Do you regard this as valuable, and is the Reporter normally a chartered accountant?—Or a solicitor.

5976. And what sort of report does he make—does it go into the merits of the fairness as between various classes of shareholders?—Yes, it goes into it exhaustively, with detailed examination of the procedure, and so forth.

Chairman: We were told by some other witnesses that the function actually performed by the Reporter was limited to interlocutory work in chambers done in England by the Registrar of the Companies Court.

5977. *Mr. Watson:* Would it be correct to say, Mr. Cook, that chartered accountants are not usually nominated in these cases?—In my experience it is usually an advocate or solicitor.

5978. And it is his duty to scrutinise the legal procedure involved in the scheme?—Yes.

5979. Does he have a duty to evaluate the merits of the proposals?—I would say I think they do report on that.

Mr. Mackinnon: They would report on a question as to whether a scheme was in accordance with class rights, for instance. I am sure I have read reports on that.

5980. *Professor Gower:* In the *Westburn Sugar Refineries* case, there was a chartered accountant who drew the attention of the Court to the fact that the object of this was tax considerations.—I thought it was a solicitor.

5981. *Mr. Watson:* It is possible the solicitor nominated may consult the chartered accountant.—Yes, I am not sure how they work it.

5982. *Professor Gower:* But you think it is a valuable procedure?—We do, yes.

5983. *Mr. Lumsden:* You mentioned in paragraph 59, under reduction of capital, the suggestion that the jurisdiction in the Sheriff Court should be increased so as to deal with companies up to a capital of £50,000 instead of £10,000. That would presumably apply to the winding up procedure?—Yes.

5984. A similar suggestion has been made for the same sort of thing for the County Court. How important do you think that is, and what are the benefits of dealing with the Sheriff Court—is it mainly expense or speed?—Expense is the main thing, and in Glasgow we prefer to deal with the Sheriff Court rather than the Court of Session.

5985. You do find this much less expensive?—Ob, I should think so, yes.

5986. And company names: you suggest the official circular is not very explicit and you believe there are departmental rules, the publication of which would prove helpful?—It was a member of

our sub-committee who prepared this, with considerable experience in this matter; and I think it is probably rather difficult for the members present to speak with any real knowledge of this.

Mr. Sutherland: I can only support what Mr. Cook said.

Mr. Lumsden: I see that the Law Society of England states that the notes issued by the Registrar on this matter are clear and reasonably comprehensive. I wondered if they were different from what we have in Scotland.

Chairman: No, they are the same.

5987. *Mr. Lumsden:* You do not mention anything about the working of section 185 dealing with the retirement of directors under the age limit. Have you any views, either on the suggestion that the section should be compulsory, without power to contract out of it, or that it should be dropped altogether?—*Mr. Cook:* We would rather drop it altogether than make it compulsory, but it seems to have been accepted and perhaps in the case of public companies it serves a useful purpose to draw specific attention to the fact that the age of a director is more than 70.

5988. If it serves a useful purpose, should it not be made applicable to all public companies?—Is it not applicable to all public companies?

5989. But you can contract out of it by amending your articles or, in the case of a newly incorporated company, putting an article in. You have no particular feeling about that?—No.

5990. It has been suggested that the procedure for winding up under supervision of the Court is now obsolete and could be abandoned.—I have no experience of the winding up under supervision of the Court, so as far as I know it is obsolete.

5991. And I do not think you mentioned the question of disclosure of nominee holdings at all. I assume you have no particular view as to whether legislation is required with regard to disclosure of the beneficial owners?—I have no particular views myself.

5992. Or the Council?—*Mr. Sutherland:* No.

5993. *Professor Gower:* Are you satisfied that the company limited by guarantee is really a sensible and appropriate organisation for non-trading companies? Do you think the guarantee really fulfils any purpose? Is it really any more than a piece of mumbo-jumbo? Have you known anybody ever call up this guarantee?—*Mr. Cook:* It is convenient to have a company limited by guarantee in certain circumstances, or at least a company which has no share capital.

5994. I accept that.—And if you have no share capital what are you going to have if you have no guarantee?

5995. The answer, I suppose, would be to have nothing. Does the guarantee really serve any useful purpose? Might it not be better to recognise that companies formed for charitable or quasi-charitable purposes can be formed without there being any liability on the part of the members at all? Have any of you ever known a case where they attempted to enforce a guarantee?—*Mr. Clarke:* There was a case recently in this city. A club went into liquidation and the liquidator called up the guarantees—there were 1,000 members, and the liquidator was in some difficulty.

5996. Did he get anything?—Yes, and he is still in process of collecting.

Mr. Brown: What about cases where there is no share capital and no guarantors who are members. They may be members without any liability. In Australia they do have no liability companies.

5997. *Chairman:* Gentlemen, those are all the questions we have to trouble you with, and it only remains for me to thank you very much for coming here and being so helpful to us.—*Mr. Sutherland:* Thank you, Sir. Apart from the memorandum, I wonder if I might raise one small point as regards the registration of names. It has only come to our attention since the memorandum was published, and it is perhaps not very important. As we are all aware, when persons are carrying on business under their own names it is unnecessary to register under the Business Names Act and apparently it

is not only unnecessary but the Registrar states he has no power to register a business name where persons are carrying on business under their own names; and we think this may give rise to difficulty in that presumably, while a partnership carries on business under the name of Smith and Jones with two partners of that name, another partnership of the same name can be formed in the meantime by different persons and be registered in that name. If the constitution of the first partnership changes, the firm will find itself unable to retain its name, because presumably it will not be able then to be put on the register. We feel it should be possible for people carrying on business under their own names, if they so desire, to register under the Business Names Act.

5998. Then you get competition, do you not, between two partnerships—both people trading under their own names

and having identical names?—That is so.

5999. You cannot get over that, can you? You have Brown and Robinson trading under that name, their own name, and if you have Brown and Robinson somewhere else in the country doing the same—what is the position then? They cannot be restrained from using their own names.—No, but I would assume one of them would have the advantage of getting on the register first.

6000. *Professor Gower*: But the Registrar in England does not refuse to register a name merely because another firm has the same name. If I am right, it is only in respect of company names in England where he does this: he does not do it with business names. There are plenty of Jones and Robinsons.—We understand, the position in Scotland at any rate, is as I have outlined.

(The witnesses withdrew)

(Adjourned until 2.30 p.m.)

MR. T. LISTER, MR. G. D. H. DEWAR AND MR. E. H. V. McDUGALL
called and examined

6001. *Chairman*: Good afternoon, gentlemen. We are very grateful to you for coming here and giving us your time, and also for the interesting memorandum which you have already submitted. You Mr. Lister, are the immediate past president of the Institute of Chartered Accountants of Scotland, Mr. Dewar is a member of the Council of the Institute and Mr. McDougall is the secretary of the Institute?—*Mr. Lister*: Yes.

6002. We have before us your very interesting memorandum, and members of the Committee have read it and no doubt will read it again. That deals with the whole field of our questionnaire. But the matter we particularly want guidance on is that of accountancy, and I think, as the time at our disposal is limited, the best course will be to begin our discussion with the accountancy problems involved, and I will ask Mr. Lawson to open the discussion.—Yes, certainly.

6003. *Mr. Lawson*: I thought we might perhaps start by considering the function of a balance sheet. You are aware, of course, of the definition of the functions of a balance sheet which is contained in the Cohen Committee's Report, and I wondered whether we could start by hearing whether you feel any amendments are needed to that definition?—We did not try to frame a definition for ourselves, and indeed the Cohen Committee's definition is not very often quoted nowadays other than in contexts such as this, and we do not think that definition wholly suitable. In our view anyone studying a balance sheet is concerned to form a view as to the value of the assets and not merely to know what they cost. The discrepancy between written-down cost and present-day value is of course to a great extent the result of the changes in the value of money which have occurred in the last 20 years or so. In our view the ideal arrangement, if it were practicable, would be to

revalue the fixed assets at intervals, and any such valuation should have regard to the going concern values, which would normally be related to written-down replacement cost, rather than to values realisable on liquidation. I make that point because it is suggested that any revaluation might be misleading in that it could not be obtained on liquidation. I do not accept that that is a relevant matter. If prices were to remain stable, as we hope they might, the intervals between these revaluations might be quite long. We recognise that the principle which I have indicated is an objective to be aimed at, rather than a fully attainable one, and we have never suggested that revaluation should be made compulsory. That, of course, does not give you a fresh definition, but it does indicate that we do not accept as relevant or adequate today a definition which concerns itself wholly with written-down actual expenditures on assets. Perhaps I would add this to the statement by the Cohen Committee and the consequent legislation of 1947-48, that in fact the present Companies Act does require disclosure of values in certain cases, for example quoted investments.

Mr. Dewar: Perhaps I might add that it might be particularly important to revalue from time to time in the case of land and commercial buildings; perhaps more so than in the case of industrial plant, because I think, as is suggested later, industrial plant might be specific to a particular business, whereas land and commercial buildings probably have a value quite separately from the trade which is being carried on.

6004. Am I right then in thinking that you do not consider it is the purpose of a balance sheet to show the values which might be realised on a liquidation?—*Mr. Lister:* Quite definitely.

6005. Then, from what Mr. Dewar said, you consider the problem of valuation arises mainly in connection with long-life assets, and particularly with those which have a value apart from the business—what you might term a non-specific value?—*Mr. Dewar:* Yes, I would agree.

6006. Would you have a different view, Mr. Lister?—*Mr. Lister:* I would say this, that one of the purposes of trying to

ascertain the current value is to measure depreciation properly, and that the land and long-life commercial buildings do not present nearly as important a problem for depreciation as plant specific to the business; and as regards the latter the current replacement value is, in my view, material.

6007. I will come back to the depreciation point if I may. There seems a slight difference of opinion between the two of you on that subject, in that I think Mr. Dewar is more inclined to the view that any measure of under valuation in plant and machinery which exists works itself out of the system quickly.—*Mr. Dewar:* I would not say there is a difference of opinion between us. I was merely mentioning one particular feature of assets.

Mr. Lister: There is no difference of opinion between us on short-life plant, where the problem is not a material one because it soon works itself out in any case—the motor-car, for example, replaced after five years' use.

6008. Following up from that, let us take first of all the type of fixed asset which is specific to the business—for example a steelworks and steel plant. I suppose the value of that is really dependent on the earning capacity of the business. Apart from the earning capacity of the business it might be said to have very little value—less than the cost?—Undoubtedly it would. But earning capacity is also related to the value in that the amount of depreciation—the amount you have to set aside to provide for ultimate replacement—is related to today's value rather than the value of 20 years ago.

6009. Before I come to that depreciation point, am I right in thinking that a good deal of your difficulty results from the very exceptional degree of inflation, we hope, that took place between, shall we say, 1945 and 1956-57? We have got into a situation where costs have really trebled over a relatively short period of time, and balance sheet values have got completely out of line. That is a fact, is it not?—That is so.

6010. Could we consider the position, on the assumption that we were going to get a period of 15 to 20 years when, if there were inflation, it would be on a

relatively minor scale. Do you think in those circumstances there should still be a revaluation of assets at periodic intervals, or is your requirement of revaluation linked to this question of inflation?—It is very largely linked to the question of inflation, Sir. If one accepted the assumption that you have just put forward, I think it would lead to a revaluation now, and one would hope it would not be necessary to have another one within the foreseeable future. It depends on how much you allow for as moderate inflation.

6011. Would you agree that in times of stable prices the tendency of costs of construction of plant and equipment, bearing in mind technical improvements which are going on all the time, is downwards; so that if you can imagine a situation of stable prices and periodic revaluation, the revaluation would normally be downwards and not upwards?—It might be.

6012. What would you say if it were downwards? Would you still say it should be measured in your accounts?—Theoretically, yes. In practice the downward rate would be likely to be so small that I would not think it was a practical proposition to make a revaluation for that alone.

6013. Would it be so small? Take, for example, electrical generating plant. You will see in the report of the Central Electricity Generating Board for 1959–60 that the capital cost of building a generating station is now rather lower than it was in 1948, despite the tremendous increase in the general level of costs that has taken place during that period. If you had had stable prices between 1948 and now, you would have had a very great reduction in plant cost, and there are other examples of that. What would you do in that type of case?—I think, if I may over-simplify by assuming that electricity is sold on commercial lines—that is for what it would fetch—I think I would come to the conclusion that the plant built in 1948 could only be valued today on the basis of cost per kilowatt of 1960, and therefore if it was at the higher figure it was over-valued.

6014. You would get a big loss in your accounts?—Yes.

6015. What would you do with that, write it off?—Write it off. I think you will appreciate it is rather theoretical, but that is the answer I would give in theory.

6016. It is not really a theoretical question, because we have in the last two or three years had much greater stability of prices, and there are I think quite a number of examples, I have given an outstanding one, where costs of construction have fallen as a result of new methods of construction.—It may well be, and I think the logical, the proper course would be to apply it both ways. I am far from suggesting that revaluation, if it is acceptable, is only acceptable in one direction.

6017. You are willing to face up to that situation?—Yes.

6018. *Mr. Watson:* In this modern world does a company normally just replace the plant that is worn out? Surely with the growth of research and the development of modern machines to eliminate the use of labour, is it not true that machines that are worn out are as often as not replaced by very much more costly machines?—Undoubtedly.

6019. Take, for example, in the cotton trade, the hand loom being replaced by the automatic loom. Your theory of depreciation is, I think you said, based on the idea of replacement cost, but how can you apply that theory to a situation of this kind?—I think my theory, although as you say it is based on replacement cost, is based alternatively on the view that you should write off as an expense of the year the amount by which your assets have deteriorated by the usage of that year, and I think in the case you have just mentioned that your antiquated looms would have diminished in value by something which would be a matter for ascertainment; either it would be a proportion of the cost of such looms, or it would be arrived at, in the case you have taken, by writing down those looms, like Mr. Lawson's out-of-date electricity stations. So that the situation would be dealt with in part by taking a loss due to obsolescence, and partly by writing off ordinary depreciation on what was left.

issue we have been discussing and would require the information to be incorporated somewhere, which would enable profits to be calculated on the replacement basis.

6034. That is a different point. I think many people take the view that if you make your profit and loss account on the historical cost basis, there is a lot to be said for explaining to the shareholders or the prospective shareholders that it is based on historical costs, and that an estimated amount of so much would have to be set aside out of the profits in order to maintain the business. That is a different approach. But I understood you to say that you contemplated that we should leave the existing situation as far as the Act is concerned, and when the auditor says "a true and fair view of the profits for the year" it may be either on historical costs or on present valuation; and you want us as a Committee to recommend that either would be permitted and both should run side by side.—The questions you and other members of the Committee have put to us indicate a good deal of difference of view held around this table. It would be foolish for me to suggest there was not a difference in the Scottish Institute as there is in other accountancy bodies, including the English Institute, and I think that is fair.

6035. Since you and I discussed this together some years ago, I think it is fair to say that in the English Institute, certainly on the Council, there has been quite a change, and I should have thought it was almost unanimously accepted in the English Institute, that you make your accounts on historical costs, but may go on and provide something out of profits by way of replacement. But I think there are very few people in my experience, certainly, on the Council of the English Institute who would accept the view you are putting forward now with regard to this.—Then I must withdraw what I said about the English Institute. But it is a fact that opinions are divided in the Scottish Institute, as they are divided in every other accountancy body I know of—certainly in America. That being so, we do not take the view that it would be useful to recommend that there should be a compulsory revaluation. On the other hand, we do take the view, and that is

very clearly set out I think in Appendix I to our memorandum, that there is a lot to be said on the side of revaluation, and that we do not want to see the thing frozen in the position in which it was in 1939 (and still is to a large extent—though many companies do revalue their assets now).

6036. To come now to another aspect of revaluation. There is the case of a bit of land or a building where owing to a change of circumstances the site value has tremendously increased, and perhaps that property could be put to a different use from that for which it is now employed, and which might greatly improve the revenue of the company, or it might be sold off for a very large sum of money. With regard to an asset of that type, a non-specific asset—I do not know what would be your view about that. It is difficult to see how one can deal with it in the balance sheet.—I think it is difficult, and I think that case is one of degree. Supposing one had a factory which could be used for some other purpose, for which it would be worth 20 per cent. more. I would not suggest that that was a major matter or that revaluation must show up an increase of 20 per cent. But if you had a dwelling-house used by the factory manager, which would be worth £50,000 if reconstructed as a shop, you would not be telling the shareholders all the facts if they were not informed of that in some way; if the management did not take steps to convert it, clearly they would not be using the assets to the best advantage possible. That is why I said it was a question of degree.

6037. Would I be right in thinking in your experience that type of case is not very common—that is to say, although there is a lot of shop property, for instance, which might be worth a good deal more than book value, nevertheless that is reflected in higher earnings of the shops themselves, so that if you are valuing on earning capacity it is not so important. The difficult case is one where the directors are not using the property to the best advantage.—That is the difficulty, but I do not think it is very common. However, there may be more cases than one knows, because in the nature of things you are not told about them.

the balance sheet each year?—I would say that was a somewhat special case. It might or might not be appropriate to carry these differences in. It partly depends on whether the tankers are really saleable or only theoretically saleable, consistent with the maintenance of the business; but I would prefer to take that out as a special case.

6026. That is a simple example, but fixed assets which are held in the business can have a market value. It is not that you are after, it is the cost on today's valuation?—It might be called the adjusted cost.

6027. *Professor Gower*: Could I put it this way? The Cohen Committee, despite what they said, did envisage that a balance sheet would give a picture of the state of affairs of the company as at the end of its financial year. They presumably thought in 1945 when they were reporting that a fair picture could be given even although you merely put your fixed assets in at cost less depreciation. Are you not saying that today, owing to inflation, you cannot give a true picture of the state of affairs of a company as at the end of its financial year by putting in the fixed assets on that basis?—I am really saying that. I would say the Cohen Committee contemplated that something had to be done about valuation in some cases. I mentioned that of trade investments. But on the other hand in the statement in their Report I cannot see much to indicate that they contemplated revaluation except in special cases, and that is where I do not accept the basis on which they proceeded. The question of inflation was looked at differently in 1945, but it already had begun. They perhaps thought it would go into reverse, which it did not.

6028. *Mr. Bingen*: The Cohen Committee did adopt the evidence of accountants of that day?—The definition (of the function of a balance sheet) adopted was not that of the Institute of Chartered Accountants of Scotland.

6029. *Mr. Lawson*: You are willing, as some people are not in this field, to face up to the fact that if prices are going down you would have to write your assets down. What would you do with the

deficit which would then emerge? Would you have to write that off against profits in the year, or what would you do with it?

—I am old enough to remember the reductions of capital that were common in the thirties, and if the company could not write it off out of revenue it would perhaps start with a reduction of its reserves. If you could not write it off out of reserves my view would be that you should go to the Court and have a capital reduction, as companies were doing wholesale 30 years ago.

6030. *Mr. Brown*: You would write it off first of all out of the year's profit?—Definitely not; I would only write off current depreciation, calculated according to the principles the company adopted, out of the year's profit. I have indicated what principles I would adopt in calculating such depreciation.

6031. *Mr. Brown*: You would set up a deficit account and keep the trading and the current profit.—I will come to this, but I would regard a proper statement of the profit of the year as ranking very high in the requirements of published accounts.

6032. *Mr. Lawson*: We will come to that later. I think the purpose of revaluation, apart from showing it in the balance sheet which Professor Gower mentioned, you have in mind is that generally speaking it would show a truer figure?—Yes.

6033. But on the other hand you do not propose that revaluation of assets should be made compulsory, so that as I understand it you would permit some companies to go on charging depreciation on a historical basis and others to charge it on a replacement basis, however you might define replacement. So that you might get two prospectuses appearing in the newspapers on one day, one would show the profits calculated by one method and one by another. I am wondering whether that would not cause a certain amount of confusion?—I think it would cause some confusion. But from the point of view of the man who thinks that the replacement basis is right, it does not seem very attractive to say that he must adopt a basis he thinks is wrong just because a lot of other people do. It is a dilemma from which there is no escape, except this, I would hope that more and more prospectuses would face up to this

issue we have been discussing and would require the information to be incorporated somewhere, which would enable profits to be calculated on the replacement basis.

6034. That is a different point. I think many people take the view that if you make your profit and loss account on the historical cost basis, there is a lot to be said for explaining to the shareholders or the prospective shareholders that it is based on historical costs, and that an estimated amount of so much would have to be set aside out of the profits in order to maintain the business. That is a different approach. But I understood you to say that you contemplated that we should leave the existing situation as far as the Act is concerned, and when the auditor says "a true and fair view of the profits for the year" it may be either on historical costs or on present valuation; and you want us as a Committee to recommend that either would be permitted and both should run side by side.—The questions you and other members of the Committee have put to us indicate a good deal of difference of view held around this table. It would be foolish for me to suggest there was not a difference in the Scottish Institute as there is in other accountancy bodies, including the English Institute, and I think that is fair.

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6036. To come now to another aspect of revaluation. There is the case of a bit of land or a building where owing to a change of circumstances the site value has tremendously increased, and perhaps that property could be put to a different use from that for which it is now employed, and which might greatly improve the revenue of the company, or it might be sold off for a very large sum of money. With regard to an asset of that type, a non-specific asset—I do not know what would be your view about that. It is difficult to see how one can deal with it in the balance sheet.—I think it is difficult, and I think that case is one of degree. Supposing one had a factory which could be used for some other purpose, for which it would be worth 20 per cent. more. I would not suggest that that was a major matter or that revaluation must show up an increase of 20 per cent. But if you had a dwelling-house used by the factory manager, which would be worth £50,000 if reconstructed as a shop, you would not be telling the shareholders all the facts if they were not informed of that in some way; if the management did not take steps to convert it, clearly they would not be using the assets to the best advantage possible. That is why I said it was a question of degree.

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6038. Do you feel that something should be done about it?—If there was revaluation, a proper revaluation, the thing would be brought into the daylight and pressure would be put on the board if they were not taking proper action.

6039. Now to turn your own alternative suggestion, which is that if there is not a revaluation, figures should be given separately of the costs of items which are more than 15 years old.—Yes.

6040. I think I see the thought behind it, but I am slightly puzzled as to why you fix on 15 years: and, if you are going back like that, ought you not to show the figures perhaps in blocks of years. For instance, there is a lot of difference between buildings built, say, pre-1939 and others built in 1945.—Yes. What moved the Council in suggesting 15 years was, I think, that it would give an approximate indication of how much capital expenditure applied to plant generally could be regarded as recent and up to date, and second, it would give an indication of the kind of £'s with which the assets had been purchased. Why was it 15 years? They took the view that that gave a reasonable division between the old and the new assets, and had also regard to the date at which the major inflation after the war began. If you ask me why not in blocks of ten years, I do not know that I have any very convincing answer to give. Perhaps Mr. Dewar would like to add to that.

Mr. Dewar: The figure of 15 years was taken, as Mr. Lister said, as giving a rough idea of the more recent capital expenditure.

6040A. As time goes on, in another 15 years' time, there will be a different position?

—*Mr. Lister:* As far as showing the difference between the old and the new is concerned, 15 years would be as good as ten years then, if it is as good today; as far as showing the effect of inflation is concerned, it might not be.

6041. I think you have in mind as an alternative that if we did not accept your view about valuation it would nevertheless be of value to shareholders to see the years or blocks of years in which the

assets were purchased; and if there were buildings built in 1939, the assumption would be that at present day values they would be a great deal more valuable?—Yes.

6042. I would now like to ask you for your views on what is quite a different point about which one or two decisions have recently been given in the Courts. That is, assuming the assets are revalued, for whatever reason, whether because of inflation or because of any other change in value, and a surplus emerges, what should it be reasonable to do with that surplus? There are many different views about that. The extreme view might be to say it is unrealised, and you should do nothing with it. Another view is that you may issue bonus shares so that it is incorporated in the share capital; and there is a third view which has met with some approval from Mr. Justice Buckley last week that it should be available for distribution in cash dividends to the shareholders. Of those three different views, what is your view?—We thought that a surplus on revaluation should not be available for distribution in cash. We saw no objection to it being used for a bonus issue. In forming that view the Council were concerned with what they regarded as consistency with proper accounting treatment, not what was possible under the law, and I would hesitate to embark on that latter question, Sir. Have I avoided answering your question?

Mr. Lawson: No, I think you have answered it, and I think on that question I would say the English Institute is in line with the Scottish Institute; I do not think there is any difference. The lawyers I think would not agree with either.

6043. *Mr. Lumsden:* I take it you would limit capitalisation to capitalisation in the form of shares and not in the form of debentures?—I would. But there again I am not quite sure that lines up with the distinction the law draws.

6044. *Mr. Lawson:* No, I was asking you purely from the accountant's point of view. There is another point about revaluation which I would like to put to you. It has been suggested to us that

occasionally—in my experience very rarely—the interests of preference shareholders, and participating preference shareholders, can be harmed by this writing up of assets because of the higher depreciation charge which emerges, as you have pointed out; and therefore they may not be able to get a dividend which they would otherwise have got. Do you take the view that that is something they have just got to put up with?—First of all I agree with your observation that it is a very rare occurrence in present conditions; the phenomenon that produces the need for revaluation also protects the preference shareholders by giving them greater capital cover. But perhaps that is not really facing the issue. I think one has got to look at the sort of case that could arise and ask what would happen, and as I see it what you are thinking of is a company which has only been able, without very much to spare, to pay the preference dividends, and if you adopt the revaluation, and if it shows you have got to charge more depreciation, it does so because that is what is needed to maintain the undertaking. If you pay it out in dividend, by definition you will not be able to maintain the undertaking, you will not be able to raise any fresh capital because your profit will not justify it, and I think the preference shareholders are going to be in that unfortunate position anyway. It may be a question of how soon. But I do not think maintaining historical depreciation only is going to be a very satisfactory protection for them in those circumstances. And furthermore, if the directors rejected the revaluation principle and said that they must retain enough profits to keep the business going and replace at higher prices, knowing, in the case I am postulating, that they will not be able to raise fresh capital, then the preference shareholders would be likely to be going without dividends anyhow—because the money would be needed to keep the business going.

6045. I think that is no doubt true in a number of cases, but I think one can visualise the case where in fact there is plenty of cash available—possibly because the business or industry is declining—and where dividends could be paid, and where you are prejudicing the present

shareholders by adopting this system of valuation. I am wondering what your view would be if that situation arose. Should it be left to the discretion of the directors in that case not to revalue, or do you think you ought to try and provide some safeguards?—I do not know whether, if I were left to make a judgment, that would be a case in which revaluation upwards would be appropriate. If you are taking a declining business, meaning a business which is not going to renew its assets, the whole problem shifts a bit. I think directors have to act in the interests of the company as a whole, and I think if what they do is done *bona fide*, the fact that it comes rather hard on one class of shareholders cannot be helped.

6046. Your answer is very much in line with the answer from another witness on the same point, namely, in that type of case normally the directors probably would not revalue.—I am really saying there might be no case for revaluing the assets.

6047. *Mr. Mackinnon*: You say that you would not want to see an unrealised capital appreciation distributed in cash?—Yes.

6048. Supposing an asset is sold for cash and there is a big profit on the sale of the asset, then would you contemplate that in any circumstances that type of capital surplus could be distributed?—I think, with respect, it is quite clear that it legally can be distributed, and I do not think there would necessarily be an accountancy objection to it as a matter of policy, if that is an accounting question.

6049. May I put the accountancy question? In order to justify the distribution of that surplus, I think you would agree that all the assets would have to be looked at to see whether their values were up to standard?—I quite agree.

6050. Supposing the surplus was realised on one-tenth of the total assets, and you then revalued the others and some assets were up and some were down. You would in that process be involved in a revaluation problem, would you not?—If you wanted to see the value of the assets there you would take pluses and

minuses. You would not be perturbed by one of them being down.

6051. But if the ones that were down were more than the ones that were up, and the surplus realised on the particular asset was not sufficient to offset the losses on the revaluation of the other assets, you could not distribute?—You should not distribute that, and I doubt if you could legally distribute it.

6052. What I am getting at is, in the hypothesis we are looking at, you have to revalue some of the assets, and you take a revaluation figure for that.—Yes.

6053. I do not quite see why you say you can distribute the profit on realisation, when the revaluation of the other 90 per cent. of your assets would justify it but you dig your heels in against distributing the unrealised profit. Do you see my point?—I do see your point. I think, as I said in a different connection, it is a question of degree, and I would feel that if you only justified distribution of the realised profit on 10 per cent. by the revaluation of 90 per cent., with a narrow margin your justification was not complete.

6054. So that the theory you are advancing is that you would not be justified in distributing any capital surplus so realised. You would have to take a further factor into account, namely the result of the revaluation of the other 90 per cent. of the assets?—I think that is right.

6055. That is going to produce a very difficult problem—deciding whether you have got a distributable capital surplus—I am wondering how you could express that in a legal way.—I did not suggest that one could graft something like that on to the law as it stands. One would have to tidy up the whole thing.

6056. *Mr. Lawson:* I was going to add an additional point—I do not know whether you agree with me. You would also take into account the extent of the surplus. If in valuing 90 per cent. of the assets you came to the conclusion that they were worth two or three times the present value, you would not be so squeamish about distributing the profit on the 10 per cent. that had been sold. Is

that not so?—Thank you, I had that in mind. I was assuming Mr. Mackinnon was speaking of the case where you need the revaluation of the 90 per cent. to justify distribution of the realised profit on the 10 per cent.—if there was an ample margin, in my view, it should be distributable.

6057. Some process of reason would have to be applied by the board in deciding whether there was a distributable surplus?—Yes.

Mr. Lawson: You would be entitled to distribute a capital profit because your capital clearly would still be intact.

6058. *Professor Gower:* At present you are entitled to distribute dividends I think on a current year's profit on trading account even although your capital has been reduced by losses in previous years. Do you want the whole law tidied up so that no company can distribute a dividend unless, after it has done so, its assets exceed its paid-up capital, or are you prepared to have the present rather illogical position that you can only distribute out of capital profits if your capital is intact, whereas you can distribute out of a current year's profit on revenue account even although your capital is not intact? This is what seems to me to be illogical.—I found this subject a bit illogical and it has worried me for many years because of that. I came to the conclusion, thinking through it again recently, that a firm starting point was this: you have a company with paid-up capital, and that is represented to the creditors as the measure of its ability to meet its obligations, and as long as the paid-up capital is intact the creditors would know the obligations could be met. That would not allow you to pay a dividend while past losses had impaired the capital.

6059. *Mr. Lawson:* The question I was going to ask you was, you do not take the view that you need not make good past revenue losses before distributing current revenue profit? You would take the view a number of accountants take that that is illogical, whatever the law may say, and that you ought not to pay any dividends until you have made good that loss?—That I think is right, and I think the-

ground on which I put it forward would be what the creditors were told about the total capital. I am not speaking for the Council now, that is just the result of some thought of my own.

6060. *Mr. Bingen*: Would you distinguish between fixed and circulating capital in considering whether the capital was intact. Can you ignore losses on fixed capital account?—No.

6061. *Chairman*: If you take an asset such as colliery leases, as one could get in the old days, they would have an ascertainable future life, say 50 years, by which time they would have been worked out. Supposing the only asset of the company consists of a wasting asset of that description, is it necessary to make the waste good before you can say the company has earned a profit?—It has not been so in law, I think that is clear, and I think the question of a company with a wasting asset, and in particular one wasting asset, whether it is a single ship or a colliery lease, would be a special case that would need consideration. I personally would say it would be a sound principle to say that the losses had to be made good, and at any point of time the paid-up capital ought to be there.

6062. *Mr. Watson*: Where you might have a realised capital profit and you might have an unrealised capital depreciation, would your view be that the realised capital profit should not be distributable?—That would be my view today; it would be my view, for what it is worth, of the law today.

6063. And in dealing with accumulated revenue losses, your view is that before you can pay dividends out of future profits you must either use these profits to eliminate that accumulated deficit or go through a capital reduction scheme?—Yes.

6064. Yet it has been true, has it not, that in the past, where realised capital losses have been made, revenue has been distributed as dividends quite legally, and that situation you would continue to allow?—No, I would not.

6065. It was a situation which affected a lot of investment trust companies in the early 30's when many of them realised

losses on changing their investments and there was a realised loss appearing in their balance sheets, and they went on paying from their current earnings their preference and sometimes their ordinary dividends. That you think should have been quite illegal from your point of view?—It was not illegal as the law stood, but I am saying if you applied the principle which I have tried to enunciate it would not be permissible.

6066. *Mr. Brown*: You would apply this approach to the case discussed earlier. Having revalued your assets, taking into account technical improvements, and written-off depreciation, would you rule that you must not pay dividends until you had rebuilt your capital?—That would have to be done on those lines.

6067. *Mr. Lawson*: Could I follow with a matter which causes us a great deal of difficulty, and that is the position of the share premium account. You remember that before the 1948 Act, if the articles allowed it there was no reason why share premiums should not be distributed as dividend. That was roughly the law. Then the 1948 Act tightened that up, and apart from one or two minor exceptions said that the share premium account should be regarded as capital for all purposes. On that point, to begin with, what is your view? Do you think the 1948 Act was right?—At the time I thought it was right; I thought it was silly to distribute the share premium; but being silly and being offensive in principle to the law are two different things, and I do not feel as strongly about the share premium as I did 14 years ago.

6068. How do you feel now about no par value shares? If we were to recommend that no par value shares should be permitted, would you agree that some part of the paid-up capital should be treated as a capital reserve or a surplus which could be distributed? In America I believe that is permitted. Would you go as far as that, or confine the possibility of distributing anything out of capital proceeds to share premium account?—I think if no par value shares are brought in you have got to accept what goes with it, namely, the cash representing a share

is what is paid for it, and you should not have it both ways. If you have shares with par value you can have par value and premium; if you have no par value shares there is no par value, and the whole thing is capital.

6069. You really draw a distinction between no par value shares and par shares issued at a premium.—There is a distinction. There again I must make it clear that this is not a point on which our Institute has made any submissions. I am expressing a personal view about this question of what can be distributed.

6070. You did say in your evidence that you were giving further thought to the share premium account, and I do not know whether your Institute has anything to add on that?—No, Sir, we have not as a Council anything to add to what is in the memorandum.

6071. The suggestion has been made by the English Institute that although share premiums should continue to be regarded as capital, nevertheless the rules should be amended so as to allow the use of the share premium account for a wider range of purposes. In particular, it is suggested that where shares are issued at a premium in exchange for shares in another company, then the share premium account could be used to write down the cost of those shares so as to eliminate the goodwill element. I take it you probably favour that sort of thing personally in view of what you have said?—No, I do not think I do, Sir. I start with this. On an amalgamation or an acquisition the price paid is, broadly speaking, ascertainable—it is exactly ascertainable if it is in cash and it is approximately ascertainable if it is in shares at a premium—and that is the price the acquiring company has paid for what it has acquired. It is not material in my view initially whether it has acquired tangible assets or intangible assets, and therefore I do not think it is appropriate that the share premium that arose could be used to write off the intangible assets. That should be dealt with on valuation or by appropriations, as it would have been if it had been its own goodwill from the beginning.

6072. *Mr. Bingen*: Assuming you write down the shares acquired against the share premium account, all you do is reduce the balance sheet on both sides, you are not distributing anything in any way. Who is detrimentally affected?—Nobody is detrimentally affected. It is just a partial revaluation and I deal with it on general principles; I would not deal with it differently just because it happened to be share premium. But of course if it is linked to what was said earlier about the paid-up capital, then the share premium becomes a different matter altogether.

6073. *Mr. Lawson*: The way the point has been put is this. In an amalgamation of that kind, the effect of bringing the acquired shares in at full value, including goodwill, based upon the market value of the shares issued—that is broadly the way in which you provide for that—is, when you come to consolidated accounts, that you are valuing the business you have purchased on one basis, namely the fairly high value based on market prices, whereas the assets of your own company, including the goodwill of your own company, are not revalued so that the consolidated account is a mixture, and you have a goodwill figure applying only to one part of your combined business. Do you see what I mean?—I do, Sir, and I confess I also see the advantage of revaluation, getting them both on to an appropriate basis.

6074. You would not revalue the goodwill, would you?—It all depends. In principle I do not know that there is anything more vicious in that than in valuing anything else.

6075. *Mr. Mackinnon*: Of course a goodwill value could be taken into the consolidated balance sheet and shown as goodwill which might not be goodwill at all, it might be represented by the real excess value of the assets acquired over the book value at which they were taken. That could be a misleading description of the balancing item, could it not?—It could be, and it would be if insufficient inquiry had been made as to what values were really reckoned for the assets acquired. If I were consolidating a balance sheet of a newly acquired subsidiary, I think I would want to know

what information the directors of the acquiring company had about the true value of the fixed assets, and only after taking account of that would I recognise goodwill in the purchase.

6076. In other words your description of the balancing item in the consolidated accounts would not be a goodwill description but might well have another description, on your principle, you would write up the value of the assets acquired? —There might be no balancing item, it might all disappear, but if there were a balancing item on that side it would be of the nature of goodwill.

6077. But not necessarily. The practice today is just to balance the item with a figure called goodwill on consolidation? —*Mr. Dewar*: I would not say, Sir, that it is the practice to do that without considering the value of the assets. I think that, if a price were paid for the shares in the subsidiary company, in bringing the subsidiary's assets into the consolidated balance sheet, they would be looked at again in the light of any values the directors had in mind when they paid for the shares, and fresh values might be placed on those assets for the purpose of consolidation, thereby possibly reducing the amount of the balancing factor which would be described as goodwill.

Mr. Mackinnon: That is the point I wanted to bring out.

6078. *Mr. Lawson*: What would you say about using the share premium account to take care of an accumulated debit balance on profit and loss account—the point we were on just now? At present, of course, that is not permitted, you have to go to the Court for a reduction of capital. Do you think that should be permitted without leave of the Court, or how do you feel about it? —*Mr. Lister*: That is all part of this question of whether you are going to face up to a fundamental revision of the law regarding distribution and so on. If you adopt the line that I suggest is a possible one, that what has to be maintained is the nominal paid-up capital, then the share premium would be available to write off a debit balance on profit and loss account. If you adopt the present view, the view of the 1948 Act, that share

premium must be treated in the same way as paid-up share capital, it would not be available, and I think a good deal could be said at least for examination of the former view. But I do want to repeat it is a personal view that I have offered to the Committee.

6079. Could we come from there to an even more difficult question, the question of pre-acquisition profits? I think your Council has given us some evidence on that. I think broadly the effect of that evidence is that where a holding company buys shares in another company for cash, then those shares have to go in at the full value in the balance sheet of the holding company, and that pre-acquisition profits if distributed as dividends to the holding company have to be applied in reduction of the cost of the shares. Therefore they are frozen as capital reserves. That is the position if the shares are bought for cash? —Yes.

6080. But on the other hand if the acquisition is made through a share transaction, and if that share transaction results in a share premium account, you are suggesting, I think, that you would allow the use of the share premium account to write down the value of the investment to the extent that pre-acquisition profits are brought in as dividends? —That is substantially what we are suggesting, and that is the only suggestion we make for cutting into the share premium account. That, I think, corresponds in substance, although not quite in form, pretty much with the recommendation of the English Institute on the same topic. But they require certain sanctions that we have not thought about.

6081. I think in principle it is the same, but let me put one or two questions. At what point of time would you suggest the share premium account might be used in this way? Should it be used in that way immediately after every amalgamation or only when the dividend is paid to the parent company from the subsidiary, which of course might be ten, twenty, any number of years later on? —I would not touch it until the dividend was paid.

6082. Would you consider this? Supposing in the meantime credit had been

given to that parent company; would you not think those creditors would feel that they had been damaged if they suddenly woke up later on and discovered that the share premium account was being used in this way and that the assets of the company were not what they thought they were?—I should have taken that into account and given a different answer to the previous question.

6083. I think that must be right: it has to be done at once.—Yes, as long as the share premium account is subject to the submissions we have made.

6084. Do you think there is any danger of that leading to abuse in the sense that a holding company, which was perhaps beginning to get in a bit of trouble, whose directors were under criticism because dividends had not been maintained, could in effect buy profits by buying up other companies with large profit and loss balances.—First of all there is the question of how these dividends, drawn out of pre-acquisition profits, are to be described. I would think it quite improper to describe them as profits of the holding company. They ought to be shown as emerging in a way that makes it quite clear they are not profits but pre-acquisition profits used in this special way. So the first possibility of misunderstanding or misrepresentation would be taken care of by that. It would still be possible, if the company had no current profits out of which to pay a dividend, and nothing but a dividend was looked at, for misunderstanding to arise.

6085. *Mr. Brown:* Would not a consolidated profit and loss account overcome that?—Or even an ordinary profit and loss account would overcome it; but if somebody simply looks up the Stock Exchange records and sees the dividend of so much paid, that would not overcome it.

6086. *Mr. Lawson:* But the origin of the restriction in the 1948 Act on the use of the share premium account did arise, I believe, partly from a well-known case in pre-war days, where the directors used the share premium account in order to pay dividends which could not otherwise be paid on preference shares, and so avoided the preference shareholders getting votes:

thus they were able to maintain themselves in office without being thrown out by irate shareholders. If you are arguing this in the way the English Institute is suggesting, are we going right back to permitting that type of situation?—I think there is a danger: whether it is a big danger or one that would outweigh the supposed advantages of being able to do this, I could not offer an opinion.

6087. I think the English Institute's evidence is that in many cases this is perfectly legitimate and should be allowed. There are cases where it should not be allowed, and of course it is extremely difficult to legislate to distinguish between them: that is what it comes to.—Personally, I find it difficult to envisage a case in which anybody would want to do it.

6088. I have given you one example: it may be a bad one.—One has thought of, for instance, the case of Insurance Companies. There is the possibility of a very bad underwriting year just after the amalgamation, and the company nevertheless wants to pay a dividend. The directors of companies do not like the accounting nonsense, as they look on it, that because profits have been earned at a certain time they cannot be distributed.

6089. I think in almost all amalgamations in my experience, the directors want to treat these pre-acquisition profits as available for dividend; yet personally I have never found a single case where it ever became necessary to use them.—My experience is the same.

6090. *Mr. Brown:* Is it right to say a revenue reserve for special losses is only used when the occasion arises? Surely the mere ability to begin trading and taking large risks depends on having those large resources, to have them when they are needed?—Would it not be the case that the ability to go on trading depends on having adequate resources—not on whether they are capital or revenue reserves?

6091. Strictly, yes; but in practice the risks you take in business, particularly where the results fluctuate substantially, depends on having available reserves without prejudicing your capital. If they are frozen, you have to start building

available reserves again.—I am afraid I am not quite with you, Sir.

6092. *Mr. Lawson*: I should like to turn now to a few points which you will probably find less contentious. Do you think there is anything to be said for providing that companies should disclose the method of depreciation employed on fixed assets—whether straight line or reducing balance, and approximately the rates on the major assets?—It sounds attractive, but in the case of the larger companies there might be several categories: the rates might vary, and I think in practice it would be found not to be terribly helpful for that reason. I do feel, unless there is a reasonably substantial case for putting more detail into published accounts, we tend to have too much rather than too little detail now.

6093. *Mr. Bingen*: I take it you, as an auditor, regard it within your province to be satisfied as to the depreciation rates? If they were demonstrably too little, would you comment to the board of directors on that?—Yes, and I am particularly concerned to see they are consistent. If a company had been applying 10 per cent., and cut it down to 5 per cent. and did not say anything, and the figure looked about the same because there was a lot more plant, I would say that was something which required comment.

6094. So there is the preliminary check, by virtue of the auditors?—Yes, but the Committee must not get an exaggerated idea of the auditor's ability to judge the rate of depreciation.

6095. *Mr. Lawson*: It makes a tremendous difference whether you employ the straight-line method or the reducing balance method in the early years.—Yes.

6096. And it is mainly for that reason I asked you the question. Do you think it would be helpful?—I think on the whole there is something in that. Again, it might depend partly on the type of company. For instance, you get the Steel Company of Wales, which put up an enormous plant a few years ago, and no doubt employs the straight-line depreciation method. It will not be replacing that plant, or any other plant, for a long time.

You also get, say, I.C.I., who are putting up plants every year, and it does not matter very much whether it is straight-line or diminishing value in the latter case.

Mr. Bingen: Unless their capital expenditure falls off in later years.

6097. *Professor Gower*: I can see one will sometimes be appropriate and sometimes the other, but surely it does make a difference to the informativeness of the accounts to the shareholder? I can see that either method may be appropriate, but I cannot see why you should think the shareholders would not be interested in knowing which method has been used. Surely it makes a considerable difference, in using the accounts to assess the true value of the shares, according to which method is employed, particularly in the early days, as Mr. Lawson has said?—Yes, I think on the whole it is right that some indication should be given as between straight-line and reducing balance.

6098. *Mr. Lawson*: I think it is important in the case you mentioned, where there is a big expenditure on one single item of plant and then not any further expenditure year after year: if there is further expenditure year after year of approximately the same amount, it tends to work itself out.—Yes.

Mr. Bingen: I am not quite sure how you would disclose these figures in the balance sheet, where you have different rates of expenditure on different plants—as in the company with which I am concerned?

Mr. Lawson: I am not sure; but you can say "We are on straight-line or decreasing balance". If the shareholder knows whether you are on straight-line or not, he has the balance sheet in front of him and he can make a calculation of the rate.

6099. *Mr. Bingen*: What about investment allowances: should they be disclosed?—I think investment allowances are usually indicated by a note.

6100. *Mr. Bingen*: They have not got to be.—The Act says nothing about them: they did not exist when the Act was passed.

6101. *Mr. Lawson*: I would like to come back to some of these points later, if

I may. Have you any views about the present distinction between capital reserves and revenue reserves? It is a rather curious definition in the 1948 Act. It has a lot of merit for people like you and me, because it is pretty easy to apply. Do you think we ought to be a little more scientific about it?—I think the only firm distinction that can be put into the Act should be between reserves that can legally be treated as revenue reserves and those that cannot: in other words, not this business of "regarding" it as capital. It is not satisfactory, because that is purely a matter of opinion, and the Act does not say whose opinion.

6102. No, I can see why our predecessors came to that view though, because it is difficult to define a distributable profit, is it not?—My view would be that the classification should be based on the legal position. That would have the consequence of some reserves now classified as capital being reclassified as revenue; and in that case I would prefer to have capital reserves and other reserves—just as a matter of phraseology. The other reserves would be sub-classified as the auditors and directors saw fit.

6103. Where would you put the realised capital profit which could be distributed, given the proper valuation? Would you put that with the other reserves or in the capital reserves?—I would put it as distributable capital reserve, if it was clearly ascertained. Whether or not it was distributable might depend on the articles of the company.

6104. Yes, I see that: but broadly you would divide it between what is distributable and what is not?—Yes.

6105. I see. Now to follow on from there, could we have a look very briefly at a few of our Institute's recommendations? You know the recommendation about stock-in-trade, a rather contentious matter, which has been recently issued. The English Institute say companies should describe in a fair amount of detail the method employed in valuing the stock—that is what it comes to, I think. Do you think that is the sort of thing we ought to put into the Eighth Schedule?—I think, as in the case of depreciation, it is easy to describe it in many cases but not in

all; and I would hesitate to say it ought to be put into the Schedule. I am speaking personally, we made no submission as a Council on that point. I would add this, if I might, that what strikes me about the question of stock more than anything is that the adoption of a consistent basis from year to year does not, of itself, necessarily suffice to produce a fair statement of profits from year to year. I do not think you would be able, by regulation, to overcome that difficulty; and that seems to me to be the thing one ought to concentrate on.

6106. Could we put the question differently? Given that there may be differing views as to what is a proper basis to adopt in regard to stock, and particularly as regards overhead expenses, it must be common ground that if you do not put in overheads you get a different trend of profits shown from that which emerges if you do put overheads in?—Yes.

6107. And I think the reasoning behind the Institute's recommendation, which does not attempt to determine the question as to whether you should put in overheads or not, is that you should disclose to the shareholders which method is being used.—I think that would be going a long way, and it would be beyond what public opinion other than in accounting circles would accept just now. I am thinking of the difficult cases. One gets, for example, the aircraft industry, where you have an enormous amount of work in progress, the valuation of which on any basis may largely depend on settlements not yet made with the Ministry concerned; and I should have thought the difficulties of arriving at a valuation there and the difficulties which the company concerned would have in explaining the basis of valuation would cause a very great deal of opposition to disclosure.

6108. Would you say do nothing then, as at present, or should there be some change?—I would be content to leave it on the basis it stands on at present, hoping that as regards the question of valuation, and particularly in relation to overheads (which is just another aspect of this valuation question generally) we would move in the direction of including overheads to a greater extent than at present.

6109. Yes, you would rather leave present practice to develop still further?—I do not think it has developed far enough to be desirable to regulate it now.

6110. I see. Then generally there are quite a number of other Institute recommendations which you know have been made since the 1948 Act, and of course a number of them are small points of detail. But there are some which are more fundamental. For example, the recommendation was made fairly recently about disclosure of information in connection with pension fund arrangements. I am wondering whether it is that the time has not come when companies ought to give some information as to the type of arrangements they have in regard to pension funds, and as to whether there is a solvent pension fund, or commitments for pension funds that are not provided for—that type of thing? Have you any views on that?—I could only offer a personal view on that again, Sir; and I should have thought there was not sufficient reason to place an obligation on companies to disclose pension arrangements. I would be content with the matter as it stands at present.

6111. It is done in America, I think the S.E.C. insist on it—but you think we have not reached that position here?—I think your Institute recommendation, paragraph 32, refers to the accounts of an employer who has contractual obligations. I think contractual obligations ought to be dealt with, of course. I think that would be necessary in any case, unless they were taken to be in the ordinary course of business—like any future obligations in the ordinary course.

6112. But there is a great variety of practice as to how these things are dealt with in balance sheets. Anyway, you are rather inclined to be against that?—Yes, I am against legislation on that point.

6113. Would you agree that nowadays the question of investment is becoming much more of a science? That is to say, there are more people who study it, and advice is based much more on figures and facts than it used to be; and in consequence of that change there is perhaps a demand

for fuller information than used to be the case?—Most certainly.

6114. And therefore in approaching this question of what should be in the Eighth Schedule, it is that climate of opinion that we have to have in mind?—Yes.

6115. You agree in general?—I would agree to that.

6116. *Mr. Scott:* Do you mean the demand from shareholders for more information, or from creditors?—Certainly not from creditors at present: but from the best-informed shareholders I would distinguish between the best-informed and the average shareholders.

6117. *Mr. Lawson:* I had in mind, particularly, stockbrokers and investment advisers. There is the associated company or, if you like, trade investments, where the holding is something below 50 per cent. but is nevertheless substantial, and where under existing legislation the accounts reflect only the dividend received from that investment. You, I think, advocate giving a good deal of information in that type of case?—We do.

6118. I would suggest two points: firstly, would you agree it would be sufficient to give information of that kind in the aggregate, and it is not necessary to give the details of each particular investment?—I think in many cases it would be sufficient to give it in the aggregate, and if it is given in the aggregate of course it is in a more easily assimilated form than if it is given in great detail. There would be no doubt cases where a particular trade investment was so different from the others or so large in relation to the others that it might be proper to give information regarding that one separately; but at this stage we would not recommend any more than the aggregate.

6119. And in your evidence you tend to stress the importance of the asset position or the balance sheet position in these companies. I am wondering whether you would not agree that it is the profits which are really more important, in that the company which owns the investment can look forward to higher dividends if the amount of dividend they

are at present receiving is only a small part of the profits. On the other hand, the assets of that company will never be available to the parent company?—No, the assets will not be available. What we suggest here about capital reserves and revenue reserves would give a useful indication of magnitude and change in magnitude, and further, that the statement of the revenue reserves, taking the year in question with the previous year, would indicate the growth in retained profits. So it would give an indication, though a little obliquely, of the earnings, as distinct from the dividends.

6120. Would it not be better to take the earnings quite separately and say what proportion of those earnings had been distributed, rather like one has to say now in the cases of consolidated accounts?—That would be another way of approaching it, and if it was decided not to give the capital and the capital reserves and the revenue reserves, it would be useful to give the profits of the year.

6121. Perhaps in addition?—I am suggesting that what we recommend would virtually give the retained earnings, and would have the merit—if it is a merit—of being one fewer item than if you gave it twice.

6122. I see: but anyway you feel some information of that kind must be given, and we ought to amend the Eighth Schedule to provide for it?—Yes. I would make this possible reservation, that when you are giving information extracted from accounts and not the full accounts themselves, there might be cases in which disclosure of earnings could be misleading.

6123. Yes. I suppose one would have to cover that with a note in some way—"the true and fair view" would still operate, would it not?—Yes.

6124. *Mr. Brown:* Your suggestion here is limited to cases where, a company is holding, say, 25 per cent. of the associated company and this holding is material in relation to the total assets of the parent company. Would there not be a case where, even a 10 per cent. holding in the associated company would be material

in relation to the parent's assets?—I suppose that would be true.

6125. I can think of one case where a 10 per cent. holding in the associated company is a very significant part of the holding company.—Our suggested figure of 25 per cent. is arbitrary. I suppose one might say 25 per cent. was too high or too low.

6126. *Mr. Lawson:* On another subject, what do you feel about the growing practice, certainly in America, of showing what one might term a movement of funds figure, showing where the cash had come from during the year. Have you any views on that?—This is not a matter on which we had any submission to make; so I can only give a personal view again. It has always seemed to me just one more statement to read and not particularly useful. I am not much impressed with it as an addition to balance sheet and revenue account; but I know it is practised in America.

6127. It is true, of course, that with pencil and paper anyone can arrive at it from the existing accounts.—That is precisely why I am against it.

6128. What is your view about this rather complicated question of the future tax reserve. That is rather left in the air in the Act, and I suppose we ought to try and make it clear one way or the other. Would it be better to treat it as a liability and be done with it?—My view is the future tax reserve may be a reserve or a provision, and it is a question possibly of fact or at least of judgment, in each case. At the one extreme you have a company with a business of a very stable nature and the amounts set aside for future tax could well be almost entirely reserve. An example of this would be a company with tankers let on long-term charters, possibly for 20 years. And, at the other extreme, you might have a company which had had an exceptionally good year or, might be entering on a year when no profit was likely to be earned. I suppose that would be true of some of the motor companies today; and future tax in such case would be wholly or largely a liability. Therefore I do not think it would be proper to lay it down in an Act of Parliament whether it should be a liability or reserve.

6129. The usual method nowadays is not to describe it as either a reserve or a provision, but to show it as a separate item below the capital and reserves. Would you agree that is probably as good a method as any?—Yes.

6130. Now I think the greatest difficulty arises on this point in connection with amalgamations because the legal view seems to be that this is a frozen reserve; and the purchasing company get into great difficulty if they have to treat that as a frozen capital reserve, whereas they would like to treat it as a liability—or something between a liability and a reserve. Do you not think we should do something to ease that situation?—I think if you do something on the lines that we discussed earlier about pre-acquisition revenue reserves, it really forms part of that problem.

6131. But supposing we did not go as far as that?—You are still left with the problem of doing something about this one. I think if you have sound reasons for rejecting any tinkering with the share premium account you will find it very difficult to justify doing anything about future tax.

6132. Will you?—because you have said yourself that in many cases this future tax is really in the nature of a necessary provision; not always but in many cases. If it were, surely you should be allowed to treat it as such?—I would have no hesitation in treating it as such if it were in fact a necessary provision; and I do not think a lawyer would tell me it was not a necessary provision if the directors said it was a necessary provision.

6133. You have been more fortunate than I have. Now in America I believe they have to disclose particulars of long-term rental agreements, or some sort of summary of them; and I imagine the reason for that is precisely that it is, I suppose, a pretty large liability in some cases which it is thought shareholders should have information about, and secondly it does tend to give an indication of the assets really employed in the business. If you want to compare a business which rents all its assets with a company which owns all its assets, you

are in some difficulty unless you know what rentals are paid. Have you any views on that? I know it is not general in this country at present.—I have this view, Sir—that it would be very desirable for profit and loss accounts to give the best indication possible of all fixed overheads—not only rentals under long-term or shorter-term contracts, but fixed overheads generally. That would be a very valuable piece of information for anybody studying the accounts. Indeed, I would attach much more importance to that than to a disclosure of turnover alone; but I do not think the items that would come under that category are capable of sufficiently rigid definition to be suitable for inclusion in the Eighth Schedule. You could of course single out long-term rentals and say they had to be disclosed. I do not think I personally would have any objection to that; but again that must be a personal view.

Mr. Lawson: But if we were to provide that fixed overheads were to be disclosed in a reasonable amount of detail, my point would automatically follow.

6134. *Mr. Bingen:* When you said “fixed overheads”, were you using that term to distinguish them from variable overheads?—I meant fixed overheads as distinct from those that vary roughly with turnover.

6135. *Mr. Lawson:* You do not say anything about turnover in your evidence, do you?—We considered that. We rather took the view that the emphasis on turnover as an item demanding separate disclosure had been exaggerated, because there were others which we thought of as more important; and we were also impressed by the strength of the view held by many directors that disclosure of turnover would be harmful to their companies. We thought if it were made compulsory it was likely there would be some procedure for obtaining exemption, and there would be many applications for such exemption.

6136. I think we have had evidence on that subject from both points of view, and I think it is valuable to have your view. Perhaps we should leave it at that: your official view is not to express an opinion at all, is it?—The view of the

Institute is that there should definitely be no compulsion to disclose, and the explanations I have just given are partly Council views and partly my own.

6137. I see. You state that where group accounts are not required and there are no outside shareholders, it should not be necessary to give the information now required about profits in paragraph 15 (4) (b) of the Eighth Schedule? Is that really right, have you not still got to consider creditors in that type of company?—The creditors would get additional information if that were given. We take the view that this was probably an oversight in drafting, and if the group accounts were dispensed with there was no adequate reason for retaining the very restricted substitute for group accounts; and if the interests of creditors were important we were rather thinking the way to take care of them would be by not dispensing with group accounts.

6138. Could I now leave accounts altogether and come to auditing? The first point I want to ask is about the audit certificates of banks and insurance companies and the like. You suggest the Ninth Schedule should be amended as regards that type of company, so that the auditor would not be required to refer in his certificate to the true and fair view?—Yes.

6139. My thought on that is, is it not going to weaken the position of the auditor? There are some things which can be done under the present exemption granted to banks and insurance companies which probably today an auditor would not allow to be done, because he would have to say "This is a true and fair view and I am not prepared to go as far as that if you do this". It seems to give the auditor a certain power, which would be removed if your suggestion were adopted.—I am a little puzzled by that. We suggest that instead the auditor should say the balance sheet and profit and loss account are properly drawn up so as to disclose the state of the company's affairs so far as is required—omitting reference to a "true and fair view". If the auditor has now a sanction in refusing to sign, would he not also have a sanction in refusing to sign a

report that it was properly drawn up? Would that not answer your question?

6140. I am not sure that it would under the present wording. The view could be taken—we have asked the banks this—that it would be possible for a bank, within those exemptions, to bring back part of its secret reserves to cover its ordinary banking expenses. I am not suggesting any reputable bank would do that, but it seems to be permitted; and if that is going to be permitted under the Schedule should not the auditor have the sanction of saying "I won't pass this because it is not true and fair. I will pass it as true and fair if it shows the usual trend of profits"—which is normally done—"but I won't pass an upward trend when the profits have clearly declined". That I think he could do under the present position more easily than he could do if the requirement were changed as you have suggested?—Paragraph 23 (2) of the Eighth Schedule says the accounts of a bank should not be deemed, by reason only of the fact that they do not comply with any requirements of Part I from which the company shall be exempt, not to give a true and fair view. Of course, that could be altered to "not to be deemed to be not properly drawn up"—or something to that effect. I should have thought the auditor of a bank would still be able to say, "This is going beyond what I will accept". Notwithstanding Paragraph 23 (2), if it were possible for him to say that, I would not have thought the use of true and fair affected the question: but that is a matter of opinion.

6141. You think he can still exercise some influence, I see. Is your objection to stating that it is true and fair confined to the profit and loss account? One can see that, as regards the balance sheet, after all the amount of reserves needed in a banking business must be very much a question of broad estimation, and some sort of reserve is obviously necessary.—I think what we say about true and fair applies to both. If it means true and fair subject to something that makes it not true and fair, we do not want to be compelled to say that it is—and whether it does make it not true and

fair, one could not say without seeing all the figures one was talking about.

6142. No, I accept that: but I can visualise that in some banks' accounts, at any rate, bearing in mind the nature of the business and the immense size of their liabilities, that on a reasonable interpretation of the words "true and fair" it might be said the balance sheet is a true and fair view, but it might be difficult to say that about the profit and loss account.—I would accept that. In that case the auditor's report would say "a true and fair view" applied to the balance sheet, and not true and fair but "properly drawn up" applied to the profit and loss account.

6143. I think the difficulty would be greater in the profit and loss account than in the balance sheet?—That would be so in almost every case.

6144. *Mr. Watson:* And yet it is true that the balance sheet contains hidden reserves which are not disclosed?—Yes, I agree; but *Mr. Lawson*, I understand, is putting it to me that those hidden reserves are, or may be, only what are reasonable.

Mr. Lawson: Having regard to the nature of the business and the nature of its commitments.

6145. *Mr. Watson:* You would accept non-disclosure in the balance sheet as not vitiating the true and fair view, whereas if the profits are reported after some undisclosed appropriation you would find that difficult to accept?—I would find it difficult to accept as regards the profit and loss account. As regards the balance sheet, it would be a question of the magnitude of the non-disclosure in relation to the disclosed figures.

6146. And if, as *Mr. Lawson* has said quite rightly, the practice amongst the banks is in the normal way for their disclosed profit to reveal fairly accurately the trend of earnings, would it not be sufficient for your purpose?—I find it difficult to say yes to that, because if the trend of earnings were disclosed but the earnings were understated year by year, or overstated year by year, it would still not be, to my mind, a true and fair view.

Mr. Dewar: I think, too, that anybody looking at a bank's profit and loss account is not to know whether the trend shown is following the real trend or not.

Mr. Watson: Past history is the only guide to that, I must accept that. But where this undisclosed appropriation is made, it is made no doubt with due regard to normal banking prudence in the light of a bank's very large liabilities in relation to its capital and reserves: and, if I may comment on it, I admire the way in which your comment is made on banking exemption from the point of view of disclosure of reserves—the way in which in the memorandum you have rather skated round this whole question of whether banks should continue to have this exemption. You do not in fact make a categorical recommendation on that, if I have read your recommendation correctly.

6147. *Mr. Brown:* I think we would all welcome, quite apart from your evidence as accountants, your evidence based on long experience as to whether you think it is in the public interest that these exemptions should be continued.—*Mr. Lister:* It is quite clear first of all that on accountancy grounds we would not recommend the continuance of these exemptions at all, but we recognise there are matters of public policy involved which we, as an Institute, did not presume to pronounce on. I do not know if you want me, *Mr. Chairman*, to offer any opinion on the question of public policy? I do not think it would be of any value.

6148. *Chairman:* I am sure it would be of value, if you feel like indicating it to us.—I was impressed till 1957 with the desirability of the banks maintaining undoubted strength and of the virtue of this exemption if it assisted them to maintain the strength and general appreciation of that strength. When I noted in 1957 that certain banks did not provide for depreciation of investments I came to the conclusion—with no knowledge and very likely quite wrongly—that they could not, out of their undisclosed reserves, do so and therefore the existence of undisclosed reserves had been shown, when the stress came on, to be not nearly

such a source of strength as I, at least, had assumed.

6149. That point has been taken, I think, in the Committee. I am not quite sure how it was left on the actual facts of the case, but you say in 1957 they appeared to have come to the end of their secret reserves?—I was a man in the street, and had been practically invited to assume it. I do not think they had—I expect they had not—but that was the impression caused on just one man in the street by the events of 1957.

6150. You did not rush to the bank and draw all your money out and put it in the Post Office Savings Bank?—No. Perhaps I could add this: my account was with a Scottish bank and I do not think any of the Scottish banks were in that position.

Mr. Watson: If I may comment on that, the evidence we had from the banks suggested that though these depreciation figures were shown it was not to be concluded from that fact that the inner reserves of the banks had been exhausted.

Professor Gower: Whether you were mistaken or not, the operation of the present rules led a highly intelligent person like you to have your confidence sapped, whereas everybody is saying the present rules enable stupid people, as well as intelligent ones like you, never to have their confidence sapped.

Mr. Watson: I suggest that your confidence was not sapped: at any rate you did not take your money out of the bank.

6151. *Chairman:* Would you allow any distinction for this purpose between the clearing banks operating in the comparative peace of this country, and the British overseas banks who operate all over the world, sometimes in very difficult conditions? We had evidence from them to the effect that their case was not comparable to the case of the banks at home.—I think the impression that I indicated to you, Sir, would apply to any bank, joint stock bank or overseas bank, if the circumstances were similar.

6152. *Mr. Lawson:* If I could move to quite another point, this is a matter on which there was a difference of opinion in

the Council of the English Institute, and so perhaps you would be able to give us some help here. Do you see any objection to the provision for exempt private companies, that a partner of a director may act as auditor?—So far as exempt private companies are concerned, we think that has been found very convenient, and we have no knowledge of any abuse of it. Therefore we would not, as regards exempt private companies, recommend any change.

6153. I see. Supposing the exemption were withdrawn so that even the family business and the very small business had to file its accounts, would you then feel that would alter the position, or would there still be a need in some cases for the partner of a director to act as auditor?—Our Council had not recommended the removal of the distinction between exempt and non-exempt private companies, and so they did not consider the question in relation to the present non-exempt private company. I can therefore only speak personally again. I believe there are something like 80,000 non-exempt private companies out of a total of some 340,000 private companies, and those 80,000 are at present precluded from appointing a partner of a director as auditor. We think that before recommending that any alteration should be made as regards those 80,000 the Council would wish to consider the matter. They can be asked to do so, if you require it.

6154. I see: but in general you do not think there is any abuse brought about by the present practice, and that it is useful?—That is so.

6155. That is in line with the majority view of the English Council, but there is a fairly strong minority view. Now you suggest the names of the recognised accountancy bodies should be included in the Act. I was rather wondering why. The present position is that it is for the Board of Trade to decide which bodies are competent and suitable for recognition. Is it really the type of matter to which Parliament can properly direct its attention?—Well, Sir, it is a matter to which Parliament has directed itself in the case of other auditors. Recently in the Building Societies Act, 1960, in the Nationalised

Industries, in a considerable number of private Acts—in all those cases the hodies were named; and we take the view the time has come when it would be proper to name them for the purposes of the Companies Act also.

6156. I am aware of what is done in the other Acts, but there is a distinction in that as far as those particular companies are involved there are already auditors who are either wholly or partly concerned in one of the great national hodies. When you turn to exempt private companies you open up a wider field—you get a great number of companies indeed which are audited by members of bodies which are not recognised. I was wondering whether that type of question was one for Parliament to settle, or whether it would not be better to leave it to the Board of Trade as at present.—As I say, we took the view we had already got hodies named, and not only in private acts, but building societies also—700 to 800 building societies. It is a large number, and many of them might have had auditors who were not members of these hodies. It would be a proper thing to bring it in, with the procedure which would follow that any variation in the lists should be at the instance of the Board of Trade by affirmative resolution.

6157. Now another much more general question: I do not know whether you are able to answer this, but under the present provisions of the Act, of course, discretion is given to the Board of Trade in a tremendous number of difficult points affecting accounts and other things, but I have in mind mainly accounting provisions. Do you think there ought to be any right of appeal from a decision of the Board of Trade or anything of that kind, or do you think the present arrangements in that respect are the best that can be devised? I must say at once I have not personally had any experience of difficulty.—Nor have I, and I will only say on that I have not been aware of any difficulty on which complaint has properly been made due to the absence of that appeal. Therefore if it has worked, I would leave the matter as it stands.

Mr. Lawson: Thank you very much. That concludes my questions.

Chairman: I will now ask other members of the Committee if they have any other questions they would like to raise on the accounting aspects of the matter, or any other.

6158. *Mr. Mackinnon:* You have expressed the view that it is all right to capitalise profits and issue paid-up shares on an unrealised revaluation, but it is all wrong to distribute them in cash. I suppose one could put the point of view that the whole structure and theory of the Companies Act is that the company gets a pound or a pound's worth for every share that it issues; and if there is an element of doubt as to whether it has a pound or a pound's worth to distribute I suppose the same doubt might exist when you use the revaluation reserve to pay out shares.—Yes, I appreciate the point. But an accountant tends to ask who is damaged; and if you revalue assets and your reserve emerges and you capitalise it, nobody can be damaged because the capitalised value cannot be taken away—at least no creditor can be damaged. If you pay it out in cash and if it was not truly there the assets originally purchased with the capital have been diminished. That is not a good answer from the point of view you put, Sir, that whether it is cash or some other consideration there should be a pound of consideration for every pound of capital.

6159. The only point I would go on to put is that, on your view, it would open the door to a subsequent reduction of capital by repaying part of the increased capital that had so been created.—It would, and I will put it this way—would there not be an inquiry in the Court before sanctioning the reduction, and would not a Court find it their duty to be satisfied that the capital left, so to speak, was there?

6160. I think the test would be whether the capital was in excess of the amount of the paid-up share capital, which it might well be. You see the point?—I do see the point.

6161. *Professor Gower:* The same point does arise when the shares are issued for a consideration other than cash.—*Mr. Dewar:* There is a point we did not make. If the assets are written up and there is a surplus which is credited to capital reserve

it is unrealised in the first place. But if there is depreciation on the written-up parts of the assets year by year that reserve would gradually become realised over the years. I do not think we made that point.

6162. *Mr. Lawson*: Do you draw a distinction between the part of the surplus on revaluation which arises from depreciation provided in the past and the part which is in excess of original cost? You see, it can be said that up to a point your surplus on revaluation is merely a writing back of depreciation which has proved to be excessive.—*Mr. Lister*: I think it is correct that the legal view would be that that part of the appreciation is just a cancellation of a depreciation that had not, in the event, been required, and it is only the excess over the original cost that comes into this discussion of whether they were realised or unrealised. I would not see any reason to quarrel with that view, as an accountant.

6163. *Mr. Lumsden*: But is it not important from the shareholder's point of view to have that information, because is it not the case that the one part can be received by him as a distribution on which he will not have to pay any tax, and the other part cannot?—Yes, the accounts ought to show that, and they would, I think.

6164. You would differentiate?—Yes.

6165. *Mr. Scott*: Did you suggest that directors should be required to disclose the amount or estimated amount of the fixed overheads for the ensuing year in the company's accounts?—No, I said that is information I would regard as very important to have: I am not suggesting for a moment it should be made an obligation. That is far ahead of current thought, and I am not trying to act as a reformer to that extent.

6166. Because it could be that fixed overheads might be only a small proportion of the total overheads, and therefore not be a very informative figure.—Of course, if you did try to write it into legislation you would probably have the word "substantial" somewhere, and if it was only a small part you would be let out on that. I am far from suggesting the time is ripe for that.

6167. *Mr. Watson*: On the disclosure of ownership and control, on which you have submitted some interesting views, I gather that you would like to see the directors empowered to require beneficial ownership to be disclosed of any shareholdings at any time, and the reason for this is that you think the directors are entitled to know for whom they work, and the shareholders have a right to know who their fellow shareholders are; and from the national point of view it might be desirable to ascertain whether the control of an important company is falling into foreign hands. Is that right?—Yes.

6168. We have had a good deal of evidence on this point submitted to us and your method of approach is slightly different from others: but looking at it purely from a banking point of view at the moment it seems to me to place on banking companies a tremendous burden of a great deal of inquiry, and one wonders whether the object is worth all that amount of work.—The answer to that must, I think, depend on the importance that is attached to the right to obtain this information. The banks, of course, must know in fact for whom they hold, though that is not necessarily the beneficial owner, I realise.

6169. But then, of course, there is the constant changing of holdings and so on that is going on all the time. This is not a static matter.—No, but I take it if they were to comply with something on the lines of this recommendation, it would be at the date of the request.

6170. Yes, and you think this power is advisable, in addition to the power the Board of Trade already has to cause an inquiry under section 172?—We recommend it, and I think the distinction would be that this would work faster than the Board of Trade enquiry.

6171. I see: and then you make the further recommendation that in future all trustees of shares should disclose the beneficial owner?—That, of course, runs into conflict with the law of England about notice of trusts, and I do not think I would like to embark on a discussion of that difficulty. Frankly, if you asked me why trusts cannot be put on the register in England, I could not tell you, except that it is in the Act.

Mr. Dewar: I think we suggested the transfer should show whether the transferee is the beneficial holder or is holding it as nominee.

6172. As far as I remember during the war there was a Defence Regulation which made this sort of disclosure necessary, was there not?—*Mr. Lister:* Yes.

6173. And you would like to get back to see that sort of thing enacted now for the future?—I think we feel there is a very considerable body of opinion that too much can happen without anybody knowing, and that it is reasonable that directors should know for whom they are working, as we put it, and shareholders should be enabled to know who are their co-shareholders. Of course, we remember that the attempt in 1947 to bring that about was dropped because of practical difficulties.

6174. *Professor Gower:* Would you envisage this information as to whether they were beneficial owners or nominees should be placed on the membership register as well, or is this merely for the information of the company directors and no one else?—I do not think we discussed that point, but I should think the intention is that anybody who can inspect the register should be able to get access to that information.

6175. *Mr. Scott:* Does that mean you would be against the issue of bearer shares in any circumstances?—I think that is a separate question, but this would be inconsistent with the issue of bearer shares.

6176. *Mr. Watson:* And one other question: it concerns the Institute's attitude to non-voting shares. You wish to see their future issue barred entirely?—Yes.

6177. Are you conscious of a feeling that the use of non-voting shares is going to lead, or has led, to abuses of some kind?—This is one of the matters on which, amongst our Council—as with everybody who has discussed it—opinion is somewhat divided. I have given a good deal of thought to the reasons which would justify me in coming out definitely, as we have done here, against non-voting shares for the future, and I have come to this conclusion—that from the point of

view of public policy I think it is a bad thing that power should be divorced from ownership, as can be done where there are non-voting shares. From the point of view of the person who takes a non-voting share, I think there is some case for protecting the shareholder from the ill effect of too short a view. If the shareholder was told "this company is liable to run into difficulty in five years or less—will you have some non-voting shares?" he would not buy them.

6178. Equally, do you think he would buy even voting shares in those circumstances?—I quite accept that. Perhaps I should have said "might run into difficulties". He takes the shares because he thinks everything is going to remain fine, and then when he finds things have taken a turn for the worse he has no vote; and I think there is a case, based to some extent on the propriety of protecting him in that way. Then, having once got the possibility of non-voting shares, they can be forced on him, because the company can make a bonus issue or rights issue in non-voting shares.

6179. But one may deliberately choose to buy non-voting shares because as a general rule they are cheaper and one gets a higher return on one's investment?—I agree.

6180. You do not accept the view that where there is a company with a small amount of voting equity shares with, say, five or ten times that amount in non-voting shares, there is an extra duty put on the holders of the voting shares? Presumably the directors have an extra duty to look after these poor dumb shareholders, have they not?—If I were a director, holding voting shares, I hope I would take that view; but I do not think all directors do take that view and there is no means of ensuring it at present.

6181. Then coming back to my earlier question, have you any examples in mind as to where this situation has in fact been abused?—Yes, there has been, I think, more than one case. There is certainly one quite well-known case in which a price of several times as much was paid for the voting shares as for non-voting shares; and no one could imagine that

was done purely in order to increase equally the value of all the shares.

6182. I think we are probably thinking of the same case; and is it not true to say the company has rather benefited as a result of that?—I think it is true, but the benefits might have been quite different if they had all been voting shares. I do not know.

6183. *Mr. Brown*: And are your thoughts on non-voting shares confined to quoted shares, or in principle would you apply it to private companies as well?—I would apply it to them all, because private companies can become public and the arguments that are used are not based on private company considerations. If you accept the view I am putting forward you are going to stop the non-voting shares for the future—but you will not stop them for the future if you allow private companies to have them.

6184. *Mr. Scott*: Would your argument not be met to some extent if non-voting shares were clearly so designated. Take the unfortunate man who finds after five years that he has got non-voting shares; there would then be little excuse for his only finding it out after five years? It is your recommendation that they should be called clearly non-voting shares?—I hope I did not say he found out after five years that he had got non-voting shares, but he found out after five years that votes might be very important and he had not got any.

6185. He has known all along he has no voting rights if they are labelled, so to speak.—But he thought it did not matter and that it was worth saving 5 per cent. on the price, but he found that was wrong.

6186. *Chairman*: Is there any difference in principle or practical result between the non-voting shares and the arrangement under which you have loaded votes, so that some blocks of shares carry more votes than others?—No, my Lord; I would apply the same thing. All equity shares ought on this recommendation to have similar voting rights. Loaded voting is just as objectionable, and so is full voting for preference shares objectionable, because the control is put in a different place from the ownership.

6187. You object to the head of a family forming a company, making all his property over to it and constituting himself governing director with one governing director's share carrying all the votes? Would there be anything immoral in that?—There would not be anything immoral in it, but I think that is a particular case which is possibly as much open to objection on public policy as the other.

6188. *Mr. Lumsden*: If you introduce complete prohibition of non-voting shares may you not prevent some perfectly legitimate and beneficial schemes? You can think of a case where a company perhaps is getting into financial difficulties and is rescued by a scheme of reconstruction under which the creditors, perhaps the bank, consent to take participating preferred shares which will get a prior ranking and voting rights until the profits have come to a certain stage when the deferred shares would come in. Unless the creditors could get control of the company for that period they would put the company into liquidation and would not go forward with such a scheme. Is there any danger of cutting out that legitimate transaction if you bring in a law that all equity shares must be voting?—Could that not be met by the special terms on which such shares were being issued, including a loaded vote until they were merged with the others or until some event happened. That is the sort of special case for which room could be made.

6189. I think if you permitted a loaded vote until something happens, that would open the door to loaded votes.—Preference shares have loaded votes now; at least they have votes in the conditions you are speaking of.

6190. That is why I said participating shares, because they are a class of equity.—It may be that would be an insuperable difficulty in carrying out this recommendation. I should not have thought so. I have not studied that particular illustration, I have been more concerned with the general case. I agree that there would be that and no doubt other special cases that one would have to study.

6191. *Mr. Althaus*: Is not the remedy with the investor himself, who is obliged

neither to buy the shares in the first instance nor to retain them if they are foisted upon him?—As regards their being foisted upon him, he can only get rid of them by selling them to someone else who will then have the non-voting shares foisted on him. He is not bound to buy them, but I would put it that investors take rather a short view, not the most informed investors but the average investors, and do not realise the difficulties that may face them if things go not so well.

6192. He should be protected against himself?—That is the position.

6193. *Mr. Bingen*: Arising out of take-over bids, it has been suggested that it might be a good thing if, as the starting basis of any take-over offer, some part of the consideration should be in cash; it could not be wholly an offer of shares in company A in exchange for shares in company B, company A must also offer some cash. Do you see any merit in a proposal of that kind?—I cannot see any reason why there must be some cash.

6194. *Mr. Scott*: I believe the reason indicated was that it curbs extravagant bids being made by companies who produce shares of which they have an unlimited quantity, instead of cash; and that it would act as a sort of restraint or control upon take-over bids if every company had to put a certain amount of cash down as a condition of being allowed to make a take-over offer. That is the way it has been represented. I wondered if from that point of view you thought such a suggestion would have any merit?—I can see the point. It would depend upon the proportion of cash being so substantial as to act as a reasonably effective curb, but I should have thought that would not only affect the take-over bid of the type where the bidder was just buying up a lot of miscellaneous companies, but also the take-over bid which was what we would call a genuine merger of two companies and where cash might be neither appropriate nor possibly available.

6195. *Mr. Brown*: If you could define those two classes, would you see any merit in the proposition for the first

case, the miscellaneous buying?—If I could distinguish between the two cases legally I would make it all cash in one and no restriction on the other.

6196. You do see merit in that case, in other words?—Yes, but I do not see any way in which the distinction could practically be drawn.

6197. *Professor Gower*: I have one question on paragraph 16 of your memorandum, where you say: "We recommend that practising chartered accountants be recognised under Section 15 of the Prevention of Fraud (Investments) Act, as dealers in securities." Section 15 is the section which entitles the Board of Trade to declare stock exchanges and associations of dealers as recognised stock exchanges and associations. Your recommendation therefore is that your Institute should be recognised, as I think rather anomalously the Law Society of Scotland is, as a recognised association of dealers in securities. I wondered if that was what you wanted or whether you wanted the chartered accountants to be authorised to become exempted dealers under section 16?—*Mr. McDougall*: We wanted to come in under the section under which the Law Society of Scotland come in.

6198. Despite the obligations of subsection (3); you will have to send a list every year of all your members to the Board of Trade, which they will have to publish as an association of dealers in securities.—We publish a list of our members every year.

6199. *Mr. Watson*: I take it the intention is to limit it to those practising in Scotland, practising chartered accountants?—We would not limit it to those practising in Scotland but to those practising.

6200. *Professor Gower*: You really do want this? Frankly, I am slightly puzzled at the desire for this. The idea that every chartered accountant is to be looked at as a member of the stock exchange strikes me as strange.—In Scotland it often happens, where there is a question of buying or selling shares that a practising chartered accountant may virtually do most of the

work relating to the offer that is being made, but then has to go either to a member of the Law Society of Scotland or some other person who is on the Board of Trade list for the actual offer to be signed by that person. It seemed to us a little difficult to see why that necessity should arise.

Chairman: If there is a good case a solicitor will take it to a barrister, and there would be another fee there.

6201. *Professor Gower:* In England solicitors cannot do this; they too have to take it to an exempted dealer.—In Scotland many things are different from what they are in England.

6202. I can see your second point about the Board of Trade Rules for Licensed Dealers. You do not see why you should not be included in the rubric at the bottom of paragraph 1 (b), saying "if in doubt go to your accountant"—that is a different point?—Quite different.

6203. *Mr. Lumsden:* You want to retain the exempt private company. But it has been suggested that creditors may be prejudiced by lack of the filing of accounts, and one suggestion has been made that in the annual return the auditor of the exempt company might be required to sign a certificate that the accounts had been audited and that the company was solvent. Would you have any views on that from the auditors' point of view?—*Mr. Lister:* A suggestion on these lines was in fact discussed by our Council and was not pursued, chiefly I think because it was felt there was no mischief here in practice that needed to be dealt with. The suggestion that was discussed was a rather more drastic one, I think, than the one that has been made by the English Institute.

6204. If there was pressure for some safeguard and this was thought to be a possible one, you as auditors would not have any particular objection?—As auditors we would not have any objection, and if a good case was made out that there was a mischief to be cured I would feel that a suggestion on the lines of a statement of solvency was the right one.

6205. *Mr. Lawson:* Would you not have objections as auditors to signing a statement of solvency just like that?—We thought a statement of solvency should be made by the directors similar to the statement of solvency for a voluntary winding up.

6206. By the directors, not the auditors?—Not the auditors. There was a suggestion discussed by our Council but not put forward—a declaration of solvency by the directors where there were no filed accounts—but we considered it was a more drastic remedy than any difficulty justified at this point of time. But if it has to be done, I think it would be true to say we would not find something on these lines objectionable; but not, I think, a statement by the auditors that the company is solvent, that I do not think would be right.

6207. *Professor Gower:* I do not quite follow the logic of this. Surely you are really better qualified to judge whether a company is solvent than most directors of private companies, and yet you say you would not be prepared to do it, you think it should be the directors.—If the directors take the decision to carry on, that is a decision which they should not take if the company is not solvent, and the decision may depend on valuation—not valuation as a going concern but possibly on a liquidation basis—I do not think the auditors in the ordinary course of an audit are in a position to make inquiries to satisfy themselves about that.

Mr. Watson: It may also depend on the terms which they have established with their bankers.

6208. *Mr. Lumsden:* On no par value shares, you are not convinced it should be permissible for shares of no par value to be partly paid. Have you any particular reason for that?—I think that was at least partly a matter of convenience. The whole idea of no par value shares is that there is no stated amount, and to have a share with no stated amount but something unpaid on it seems more anomalous than is necessary.

6209. *Professor Gower:* You should only be able to issue no par value shares if the whole amount were paid up on

allotment?—It might be payable at stated dates, but not if there were an amount left to be called up.

6210. *Mr. Lumsden*: But not subject to further call?—No, we would say, except insofar as this may be required for a temporary period during which new shares are being paid for by instalments.

6211. At the very end of your memorandum you say that the procedure for winding up by the Court in Scotland should be speeded up. I wanted to ask you

whether you said that because the procedure in England was quicker and you wanted to include Scotland in that or whether it was a general request.—I think it would be fair to say that the comparison was not with the procedure in England but with the procedure in voluntary winding up in Scotland.

Chairman: Gentlemen, that concludes our questions, and it only remains for me to thank you very much indeed for coming here and giving us so much of your time. It has been a very interesting afternoon.

(The witnesses withdrew)

APPENDIX XLV

Memorandum by the Faculty of Advocates

(Reference is made to the list of subjects annexed to the letter from the Committee dated 15th January, 1960.)

1. Incorporation of Companies—Memoranda of Association

(b) Limitation of objects—ultra vires rule

We are of the view that the *ultra vires* rule may operate harshly in relation to third parties who have contracted in good faith with a company. The position is not eased by the practice of drafting elaborate memoranda which offer scope for difficulties of interpretation; and it seems to us inconsistent with ordinary business practice and common sense to demand from those who contract with a company a special class of investigation and caution. We would recommend, as has already been done by the Cohen Committee, that in regard to contracts with third parties a company should be put in the same position as an individual so far as rights, duties and liabilities arising on the contract are concerned, and that the *ultra vires* rule should thus be abolished.

As a corollary to such a step we would recommend that statutory effect be given to the "main objects" rule of construction. It is appreciated that section 2 of the Act *inter alia* requires a statement of the objects of a company and that a company may state, broadly speaking, any objects which are not illegal. The growth of the "multiple" objects clause would appear to have been inspired to a large extent by the *ultra vires* rule. If that rule goes we consider that it would be in the interests of the investing public to have in the memorandum a compulsory and definitive main objects clause clearly identifiable as such and distinct from ancillary powers clauses.

Any complaint to the effect that such a step might lead to lack of flexibility to the possible detriment of the affairs of the company can be met, we think, by provision for alteration of the memorandum. The provisions of section 5 of the Act are already very broad and give protection to a defined minority interest. We would suggest that section 5 be specifically extended to cover an alteration in the main objects of the memorandum. There appear to be at the moment differing schools of thought in relation to the scope of the section.

We see no purpose in either abolishing the memorandum or putting the objects clause in the articles. The memorandum serves various purposes and has its value as a separate document.

(c) The company as a legal entity—one-man companies

One tends to hear of the "abuses" caused by the legal entity of a company covering the activities of an individual. There may be certain opportunities in the tax or estate duty field, but these are matters for the Revenue and already seem fairly well covered. Otherwise, we are not aware of any matter calling for legislation. We consider the "legal entity" to be essential; legislative control of holdings in any given company would be a massively complicated undertaking for which we see no need.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) and (b) Fundamental changes in company's activities—Disposal of undertaking and assets

We are of opinion that in many cases it would be desirable that there should be in the hands of the members a greater degree of control than presently exists over

fundamental changes in the company's activities and in the disposal of undertaking and assets. We suggest that this might be done by making it a statutory requisite of the articles of association that they should contain a clause delineating the powers of the directors to dispose of the undertaking and assets, this clause to be subject to alteration by special resolution with powers to apply to the Court as under section 72. If it were desired by the members even specific assets of the company could be protected from sale in such a clause and if in the light of a company's experience the clause proved too wide further restrictions could be placed on the directors' powers. Although at present it is possible to have such a clause in the articles of association it is not often found in practice control over fundamental changes in the activities of a company would be achieved, in our opinion, by the application of the "main objects" rule as suggested in our remarks on the "*ultra vires*" rule.

(c) *Issue of shares*

In our view all unissued shares should be issued by public issue or by rights issue *pro rata*, or as approved by the company in general meeting. This last provision would meet instances in which it might be desired to benefit employees, pension funds or the like. We recommend such provisions primarily to prevent manipulation of unissued shares for control purposes or for the benefit of individuals or particular group.

(e) *Lending money otherwise than in the ordinary course of business*

In our view directors should have no power to lend money otherwise than in the ordinary course of business unless such power is specifically given in the objects clause.

6. Directors' Duties

(a) *Should their duties be stricter and more clearly defined?*

In view of the instances which arise in practice it is attractive, at first sight, to envisage the possibility of a definite code covering the duties of directors. But on consideration and having regard to the plain necessity of considering individual cases on their own circumstances and merits we have come to the view that such definition is impossible. The common law which has grown up over the years appears to us to deal adequately with the broad picture.

(b) *Are directors generally aware of the legal duties arising from their fiduciary position?*

We consider it impossible to give any helpful answer to this question. There are good and bad directors and individual views are necessarily coloured by the chances of experience.

(c) *Directors' and officers' dealings in their own companies' shares*

A director, we understand, can deal in his company's shares in the manner open to any individual and is not accountable for profits made unless his dealings take place while he is acting as agent or in a fiduciary position *vis-à-vis* the company. It appears to us that it is impossible in law to apply the test of motive to dealing as an individual. A director may buy because he wishes to increase his investment in what he believes to be a sound company, but that wish may be inspired by knowledge gained in the board room and unknown to other shareholders; he may buy because he seeks control, and that motive may be good or bad in any given set of circumstances; he may buy to make profit on resale, the dealing being prompted again by knowledge gained as a director. We consider that it is plainly wrong that a director should profit because of knowledge acquired as a director and, to an extent, that is covered by the common law. But, short of forbidding dealings, which appears unworkable, we find it almost impossible to limit market dealings looking to the almost insuperable difficulties of proof of motive. No director, we imagine, could possibly be heard to say that his share dealings were not influenced by his board-room knowledge. In law we do not see

where the line can be drawn between good and bad dealings, nor do we see, apart from some requirement as to publication which we consider to be necessary, how any remedy, other than the most arbitrary and therefore basically unsatisfactory, could be applied.

In our view the provisions of section 195 while going far to provide for publication could be strengthened, with advantage, by making disclosure of directors' dealings throughout the year part of the information to be put before shareholders prior to the annual general meeting.

(d) Disclosure of directors' interests

We make two comments on this sub-head:—

- (i) We consider that the default penalty set out in section 198 (4) is too low, looking to the importance of sections 195 and 196 to which it applies.
- (ii) More importantly, we are of the view that the duty of disclosure of interest which is expressed in section 199 and article 84 of Table A should extend beyond disclosure to the board of directors. We do not suggest that action following upon a disclosure should await the approval of shareholders. We recommend however an additional statutory provision to the effect that at each annual general meeting of a company there should be included in the information put before shareholders an account of all "disclosures" made in the year under review.

(e) Should bodies corporate be allowed to be directors?

We are emphatically opposed to any such suggestion. It may be too sweeping a view, but we believe that the use of subsidiary companies, "shell" companies and the like has not in the main been commercially justified but rather has increasingly tended to obscure the rights of the investing public and to undermine the basic conceptions of Company Law. It may be that a stage is approaching when Company Law, as we know it, will become completely revolutionised. As it presently stands we can see no justification for such a proposal.

7. Shares with Restricted or No Voting Rights

It is well known that in the inflationary conditions following the war there has been a great increase in the practice of issuing shares in equity capital which carry either no voting rights at all, or restricted voting rights. At first sight it seems anomalous that in the class of shareholders whose capital is at the same risk some should not have the right of an equal voice in the running of the company. There are, it seems obvious, advantages to the equity shareholders of existing companies in being able in this way to increase unpreferred capital without surrendering any vestige of their existing control; but it also seems obvious that purchasers of equity shares without, or with restricted, voting rights, may be placed at an undue disadvantage in certain circumstances in the existing state of the law. As the law stands purchasers of these shares, which are not always expressly described as "non-voting" shares, may well buy without taking the trouble to discover what, if any, restrictions are imposed upon their voting powers by the articles of association of the company. That shares so purchased carry no voting rights or restricted voting rights probably will not concern most individual purchasers so long as the affairs of their company prosper and the investors' capital continue to produce a sound yield. Should, however, the company's profits decline, the lack of full voting powers may be a serious matter for shareholders whose capital will continue to be at full risk under the control of, perhaps, a minority of shareholders in the equity class. Quite apart from the adverse position non-voting equity shareholders may occupy when the company's management policy is bringing their capital into danger, the position of such shareholders may also be particularly disadvantageous should the shareholders who have voting control—especially if they are in a numerical minority—(1) decide to liquidate the company with a view to making a capital gain by realisation

of the assets or (2) decide to alter fundamentally the objects of the company or perhaps its powers of investment. No doubt as the law stands the non-voting shareholders have the protection afforded (a) by section 5 of the Companies Act (where an alteration of the objects of a company are involved), (b) by section 72 (where variation of the rights attached to the shares is involved), (c) by section 210 when it can be shown that the company's affairs are being conducted in a manner oppressive to the shareholder, with the present basis of the "just and equitable" approach. Standing this protection it is felt that there is no case for prohibition of the issue of equity shares having less than full voting equality, even if this could be achieved without seriously disturbing rights already in existence. It is however considered that prejudice of the interests of potential holders of such shares could with advantage be in future minimised, without serious interference with freedom of contract, by

- (i) requiring all such shares to be described and quoted in a manner which would expressly disclose their lack of voting rights or the fact that the voting rights attached to them are restricted;
- (ii) by requiring information of all business to be discussed at meetings of the voting shareholders to be communicated, in the same manner and contemporaneously with communication to voting shareholders, to those equity shareholders who have no voting rights or whose voting rights are restricted;
- (iii) by permitting the latter category of shareholder to attend and speak at the meetings of voting shareholders; and perhaps, in defined circumstances, empowering the less favoured equity shareholders to submit resolutions to be voted upon by the voting shareholders.

We feel that no change is required under this head in the law relating to preference shares.

8. The Protection of Minorities

In our opinion, the protection presently afforded by the Act is adequate subject to the following observations. We think there is substance in the view that in making it necessary for a petitioner under section 210 to establish that but for the prejudice to him, it would be just and equitable that the company be wound up, the remedy loses some of the salutary effects it might otherwise have. While we see that such a restriction may be desirable before an order for the purchase of the shares of the minority should be made, we think this condition is not necessary before an order for regulating the company's affairs in the future could competently be made. By the time the oppression has reached the stage of justifying a winding up much harm to the minority and possibly even the majority may have been done which could by an order at any earlier stage, readily have been prevented. In most cases it is highly desirable that a minority group should be able to act with speed and effectiveness. We would suggest amendment of section 210 accordingly.

9. Protection of Special Classes of Shares

The present machinery for the modification of class rights would appear to afford adequate protection to the holders of shares of that class. Whether the alteration be by virtue of a power contained in the memorandum or in the articles or whether as a result of a scheme of arrangement under section 206, opportunity is afforded to members of the class to be affected to object to the modification upon the ground that they would thereby suffer unfair prejudice. If they establish this to the satisfaction of the Court the modification will not take place.

It is customary in a modification of a rights clause in a company's articles (following article 4 of Table A) to provide that consent of a specified proportion of the holders of the issued shares of that class shall be required before any modification of their rights may be effected. The operation of such a clause may give rise to difficulties where a reorganisation of a company's capital becomes urgently necessary owing to

adverse trading and where a quorum in terms of the articles cannot be obtained owing to the indifference of the members of the class. It may be that in the end of the day the Court has an inherent power to confirm a reduction of capital or sanction a scheme of arrangement where it is shown that the requisite quorum at any class meeting cannot be obtained. It would, however, be preferable if there were an express statutory provision whereby if the requisite quorum were not present at the meeting and an adjournment thereof, the Court should have power to order a further meeting with a reduced quorum and treat any resolution passed thereat as a resolution passed in accordance with the articles of the company. This could readily be effected by a provision that section 135 should apply to class meetings as well as to meetings of the company.

10. Board of Trade Powers to Appoint Inspectors

By section 167 (2) of the Companies Act, 1948, an inspector appointed by the Board of Trade has power to examine officers and agents of the company (defined so as to include past as well as present officers, and bankers, solicitors and auditors) on oath.

By section 167 (4) the inspector may, if he thinks it necessary to examine a person whom he has no power to examine on oath, apply to the Court for an order that such person should attend and be examined on oath. A person so ordered to attend may be represented at his own expense by solicitor and counsel who may put to him such questions as the Court may deem just for the purpose of enabling him to explain or qualify any answers given by him.

In relation to examination of officers of the company (as defined) there seems to be no right in the person examined to be represented by solicitor or counsel. In practice solicitor or counsel may be allowed to attend by concession of the inspector, but is not normally allowed to take part in the proceedings apart from assisting in any question of law which may arise. It seems that the person under examination may not refuse to answer any question on the ground that it may incriminate him. (*Re Atherton*, 1912 2 K.B. 251.)

It is for consideration whether such an inquisitorial style of procedure is in accordance with English and Scottish conceptions of justice. It may be that there is something to be said for a statutory right in an officer of the company who is under examination to be represented by solicitor or counsel, who may put to him questions for the purpose of enabling him to explain or qualify any answer. This would put an officer of the company who is examined before the inspector in the same position as a non-officer who is being examined before the Court under section 167 (4).

It is suggested that such a provision might constitute a protection against any possible tendency on the part of an inspector to assume the role of a hostile cross-examiner.

11. Disclosure of Ownership and Control—Nominee Shareholders and Directors

We take the view that if the remedies for protection of minorities are to be effective the information necessary to enable a shareholder to consider his position relative to these remedies should be reasonably accessible to him. *Meyer v. Scottish Textile and Manufacturing Co. Ltd.*, 1958 S.L.T. 241, shows how important in relation to section 210 it may be to know whether directors or shareholders are nominees. Although we appreciate the practical difficulties, we are in favour of making it obligatory to disclose the names of those having interests in shares other than the registered holder but excepting such interests as are excepted in the Seventh Schedule of the 1948 Act. In the case of a trust having an interest we would think it sufficient if a reference to the relative deed of trust were given without details of the names of the trustees. The register disclosing those interests would be open to inspection only by the members of the company and their duly authorised agents. Further, it should, in our view, be made compulsory that a "nominee" director should disclose his

principal and that such information should be included in the information put before shareholders at any annual general meeting, should be disclosed to shareholders whenever an election is due and should be intimated to shareholders whenever the board co-opts a director. This is in accordance with what we consider to be the essential point that an investor should have all reasonable knowledge of his company's affairs.

16. Take-over Bids

Opponents of "take-over" bids are inspired in their views, in general, by instances in which the successful "bidder" acquires assets, and especially liquid assets, at a price below their value. It may be that there is something ethically wrong in a *coup* which is designed solely to yield an immediate profit, but we can see nothing legally wrong in it. Further, there are many "take-over" bids which are made for reasons sound both economically and commercially. Whatever be the reason behind a "bid" it cannot succeed unless the "bidders" acquire the necessary control. Where, as is usual, this is acquired by an offer to shareholders its success lies in the attractiveness of the offer. In short, the shares are worth more than their quoted value or the value determined by articles. In practically every case this under-valuation, with its attendant vulnerability to a "bid", is the fault of the management of the company concerned. One need not elaborate that. It is sufficient to note the lively interest suddenly evinced in the financial rights of shareholders by boards which face a "take-over" bid.

We turn to the sub-heads:—

(a) Procedure

We do not see how any code of procedure can be effectively laid down.

(b) and (c) *Securing disclosure of information and functions of directors*

In practice, boards in most cases advise on the merit of the bid. In our view it should be made obligatory for directors to issue a statement to shareholders giving reasons for such advice and containing a full and fair disclosure of the position so far as known to the directors so as to enable shareholders to form their own opinion. There is a difficulty in defining when the "bid" is made and thus the time at which the issue of such a statement would be necessary but we do not consider this difficulty insuperable. It is important that shareholders should have sufficient information on which to decide whether or not to accept the bid and if our recommendation of an obligatory statement is accepted there should in our view be a statutory sanction similar to that for making a false statement in a prospectus.

(d) *Disclosure of identity of bidder*

The identity of the bidder may often be a relevant matter for consideration by shareholders in deciding whether or not to accept a bid. Without this information they may be unable to make a true assessment of the value of the bid as related to the value of the company, and in our view some provision for compulsory disclosure of identity would be desirable.

(f) and (g) *Sections 191 to 194 and 209 of the Companies Act, 1948*

We consider that the sections to which reference is made are adequate in their provisions.

20. Reduction of Capital and Purchase by a Company of its Own Shares

We consider it advisable to retain the existing prohibition of repayment of capital to shareholders otherwise than by a reduction of capital in accordance with the existing law. Permission to purchase shares is open to abuse and the practice, even if limited to the use of reserve funds for such purposes, is in our opinion, fraught with danger to the financial stability of companies.

Although a company cannot be a member of itself shares surrendered without consideration or bequeathed to the company may in certain circumstances be held by a member or members of a company in trust for the company (in *re Castiglione's Will Trusts* (1958), Ch. 549) because no reduction of capital is then involved. This practice would seem to be objectionable so long as the directors are permitted to control the votes pertaining to shares held for its behoof. We suggest that the legality of such a trust should be expressly recognised by statute but that it should be laid down that shares of a company so long as they are held in trust for the company should carry neither vote nor right to dividend. It is understood that in certain states of the U.S.A. where a company is permitted to purchase its own shares, shares held by the company carry no vote.

22. Audit

(a) Qualifications

Prior to the 1948 Companies Act no professional qualifications were required for the auditor of a company. Following upon the recommendations of the Cohen Committee, section 16 (a) of the 1948 Companies Act laid down professional qualifications or a special Board of Trade authorisation as a *sine qua non* of appointment as auditor. There appear to be no reasons for altering the provisions of section 161 in so far as they relate to public companies and private companies which are not exempt.

Appointment

It is for consideration whether a first auditor appointed by the directors and sought to be removed by resolution of the company in general meeting under section 159 (5) (a) should not be entitled to the same notice of the resolution as a retiring auditor whose re-appointment is challenged is entitled to receive under section 160 (2). Without such notice it is difficult to see how he could exercise his right to make representations under section 160 (3).

Apart from the above two matters there does not appear to be any case for altering the provisions of sections 159-160.

(b) Duties and responsibilities of auditors

It is interesting that the Cohen Committee made no direct recommendations with regard to the duties and responsibilities of auditors, but did recommend that the auditor's report should contain certain further information. Their recommendations were largely given effect to in the provisions of section 162 and the Ninth Schedule to the 1948 Companies Act. The auditors report does not require to express any view upon the value of the assets of the company. The duty of an auditor is "to ascertain and state the true financial position of the company at the time of the audit" (*re London and General Bank*) (No. 2) 1895 2 Ch. 673, Lindley, L. J., at 682) and in doing this he is bound to exercise reasonable care and skill. Any disputes as to his duty appear to have arisen where the assets of the company have been over-valued thereby presenting a false picture of the company's financial position to members *re London and General Bank* (supra), *re Kingston Cotton Mill Co.* 1896 2 Ch. 279. In view of the prevalence of take-over bids it is desirable that shareholders should have before them reasonably accurate information as to the value of the company's assets in order that they may be in a position to assess thereby the value of their shares. While it is no part of an auditor's duty to conduct a detailed valuation of a company's assets it is desirable that auditors should be made aware that their duty to state the true financial position of a company extends to cases not only of over-valuation but of under-valuation. It is for consideration how best this means may be achieved.

(c) Exemption of "exempt private companies" from section 161 (a) of the Companies Act

Section 161 (a) of the 1948 Companies Act which, as already noted, make provision for the professional qualifications of auditors does not apply to "exempt private companies" which remain in the same position as all companies were prior to 1948.

The Cohen Committee did not recommend that "exempt private companies" should in this matter be treated any differently from other companies. The duties and responsibilities of the auditors of an "exempt private company" are no different from those of the auditors of any other company and there would seem little justification for a distinction in necessary qualifications.

26. Internal Management and Administration

(c) *Securing proper disclosure of information in circulars seeking proxy votes*

We consider that it should be a statutory requisite of all circulars sent out with the authority of the board of directors seeking proxy votes that they should contain a true and fair account of the matters in respect of which the proxy votes sought are to be exercised, and that the usual consequences will accrue to any person having responsibility for the circular in respect of breach of this requirement.

(d) *Exercise of voting rights in cases of interlocking shareholdings, unit trusts, etc.*

We consider that any trust, whose vote can be controlled by the directors in their capacity as such, should not be permitted to vote in respect of any shares in the company or any subsidiary held by such trust.

28. Problems of Administration and Enforcement of the Law

(i) We would point out the confusion which seems to exist in Scotland with regard to sections 104 and 105 of the Act. Do these sections apply to companies registered in Scotland? In *Carse v. Coppen*, 1951 S.C. 233 at 241 Lord President Cooper, with whom Lord Carmont and Lord Russell concurred, says "The provisions of Part III relating to registration of charges (which includes floating charges) are limited to companies registered in England", but he points out the doubt raised by section 106. Having regard to the point reserved by Lord Carmont and Lord Russell in *Carse*, and to the confusion existing in the standard texts on this question, we suggest that it would be advisable to add to the end of section 106 a proviso that save as therein provided Part III shall not apply to companies registered in Scotland.

(ii) We would suggest that the powers of the Court conferred by section 135 of the Companies Act, 1948 should be applied not only to meetings of the company but also meetings of creditors or classes of creditors or members or classes of members of a company, and in particular that the power to make a direction that one creditor or one member shall be deemed to constitute a meeting should be conferred with reference to such meetings.

(iii) We would draw attention to the decision in *Clydesdale Bank (Moore Place) Nominees Ltd. v. Snodgrass* 1939 S.C. 805 pointing out the ambiguity of the predecessor of section 32 (4) of the Companies Act, 1948. It is suggested that the phrase "it is executed in accordance with the provisions of this Act" be dropped from the section or else its meaning be made more plain. In our view it is preferable that the formalities of execution of a deed by a company be fixed clearly by statute and not left for each company to determine for itself by provisions in the articles if it is so minded, as seems to be the effect of the quoted words as construed in the case cited.

APPENDIX XLVI

Memorandum by The Council of The Law Society of Scotland

Preliminary

1. This memorandum is submitted to the Committee under the Chairmanship of the Rt. Hon. Lord Justice Jenkins, appointed by the President of the Board of Trade with the following terms of references:—

"To review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable."

2. The Law Society of Scotland is a statutory body set up by the Solicitors (Scotland) Act, 1949, and comprises all solicitors practising in Scotland. The Council consists of 36 representative members directly elected on a regional basis and two co-opted members.

3. In preparing this memorandum the Council has invited and has considered the views of individual members of the Society, and a number of suggestions from that source were considered.

4. The Council have confined this memorandum to the submission of evidence on certain only of the matters within the remit of Lord Jenkins' Committee.

5. The Council is willing, if desired, to supplement by oral evidence the evidence which is contained in this memorandum.

1. Incorporation of Companies—Memoranda of Association

(a) Requirements as to minimum number of members and other conditions of incorporation

6. We regard the requirement of at least seven members for a public company and two members for a private company, now well established, as generally satisfactory. Where, however, a private company is the wholly owned subsidiary of another company we see no good reason why it should require to have two members. This requirement results in unnecessary work in having shares transferred into the names of one or more nominees and appears also to have the result that a private company which is the wholly owned subsidiary of an exempt private company ceases itself to be exempt. We recommend that a private company which is a wholly owned subsidiary need have only one member.

7. We are concerned about the incorporation of private companies where the object of the subscribers is merely to sell the shares in the company. Such incorporations have been numerous in recent years and are advertised for sale as "ready made" under assurances that the companies have not traded. This practice appears to be an abuse of the privilege of incorporation. Section 1 of the present Companies Act provides that persons "associated for any lawful purpose" may form an incorporated company and it would seem doubtful whether, where the object of the subscribers is merely to sell a ready made company, they can be considered as associated for a lawful purpose within the meaning of section 1. It is believed that many of the companies formed purely with a view to selling the shares do not comply with certain of the formal requirements of the Companies Act. Breach of a number of these

requirements render the company liable to penalties, e.g., section 107 which requires a company to have a registered office and to give notice of the situation thereof within 14 days after incorporation; section 108 which requires the company to affix its name on the outside of every office or place of business; section 110 which requires the company to keep a register of its members; section 131 which requires a company to hold an annual general meeting in every year; section 145 which requires minutes of all general meetings and of all meetings of directors to be entered in books kept for the purpose; section 159 which requires the company to appoint an auditor; and section 200 which requires every company to keep a register of its directors and secretaries. Accordingly members of the public may acquire the shares in a company which has rendered itself liable to penalties for breach of various administrative provisions of the Companies Act. In our view the practice of forming companies with a view to the sale of the shares is undesirable and we recommend that section 1 should be amended to define the "lawful purpose" for which persons may be associated to form an incorporated company as being one of the objects stated in the memorandum of association of the company.

8. The privilege of incorporation can at present be obtained by a company with a share capital however small. We think there should be some minimum limit to the amount of issued share capital and we recommend that no company should be incorporated unless share capital to the nominal amount of at least, say, £100 has been subscribed for and that such share capital must be paid up in cash.

9. We doubt whether, at least in the case of private companies, the present form No. 41 Declaration of Compliance pursuant to section 15 of the Act serves any useful purpose. The papers which it accompanies are checked by the Registrar of Companies whose certificate of incorporation is, in terms of the section, conclusive evidence of compliance with all the requirements of the Act in respect of registration and matters precedent and incidental thereto. It is difficult to see in what respect the signed, and in the case of the memorandum and articles, attested documents upon which the Registrar issues his certificate, are in any respect amplified by the formal general declaration, unless to show compliance with section 1 as regards the "lawful purpose" thereunder. If the recommendation we have made in paragraph 6 above is adopted we recommend that the form of Declaration of Compliance be amended to refer to that section. If the above recommendation is not adopted we recommend that the use of this form be discontinued.

(b) *Limitation of Objects to those stated in the memorandum, &c.*

Ultra vires rule

10. A contract made by the directors of a company upon a matter not within the ambit of the company's objects is *ultra vires* the company and is, therefore, beyond the powers of the directors, and cannot be ratified by the members. The Cohen Committee referred to the practice which has grown up in drafting memoranda of association very widely so as to enable the company to engage in any form of activity in which it might conceivably at some later date wish to engage. They concluded that the doctrine of *ultra vires* was an illusory protection for the shareholders, might be a pitfall for third parties dealing with the company, and served no positive purpose and they recommended that every company should have, as regards third parties, the same powers as an individual and that the existing provisions in memoranda as regards the powers of companies should operate solely as a contract between the company and its shareholders. The case of *re Jon Beauforte (London) Ltd.* (1953) Ch. 131 illustrates the hardship which the doctrine may cause to innocent third parties. We respectfully agree with the views expressed by the Cohen Committee and recommend that every company should have as regards third parties the same powers as an individual.

11. Many of the incidental powers which the company needs are generally set out as separate objects in the memorandum of association. It is probable that these

powers would be implied as being necessary to enable the company to carry out its main objects, but business men prefer to see the powers set out in detail. It would be convenient if the Companies Act set out the common form powers which are usually incorporated in the objects clause and provided that all companies should be deemed to have these powers. We recommend accordingly.

Present method of altering objects

12. The present Act, in section 5, provides that a company may by special resolution alter its objects in certain ways unless an application is made to the Court by members or debenture holders holding interests amounting to at least 15 per cent. within 21 days, for a cancellation order. Whereas the ways of alteration specified are defined in wide but not unlimited scope, subsection (9) closes the door against steps to have an alteration declared invalid on the ground that it was not authorised by subsection (1) unless by proceedings taken within 21 days. This had led to cases of complete abandonment of existing objects for different ones (an alteration not specified in section 5) without scope remaining for question after the 21 day period. It seems desirable, as that presumably was not the intention of Parliament, to amend the section so as specifically to authorise competent application to the Court outwith the period of 21 days to prevent the proposed alteration as being unauthorised by subsection 5 (1).

(c) The company as a legal entity distinct from its members—"one-man" companies

13. The legal concept of separate existence being now long and well established without detriment to the public interest, so far as we are competent to judge, we see no case for amending the law. Fiscal legislation has already encroached upon the doctrine and further such measures can still do so, without rendering the rule untenable in contractual matters. The principle is fundamental to incorporation and is one of the chief reasons for the extensive use of companies to promote the development of industry and commerce in the widest sense. Equally we see no reason to suggest any reform designed to exclude the so-called "one-man" company from the scope of the Act, or to restrict its formation in any way. Such companies often develop into much more comprehensive units.

(d) Shares of no par value

14. We refer to the memorandum by our Council on this matter, dated 7th March 1953, to which we have nothing to add.*

3. Classification of Companies

(a) Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter

15. The nature and merits of distinction between public and private companies and the adequacy of restrictions imposed on private companies have been examined. The provisions of the Companies Act, 1948, with regard to these matters are considered to be satisfactory.

(b) Nature and merits of distinction between exempt and non-exempt private companies

16. The nature and merits of the distinction between exempt and non-exempt private companies has been examined. Schedule VII of the Companies Act, 1948, has many involved definitions and in practice it is sometimes difficult to advise whether a company is an exempt private company or not. In any event, it is considered that the major and long accepted distinction between public and private companies could be extended so that all private companies have the privileges of exempt private companies conferred by the Companies Act, 1948. We feel that a private company should cease to be exempt if a public company is a beneficial owner of shares in the private company. We feel it would be a great advantage to all if this simple basis as to whether a private company is exempt or non-exempt were to be substituted for the present provisions of Schedule VII.

* Minutes of evidence taken before the committee on shares of no par value, pp. 281-283, H.M.S.O., London, 1954.

17. We, therefore, recommend that all private companies should be exempt and should be entitled to the present privileges of an exempt private company. Where, however, a public company is the beneficial owner of shares in a private company that private company should be non-exempt.

(c) *Unlimited Companies and Companies limited by Guarantee*

18. No general change in the provisions of the Companies Act, 1948, relating to the classification of these companies is recommended. The following points have, however, arisen during the examination of these provisions.

19. Section 8 (1) of the present Act permits the adoption by reference, of all or any of the regulations of Table A for companies limited by shares. There is no corresponding provision for the adoption by reference of the regulations contained in Table C for a company limited by guarantee and not having a share capital which such a company is under section 11 (b) required to follow as near as circumstances admit. Consequently companies of this type must in all cases print full length articles which will largely repeat *verbatim* the regulations in the second part of Table C. The adoption of Table A by reference is a valued facility of which the majority of companies limited by shares take advantage. It appears to be an anomaly that companies limited by guarantee and not having a share capital are denied a similar facility for no reason apparent to us.

20. Accordingly, we recommend amendment of section 8 to include a new subsection to permit companies of this type to adopt all or any of the regulations contained in the second part of Table C which could suitably be sub-divided into a first part containing the memorandum and a second part the regulations to form the standard articles.

21. There are references in the Act to prints and copies (e.g., section 9 (a) and section 143 (1) (3)). It is understood to be the practice of the Registrar in certain cases to accept copies reproduced by type lithographic printing. We recommend that the Board of Trade be given powers by regulation to lay down the circumstances and form in which prints and copies will be accepted. If this recommendation is not acceptable, then it is further recommended that the privilege granted under section 143 (1) to exempt private companies should be extended to all private companies and to companies limited by guarantee and unlimited companies.

22. We understand that in the case of a company limited by guarantee and not having a share capital the Registrar of Companies will accept for registration Articles of Association which restrict the transfer of shares although there are no shares. This legal fiction is, we understand, resorted to in order to comply with the provisions of the Companies Act, 1948, with regard to the constitution of a private company—restriction of the right to transfer shares and prohibitions of invitations to subscribe for shares being prerequisite. We are of the opinion that such companies should be entitled to the privilege of being private companies without requiring to restrict the transfer and prohibiting invitations to subscribe for non-existent shares.

23. We accordingly recommend that a provision should be inserted in Section 28 (1) (a) to the effect that paragraphs (a) and (c) of subsection 1 of section 28 should not apply to companies limited by guarantee and not having a share capital.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

24. The Articles of Association of a company usually confer upon the directors virtually all the powers of the company, including power to sell the whole undertaking and assets of the company. It is, however, a frequent practice for directors before exercising this latter power to obtain the approval of the company in general meeting. Section 191 of the present Companies Act provides that it shall not be lawful for a company to pay compensation for loss of office to a director unless

particulars of the proposed payment are disclosed to the members of the company and the proposal is approved by the company. Table A restricts the borrowing powers of the directors and if they desire to exceed their powers they are required to obtain the sanction of the company in general meeting. It is undesirable to interfere more than is necessary with the discretion of the directors in managing the affairs of the company, but in our view there are certain decisions of so great importance to the future of the company that it is desirable that the directors should be required, on the analogy of section 191 and regulation 79 of Table A, to give information in regard to them to the members and obtain the approval of the company in general meeting. In our view these included a substantial alteration in the nature of the company's assets and the abandonment of a main trading activity.

25. It is quite usual to empower directors to issue unissued shares to such persons at such price not below par, as they may determine. The issue of shares at a price below their real value, otherwise than to the existing shareholders *pro rata* to their holdings, affects adversely the value of the issued shares and may also affect the voting control of the company. We recommend that the approval of the company in general meeting should be required to the issue of shares otherwise than to the existing shareholders *pro rata* to their holdings.

8. The Protection of Minorities

Adequacy of existing remedies. Winding up under the "just and equitable" rule (section 225 (2) of Companies Act, 1948); the remedy afforded by section 210

Remedies

26. The remedies available are:—

- (a) The Common Law rights of action of declarator and interdict, the former to have declared void some action of the company, the latter to prevent the company from carrying out some improper action.
- (b) Winding up under section 222 (f) of the Act—just and equitable rule.
- (c) Winding up under section 225 (2) of the Act—just and equitable rule.
- (d) An order under section 210 of the Act.
- (e) An inspection by the Board of Trade under sections 164 and 165 (a) and (b) of the Act.
- (f) Certain remedies in connection with schemes of arrangement and reconstruction.

Common Law Remedies

27. Shareholders' rights are broadly rights to return of capital, rights to dividends and rights of voting and attending meetings. For many years it was considered that not only was every share equal in respect of capital and dividend rights but every shareholder had an equal vote irrespective of the number of shares held. Section 78 of the Companies Clauses Act, 1845, which weighted voting rights in favour of small holdings, was defeated by splitting holdings and apart from the innocuous provisions of article 62 of Table A of the Act equality of shareholders disappeared during the nineteenth century—*Andrews v. Gas Meter Co.* (1897) 1 Ch. 361 C.A. At the same time the position of a minority shareholder became weaker, and his efforts to protect his interests at common law are, we suggest, largely frustrated by the rule in *Foss v. Harbottle* (1843) 2 Hare 461—that an action based on breach of duty owed to a company must be at the instance of the company and not of individual members—and by the large number of later cases in which it was considered. On the face of it there are obvious reasons for the rule, as explained by Mellish, L.J., in *MacDougall v. Gardiner* (1875) 1 Ch. D. at p. 25, as follows:—

"If the thing complained of is the thing which in substance the majority of the company are entitled to do or if something has been done irregularly which the majority are entitled to do regularly or if something has been done illegally which

the majority are entitled to do legally there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called and then ultimately the majority gets its wishes."

If there were no exceptions to this rule, however, minorities would have no protection. Although an analysis of the rule and its exceptions was made in *Edwards v. Halliwell* (1950) 2 All E.R. 1064 C.A., we feel that it is difficult not only (a) to apply the principles to different sets of circumstances, but (b) to reconcile judgments in different cases with these principles. For our reasons for this, see Annex A.

28. While it is accepted that the statutory remedies later referred to have greatly increased the protection of minorities, we consider that the Common Law remedies open to members of a company against the company and the controlling members are uncertain and inadequate, but that there are circumstances in which the type of remedy which they give is more suitable than the remedies of sections 225 or 210.

29. We recommend that the Common Law as embodied in *Foss v. Harbottle* and succeeding cases should be superseded and altered by statute along the following lines:—

- (1) (a) The company or any member to be able to take proceedings to oblige the directors or any of them to comply with their duties or to prevent them from committing a breach of their duties or to obtain redress from them for a breach.
- (b) Where a member takes proceedings he is to be considered to be taking them on behalf of the members, except the defenders, but the company and any member to be entitled to join in the proceedings. The Court should have power to direct that any sum found due to the pursuer shall be payable to the pursuer or the company or such member or classes of members as the Court thinks fit. Where the offence has been ratified during the proceedings the complaining member or members should be entitled to expenses to the date of ratification unless the action is frivolous.
- (2) Any member to be able to take proceedings against the company (a) to prevent the company acting illegally or *ultra vires* or on an improper resolution or (b) to have such a previous act declared void. There would require to be a saving to protect third parties who had transacted with the company in good faith.

Remedies under sections 210, 222 (f) and 225 (2)

30. We think it convenient to deal with these together. Prior to the Act the minority shareholder apart from Common Law action had to rely on a petition to the Court to have the company wound up on the ground that it was just and equitable to do so under section 168 of the 1929 Act reproduced in section 222 (f) of the Act.

31. *Buckley on the Companies Acts*, 13th edition, at p. 455 *et seq.* divides the type of cases in which it was found to be just and equitable to wind up the company roughly into the following classes; where the substratum of the company had gone; where there was a deadlock; where there was fraud or illegality; mismanagement or misapplication of funds; bubble companies; insolvency; business carried on for the benefit of debenture holders (section 225 (1) now expressly authorises an order).

32. A provision in the articles that a member desiring to withdraw from the company should offer his shares to the other shareholders, and if they failed to purchase he would be entitled to have the company wound up, has been considered relevant. Generally speaking, however, the Courts did not appear to be ready to grant orders under the just and equitable rule if an alternative remedy was available to a shareholder, and particularly where the complaint related to one specific act causing injury to the shareholder the Courts usually held that the shareholder should take a Common Law action. The main exception was in deadlock cases where it was

considered that a small private company was similar to a partnership and that if the circumstances were such as would warrant the dissolution of the partnership it would be just and equitable to wind up the company. See *re Davis & Collett* (1935) Ch. 693 and *Cooper Cuthbert & Sons* (1937) Ch. 392.

33. The remedy of winding up, however, as is well known, can be particularly unsatisfactory to a minority shareholder, and the Cohen Committee, paragraph 60, stated that the real objection to a winding up as a remedy for oppression is that "the break up value of the assets may be small or the only available purchaser may be the very majority whose oppression has driven the minority to seek redress".

34. Following the recommendations of the Cohen Committee there are in the Act two new remedies in sections 225 (2) and 210. The Cohen Report paragraphs 58 and 59 indicated two types of situation where section 210 could be used:—

- (1) Where directors unreasonably refused to register transfers to force a sale to themselves at a low price, and
- (2) Where they took excessive remuneration so as to leave nothing for distribution by way of dividend.

35. We feel that the remedies of winding up under sections 222 (f) and 225 (2) raise difficulties for the minority shareholder from the point of view of proof, expense, and the doubtful benefit of the remedy and that in the majority of cases the main remedy for the minority lies in section 210. It is submitted that the view of the Cohen Committee was that this section should be interpreted in the broadest way, and whether or not the remedy afforded by the section is sufficient for the protection of minorities we feel depends largely on the interpretation put on the section by the Courts. We do not have sufficient evidence to comment on the view expressed in several quarters that the threat of proceedings under section 210 by a minority may in very many cases be sufficient to ensure a more favourable treatment from the majority. Be that as it may there have only been five reported cases on applications under this section—namely, *Elder v. Elder & Watsons Ltd.* (1952) S.C. 49, which decided that the section was intended to meet only the case of oppression of the members of a company in their character as such; *Meyer v. Scottish Textile Manufacturing Co. Ltd.* (1954) S.C. 381 and sub. nom. *Scottish Co-operative Wholesale Society v. Meyer* (1958) 3 All E.R. 66 and *re H. R. Harmer* (1958) 3 All E.R. 689 C.A. where a remedy was granted to the petitioner; *re Antigen Laboratories* (1951) 1 All E.R. 110 where it was held that the petitioner must state the remedy desired; and *re Hawken (S.A.) Ltd.* where the report deals only with the question of expenses.

36. The effectiveness of the remedy given by section 210 would seem to depend on the extent to which the Courts take a broad view of the interpretation of the section, the meaning they attach to "oppressive" conduct and the facts they consider it necessary to establish to render it just and equitable to wind up.

37. From a detailed analysis of the above cases (see Annex B) we have come to the following conclusions:—

- (1) Generally speaking the Courts have taken a broad view of the interpretation of the section.
- (2) The Courts appear to have taken a fairly broad view of the meaning of oppressive conduct. We think, however, that the remedy should be available for something less than oppression; that what should be struck at is unfairness or broadly speaking any conduct, active or passive, which discriminates against a minority or is prejudicial to their interests. We recommend, therefore, that an application under section 210 should be available to a member who complains that the affairs of the company are being conducted, or the powers of the directors are being used, so as unfairly to discriminate against, or be prejudicial to the interests of any member.

- (3) There does not appear to have been any restatement of the just and equitable rule, but it would appear that there is at least the suggestion that if oppression is present a winding up under the rule would be justified. We do not think that this is necessarily so and we recommend that the requirement that there be facts which would justify the making of an order to wind up be omitted.
- (4) A remedy under section 210 is given only to meet the case of the oppression of members of a company in their character as such and not in their character as directors or employees. We recommend that where a director or employee holds more than, say, 10 per cent. of the share capital of the company regard should be had to any conduct which affects his office as a director or his employment with the company.
- (5) It appears that an order under section 210 might be refused on the ground that what was complained of was an isolated act rather than a course of conduct. We consider that application under the section should be competent in the case of an isolated act, in addition to any remedy at Common Law which may be open, and we recommend accordingly.
- (6) It is doubtful whether an application under section 210 is competent where what is complained of is discrimination within a class of members. We think that such a remedy should be competent and we recommend accordingly.

38. We further recommend:—

- (1) That where an applicant obtains an order under section 210 the Court, unless it considers it would be inequitable to do so, shall order that the expenses of the applicant and of the company, if the company appears in the actions, shall be paid by the directors or members whose conduct has been the subject of complaint, jointly and severally or in such proportions as the Court thinks fit; and
- (2) That where the applicant does not obtain an order it should be in the discretion of the Court to order the costs of all parties to be paid by the company unless satisfied that the action of the applicant in taking proceedings was frivolous.

39. We would refer to one class of company in relation to which the protection of minorities appears to us to be of particular importance, namely, those private companies which are virtually indistinguishable from partnerships. Where a partnership has been formed into a limited company the consequences on the retiral or death of a member are very different from those which follow on the retiral or death of a partner. This may, and frequently does, cause hardship to a retiring member or the representatives of a deceased member, as the continuing members, if they control the company, may distribute virtually the whole of the profits in management salaries and hinder or prevent the retiring member or the representatives of the deceased member from disposing of his or their shares to advantage. On the other hand hardship may be caused to the continuing members where the retiring members or the representatives of the deceased member have a controlling interest in the company because he or they are then in a position to remove the continuing members from office as directors and hinder or prevent the realisation of their shares in the company. If the continuing members are allowed to remain in office and the business is successful the retired member or the representatives of the deceased member may receive an undue share of the profits derived from the efforts of the continuing members.

40. In many such cases it would be more equitable and more in accordance with the wishes of the members of the company when it was formed if the consequences of retiral or death were more similar to those which follow on the retiral or death of a partner. It is therefore suggested that a new form of corporate body (herein referred to as an "incorporated partnership") should be instituted, the constitution of which

would provide that on the retiral from active participation in the business or on the death of a member then:—

- (a) the retiring member or the representatives of the deceased member should have the option of requiring the remaining members to purchase the shares of the retiring or deceased member at a fair value, failing which the retiring member or the representatives of the deceased member should have the right to apply to the Court in terms of paragraph (c) below or at his or their own hand to have the incorporated partnership wound up, the liquidator, failing agreement, being appointed by the Court;
- (b) the remaining members should have the option of requiring the retiring member or the representatives of the deceased member to sell his shares to them at a fair value failing which the remaining members should have the right to apply to the Court in terms of paragraph (c) below or at their own hand to have the incorporated partnership wound up, the liquidator, failing agreement, to be appointed by the Court; and
- (c) the Court should be empowered, on application by the retiring member, the representatives of the deceased member, or the remaining members, as the case may be, and on being satisfied that the interests of creditors would not be prejudiced, to authorise the purchase of the shares by the incorporated partnership and make an order accordingly for the reduction of its share capital.

If such an incorporated partnership were instituted it should be permissible for all the members of any existing private company to convert it into an incorporated partnership. The intention is that the constitution of an incorporated partnership, at least in relation to the matters in paragraphs (a), (b) and (c), should be unalterable except with the consent of all the members.

Board of Trade Inspections

41. Section 164 gives the Board of Trade power to appoint an inspector in the case of a company having a share capital on the application either of not less than 200 members or of members holding not less than one-tenth of the shares issued, and in the case of a company not having share capital on the application of not less than one-fifth in number of the persons on the company's register of members. The Board may require the applicants to give security for costs up to an amount not exceeding £100. Under section 165 (a) the Board of Trade shall appoint an inspector if the company request by special resolution or the Court by order declare that the affairs of the company ought to be investigated, and under section 165 (b) the Board may appoint an inspector if circumstances suggest broadly speaking that the company's business is being conducted fraudulently "or in a manner oppressive to any part of its members" or its members have not been properly informed of its affairs. We understand that accordingly any member of a company may approach the Board of Trade under section 165 (b) on the ground of oppression and we believe that if the Board are satisfied that there is a *prima facie* case for investigation an inspector will be appointed. It may be noted that this appears to give a remedy to any shareholder irrespective of the size of his shareholding without any security for costs being required. We do not have information as to how often or to what extent advantage has been taken of section 165 (b) nor what the Board of Trade require in the way of substantiating allegations of oppression. Since the Board if it considers it expedient can under section 169 (3) petition the Court to wind up the company if the Court thinks it is just and equitable, or can petition for an order under section 210, it would appear that a member complaining of oppression may find his best remedy and certainly one which does not involve unknown liability for expenses to be an approach to the Board of Trade. Moreover a threat to employ that remedy may have such an effect on the company or majority as to make its employment unnecessary. If the Board of Trade inspection attracts publicity, and moreover if there is later a winding up, we anticipate that the value of the member's interest might be less at the end of the day than if he had been able successfully to proceed himself under section 210. We have no recommendation to make.

9. Protection of Special Classes of Shares

42. Whilst the machinery provided for the protection of the holders of special classes of shares is cumbersome, it nevertheless is effective for its immediate purpose. The application to the Court must be made within 21 days after the consent to the variation is given on behalf of the class concerned or the resolution of the class meeting is passed, and the applicant must hold 15 per cent. of the issued shares of the class or, otherwise have the written authority of other shareholders of that class making up the requisite percentage. Although it is sometimes difficult to comply with these conditions in due time, yet an extension of the period of 21 days does not appear to be warranted.

43. For the application to be successful the Court must be satisfied that, having regard to all the circumstances of the case, the variation of rights would unfairly prejudice the shareholders of the class concerned, but the Court is empowered only to disallow or confirm the variation. It is submitted that the Court should have power to amend the variation or to approve it subject to such conditions as the Court may deem just and equitable.

44. An appeal to the Court under section 72 is competent only when the consent of the class of shareholders affected is required in virtue of the company's memorandum or articles. On the other hand a regulation in terms similar to article 4 of Table A is frequently inserted in modern articles of association. It is therefore submitted that it should be enacted that where the share capital of a company is divided into different classes of shares and provision is made to vary the rights attached to any class of shares, these rights should be capable of being varied only with the sanction of an extraordinary resolution passed at a separate meeting of holders of the shares of that class or with the consent in writing of the holders of three-fourths of the issued shares of the class.

45. Certain difficulties have arisen in regard to the interpretation of "variation". It has been held that an act which merely dilutes the voting power of the holders of a special class of shares does not constitute a variation of rights. Similarly where the enjoyment of the rights attached to a particular class has been "affected as a matter of business" that does not mean—it has been judicially decided—that these rights have been "varied as a matter of law". Doubt has been expressed in certain quarters as to the correctness of the two relevant decisions of the Court of Appeal. Where the rights of a class of shareholders, however, are "affected" to such an extent that their consent is required, it seems appropriate that the variation in the rights must be of a substantial nature and not simply affecting, albeit adversely, the value of the shares, nor simply reducing the relative voting strength of the shares concerned. (Undue discrimination between the holders of different classes of shares may amount to oppression from which relief can be sought under section 210.) In this connection the position might be clarified if regulation 5 of Table A were to be included as a section of the Act subject to the proviso that a company should be entitled to make provision to the contrary in its articles of association.

46. The decision in the case of *Marshall Fleming*, [1938] S.C. 873, allows in Scotland alteration of class rights which are defined in the company's memorandum of association without reserved power therein for alteration provided that the contemporaneous articles of association contain a clause on the lines of regulation 4 of Table A. This is at variance with the Law in England where it is understood that it is necessary in these circumstances to make an application to the Court under section 206. In the event of a decision reversing or disapproving the ratio in *Marshall Fleming's* case companies which in their procedure may have depended on that ratio will inevitably find themselves in difficulty. We can see no reason to question the soundness of the decision in *Marshall Fleming's* case where class consent will have been obtained, and in any event the benefit of section 72 is always available to dissentients. We therefore recommend that section 23 be amplified to give statutory

authority to the decision in circumstances which involve variation of rights without alteration of capital by way of reduction or compromise arrangement affecting its paid-up value.

16. Take-over Bids

Definition of take-over bids

47. For the purposes of the memorandum a take-over bid is deemed to be an offer made simultaneously to holders of one or more classes of shares in a company to acquire their respective holdings in an attempt to obtain control of the voting power of such company. Where the stock or shares of a company are dealt in on one or more stock exchanges control can be obtained by purchasing gradually a sufficient quantity of the investment in the market. This type of acquisition is not under consideration in this memorandum.

Merits of and objections to take-over bids

48. It is the fashion to be critical of these and it is believed that this attitude had been fostered by ill-informed reporting in the Press in a desire to create a sensation of what is frequently an eminently desirable and business-like transaction. So far has this attitude gone that the mere name "Take-Over Bids" now conveys the impression of some shady piece of financial manipulation. In point of fact a take-over bid can be, and usually is, a sound piece of business beneficial both to the holder of the shares which are acquired, because normally he is offered a price in excess of what he could otherwise get, and to the purchaser who believes that by his skill, knowledge and enthusiasm he can make his new acquisition more successful.

49. In the early stage of the development of the technique of the take-over bid it was directed mainly towards companies whose shareholders (possibly unwittingly) were suffering from a board of directors who were content to follow a policy of extreme conservatism, maintaining a small but regular dividend policy, amassing spectacular reserves and liquid assets, and not seeking to expand the business under their control. Such a policy results in the shareholders not being able to realise the true value of their holdings on the stock exchange. There have been instances of directors raising their dividends with unseemly haste and to dizzy heights in order to fight off the threat of a take-over bid.

50. The take-over bid is also frequently used as a convenient method of merging one or more concerns in similar or ancillary types of business where by common marketing policies, reduction in administrative staff, rationalisation of production, &c., there emerges a larger unit producing more cheaply. It is worth noting that where the consideration in such a transaction is shares in the acquiring company the selling shareholders retain a stake in their original investment.

51. Take-over bids do not as a rule operate to the disadvantage of the shareholders who sell their shares. The decision to sell rests with them and if the bid is accepted by sufficient shareholders to allow control to pass into new hands it is a fair assumption that the terms of the offer are reasonable. The only exception to this generality is where less than 10 per cent. of shareholders refuse to accept the offer. Under section 209 of the Companies Act, 1948, this minority of dissentient shareholders can be compelled to sell for the same consideration as in the original offer. In theory it is wrong that anyone should be forced to sell his property, but in practice it is doubtful if he is losing much in the circumstances mentioned as his position as one of a minority of less than 10 per cent. is unlikely to be enviable. The company taken over is unlikely to be administered for the benefit of the minority.

52. In the main, the shareholder accepting a take-over bid if he has had the fullest information to enable him to come to a decision, reference to which is made later, cannot complain if what follows the change in control proves he sold too cheaply. In fact it is often the use to which the acquired company is put after the change in control which is the feature of such a transaction which attracts criticism.

It is wrong, however, to lay the blame for this at the door of the take-over bid which is merely an ordinary business transaction. If it transpires that the purchaser had a truer appreciation of the value of the assets and acquired control merely in order to sell these, liquidate the company and make a profit, it may be that the former directors had failed to make full use of the assets.

53. It is submitted that shareholders faced with a take-over bid are entitled to all the help and advice which their directors from the intimate knowledge of the company's affairs can provide. Apart from a necessity for putting more responsibility on directors, the combined effect of the Companies Act, 1948, and the Prevention of Fraud (Investments) Act, 1958, and the rules issued thereunder appear adequate to ensure that shareholders are not trapped into accepting offers as a result of misrepresentation of facts or inadequate information.

54. We recommend that in every case where a take-over bid is made direct to shareholders the directors of the offeree company should within, say, 14 days of the offer, be obliged to circularise their shareholders with advice as to acceptance or refusal. In addition to the points covered in the Third Schedule to the proposed rules to be issued under the Prevention of Fraud (Investments) Act, 1958, now in draft, we consider that directors should also inform shareholders on the following:—

- (a) the prospects of the industry in general and the company in particular;
- (b) whether in their opinion the present value of the assets of the company differs substantially from the balance sheet figures;
- (c) what they know of the financial standing of the offerers; and
- (d) whether the method of settlement appears satisfactory.

20. Reduction of Capital and Purchase by a Company of its Own Shares

(a) *Purchase by a company of its own shares section 54, Companies Act, 1948*

55. There are no reported cases of proceedings taken under this section and no information is available on investigations which may have taken place through the Board of Trade. The rights of creditors and minority shareholders might however, be seriously affected if the provisions of section 54 are not observed.

56. The wording of section 54 is not at all clear and there is considerable doubt in the legal profession as to its effect. In many cases it is thought that in practice Company X is, by means of a bridging loan from a bank, purchasing the shares of Company Y and thereafter repaying the borrowed moneys by utilising the cash resources of Y or cash received from mortgaging the assets of Y. It is recommended that this section be clarified by the legislature as to whether or not such an operation involves "financial assistance . . . in connection with a purchase made".

57. Although the sale of shares in a company by a member to that company is void and he is liable to be restored to the register, any other contract of sale or any security given in breach of this section is not invalidated thereby. Circumstances can occur where such a breach would materially prejudice third parties. For example, a member of an insolvent company might purchase shares of another member in that company with the company's financial assistance. It is recommended that any act done in breach of this section be voidable at the instance of any party prejudiced thereby.

(b) *Reduction of capital*

Sections 66-71, Companies Act, 1948

58. The rights of creditors, shareholders and the investing public are in most instances sufficiently safeguarded by sections 66-71, but members might be prejudiced by the actions of company officials.

59. The jurisdiction of the Sheriff Court under section 220 is limited to companies with an issued and paid-up capital of £10,000. It is recommended that this jurisdiction

be extended to take account of increasing values and should extend to companies with an issued and paid-up capital of, say, £50,000.

60. The liability of members at the date of registration of the order for reduction under section 70 is perhaps in all cases not recognised. It is submitted that no legislative change is, however, required.

24. Company and Business Names

61. We find in practice frequent and considerable difficulty in ascertaining that a name proposed for a new company is available for registration. It is not an exaggeration to say that this aspect of incorporation is by far the most troublesome. Part of the difficulty may arise from the grounds upon which the Board of Trade considers a name to be "undesirable" in terms of section 17 being unknown to the applicant. The practice whereby the Registrar on behalf of the Board examines a proposed name avoids delay, where he is in a position to issue a letter of provisional approval. But what does cause perplexity is the situation where he may intimate that the name is not available. The applicant does not necessarily have to be given any specific reason and is under the difficulty of re-submitting the name in adjusted forms, sometimes repeatedly, or with alternative names, in order to find one which is available and which suits his purpose. This is not only a nuisance, but seems to put the staff of the Registrar of Companies to considerable and largely fruitless trouble. While the official circular with reference to section 17 (No. C.186) seeks to give guidance to the public, it does not appear necessarily to give all the reasons which will lead to the refusal of a name. It is in general terms and does not in practice seem to cover all the official rules. These rules are understood to be contained in departmental instructions issued by the Board of Trade to the Registrar and treated as confidential. Consequently, while an individual member of the public may over a period come to learn some of the official objections, others who do not happen to be frequently in touch with the Registrar on the subject do not do so. Furthermore, members of the Registrar's staff from time to time dealing with this particular matter change and complete uniformity of practice may not always be achieved in consequence. It is in our view highly desirable that the Board of Trade should make available to the public rules governing the whole matter. We can see no conceivable objection to this, always provided the Board of Trade reserves the right of final decision.

62. We believe, for example, that although the circular No. C. 186 does not say so, the inclusion of the word "Scotland" in a proposed name is not normally allowed unless the proposed company is to be an associate or subsidiary in Scotland of an English or foreign company. Not only is this an instance of a rule which is not generally known to the public, but it also denies to a Scots company the use of the country in its name which may well be fully justified by the intended scope of its operations.

63. On a company seeking the approval of the Board of Trade to change its name in terms of section 18 (1) standard questions are in all cases raised as to the reasons for the change, whether any change is taking place in the nature of the business or has recently taken place or is contemplated in shareholdings or directorate, and if so, for further information as to the consideration given for shares and the assets or liabilities of the company at the time. While the propriety of such inquiry is not in question, it appears to us desirable that as in the case of names for new companies the rules governing the sanction of changes of names should be defined and made known to the public.

64. As regards registration under the Registration of Business Names Act, 1916, as now amended, the position as to availability of names appears broadly to be the same as for companies. There is, however, a difference. The admissibility of names is in terms of section 14 of the principal Act in the hands of the Registrar who has the further power to remove a business name from the register where it is misleading. The section confers a right of appeal to the Board of Trade upon any decision of the

Registrar under it. The Registrar makes available to the public a circular (R.43) which is in effect identical with circular No. C. 186 above mentioned. We have the same comments to offer on that circular as above in connection with company names. We feel that the effect of section 14 of the Registration of Business Names Act might well be applied to company names so that in both cases the Registrar in the first instance would be the judge of availability and there would be a right of appeal to the Board of Trade for final decision in case of question.

65. We feel that any measures which are practicable to enforce more strict compliance with the Registration of Business Names Act than is believed to be generally the case should be taken, both as regards initial registration and the registration of changes.

SUMMARY OF RECOMMENDATIONS

1. Incorporation of Companies

(a) *Requirements as to minimum Number of Members and other conditions of Incorporation*

66. It is recommended:—

- (1) That a private company which is a wholly owned subsidiary need have only one member. (Paragraph 6.)
- (2) That section 1 be amended to define the "lawful purpose" for which persons may be associated to form an incorporated company as being one of the objects stated in the memorandum of association of the company. (Paragraph 7.)
- (3) That it should be obligatory for the subscribers to the memorandum of association of a company to subscribe for share capital to the nominal value of at least £100 and that it be required that such share capital be paid up in cash. (Paragraph 8.)
- (4) If recommendation (2) above is adopted that the Declaration of Compliance (form 41) be altered to state expressly that there has been compliance with section 1 as amended. If recommendation (2) above is not adopted that the use of the Declaration of Compliance be discontinued. (Paragraph 9.)

(b) *Limitation of Objects to those stated in the Memorandum, &c.*

- (5) That every company should have as regards third parties the same powers as an individual. (Paragraph 10.)
- (6) That the common form powers usually incorporated in the objects clause of the memorandum of association should be set out in the Companies Act and that it should be provided that all companies shall be deemed to have these powers. (Paragraph 11.)
- (7) That section 5 (9) of the Companies Act be amended to make it clear that application may be made to the Court outwith a period of 21 days from the date of the alteration to cancel the purported alteration to the provisions of a company's memorandum of association which is not authorised by section 5 (1). (Paragraph 12.)

(d) *Shares of no par value*

- (8) That no par value shares should be permitted to the limited extent referred to in the memorandum by the Council dated 7th March, 1953. (Paragraph 14.)

2. Classification of Companies

(b) *Nature and merits of distinction between exempt and non-exempt private companies*

- (a) That all private companies, except those in which a public company holds shares, should be exempt. (Paragraphs 16 and 17.)

(c) *Unlimited Companies and Companies limited by Guarantee*

- (9) That companies limited by guarantee and not having a share capital should be permitted to adopt all or any of the regulations contained in Table C. (Paragraphs 19 and 20.)
- (10) That the Board of Trade be given power by regulation to determine the circumstances and the form in which copies will be accepted instead of prints. If this recommendation is not acceptable that the privilege granted under the proviso to section 143 (1) of the Companies Act to exempt private companies be extended to all private companies and to companies limited by guarantee and unlimited companies. (Paragraph 21.)
- (11) That paragraphs (a) and (c) of subsection 1 of section 28 of the Companies Act should not apply to companies limited by guarantee and not having a share capital. (Paragraphs 22 and 23.)

5. Exercise of Powers of Companies by Directors and Degree of Control retained by Shareholders

- (12) That the directors should be required to obtain the sanction of the company in general meeting before:—
 - (a) taking any action which would effect a substantial alteration in the nature of the company's assets or the abandonment of a main trading activity. (Paragraph 24.)
 - (b) issue any shares otherwise than to the existing shareholders *pro rata* to their holdings. (Paragraph 25.)

8. The Protection of Minorities

That the Law be altered along the following lines:—

- (a) The company or any member to be able to take proceedings to oblige the directors or any of them to comply with their duties or to prevent them from committing a breach of their duties or to obtain redress from them for a breach.
- (b) Where a member takes proceedings he is to be considered to be taking them on behalf of the members, except the defenders, but the company and any member to be entitled to join in the proceedings. The Court to have power to direct that any sum found due to the pursuer shall be payable to the pursuer or the company or such member or classes of members as the Court thinks fit. (Paragraphs 27–29.)
- (13) That any member should be able to take proceedings against the company:—
 - (a) to prevent the company acting illegally or *ultra vires* or on an improper resolution or (b) to have such a previous act declared void. There would require to be a saving to protect third parties who had transacted with the company in good faith. (Paragraphs 27 and 28.)
- (14) That an application under section 210 of the Companies Act should be available to a member who complains that the affairs of the company are being conducted, or the powers of the directors are being used, so as unfairly to discriminate against, or be prejudicial to the interests of, any member. (Paragraphs 30–37.)
- (15) That it should be unnecessary for an applicant under section 210 to prove that the facts would justify the making of an order to wind up. (Paragraphs 30–37.)
- (16) That where a director or employee holds more than, say, 10 per cent. of the share capital of a company regard should be had to any conduct which affects his office as a director or his employment with the company. (Paragraphs 30–37.)

- (17) That an application under section 210 of the Companies Act should be competent in the case of an isolated act as well as of a course of conduct. (Paragraphs 30-37.)
- (18) That application under section 210 of the Companies Act should be competent where what is complained of is discrimination within a class of members. (Paragraphs 30-37.)
- (19) That where an applicant obtains an order under section 210 of the Companies Act the Court, unless it considers it would be inequitable to do so, shall order that the expenses of the applicant and of the company, if the company appears in the action, shall be paid by the directors or members whose conduct has been the subject of the complaint jointly and severally or in such proportions as the Court thinks fit. (Paragraph 38.)
- (20) That where the applicant does not obtain an order it should be at the discretion of the Court to order the costs of parties to be paid by the company unless satisfied that the action of the applicant in taking proceedings was frivolous. (Paragraph 38.)
- (21) That a new form of body corporate should be instituted on the lines set out in paragraph 40. (Paragraphs 39 and 40.)

9. Protection of Special Classes of Members

- (22) That, where the share capital of a company is divided into different classes of shares and provision is made to vary the rights attached to any class of shares, these rights should be capable of being varied only with the sanction of an extraordinary resolution passed at a separate meeting of the holders of the shares of that class or with the consent in writing of the holders of three-fourths of the issued shares of that class. (Paragraph 44.)
- (23) That the provisions of Regulation 5 of Table A should be included in the Act subject to the proviso that the company should be entitled to make provision to the contrary in its Articles of Association. (Paragraph 45.)
- (24) That section 23 be amplified to give statutory authority to the decision in *Marshall Fleming & Co.*, [1938] S.C. 873. (Paragraph 46.)

16. Take-over Bids

- (25) That where a take-over bid is made direct to the shareholders the directors of the offeree company should be obliged within, say, 14 days of the offer, to circularise their shareholders with advice as to acceptance or refusal and to give the shareholders information on the following:—
 - (a) the prospects of the industry in general and the company in particular;
 - (b) whether in their opinion the present value of the assets of the company differs substantially from the balance sheet figures;
 - (c) what they know of the financial standing of the offerees; and
 - (d) whether the method of settlement appears satisfactory. (Paragraphs 53 and 54.)

20. Reduction of Capital and Purchase by the Company of its own Shares

(a) Purchase by a company of its own Shares

- (26) That the provisions of section 54 (1) prohibiting whether directly or indirectly any financial assistance for the purpose of or in connection with a purchase of shares in the company be clarified. (Paragraph 57.)
- (27) That any transaction carried out in breach of section 54 be voidable at the instance of any party prejudiced thereby. (Paragraph 57.)

(b) *Reduction of Capital*

- (28) That the jurisdiction of the Sheriff Court to wind up any company registered in Scotland should be extended to include companies having a paid-up share capital not exceeding £50,000. (Paragraph 59.)

24. *Company and Business Names*

- (29) That the Board of Trade rules for the approval of names of new companies and for changes of name of existing companies should be published. (Paragraphs 61-63.)
- (30) That the use of the word "Scotland", "Scottish", "Scots" and any similar word relating to the country should be available to Scottish companies whenever justified by their own operations. (Paragraph 62.)
- (31) That there should be a right of appeal to the Board of Trade against the decision of the Registrar as to the availability of a name for a new company. (Paragraph 64.)

In Name of the Council,

J. N. DANDIE,

President.

18th August, 1960.

ANNEX A

(See paragraph 27)

1. In essence we understand the rule in *Foss v. Harbottle* does not apply:—

- (1) If the act complained of is *ultra vires* and therefore cannot be ratified by an ordinary resolution of the company.
- (2) If the act complained of is a "Fraud on the Minority" and the offenders by their control of the company can prevent the company from taking action.
- (3) If the matter complained of was one which could validly be done or sanctioned not by a simple majority of the members but only by some special majority—e.g., a special resolution.
- (4) There appears to be a fourth exception which is difficult to relate to particular circumstances, viz.:—

If the act complained of is not only a breach of duty to the company but also a breach of the complaining members' rights unless it can be ratified by an ordinary resolution.

2. With reference to the application of the principles of the rule to different circumstances:—

- (1) It is by no means easy to state what wrongful acts may and what wrongful acts may not be ratified by an ordinary resolution.
- (2) The same difficulty can arise in distinguishing between a breach of duty to the company alone and a breach of duty owed to a member. The Memorandum and Articles is a contract—albeit variable by one party alone—between the company and each member and accordingly if there is a breach of it the members' rights are affected. The fault may or may not be ratifiable by ordinary resolution. An alteration of the Memorandum and Articles is, of course, also in this sense a breach of the members' rights, but when effected by Special Resolution has statutory approval subject to certain limitations—sections 5, 10, 22, 23, 210. The question of *bona fides* still remains and in this connection we feel the Courts have taken a narrow view of cases quoted in *Buckley*, 13th edition, at pp. 38-40.

3. With reference to reconciling judgments in different cases with the principles of the rule, a fundamental issue is involved in the question whether votes have been exercised "bona fide for the benefit of the company as a whole"; that they should be is postulated in *Allen v. Gold Reefs of West Africa* (1900) Ch. 656 C.A., but see many other cases and particularly *Baird v. Baird & Co.* (1949) S.L.T. 368, and the Master of the Rolls "hypothetical member" in *Greenhalgh v. Alderme Cinemas Ltd.* (1951) Ch. 286. Another example of decisions which we believe to be difficult to reconcile with the rule are those relating to appropriation of the minority's shares by the majority commencing with *Brown v. British Abrasive Wheel Co.* (1919) 1 Ch. 290 which are fully discussed in Professor L. C. B. Gower's *Principles of Modern Company Law*, p. 499 *et seq.* It would also appear that the rule excludes a member as opposed to the company taking proceedings where the breach of duty arises from negligence rather than fraud, *Pavlides v. Jensen* (1956) Ch. 565. Furthermore when a member can take action where there is involved a breach of his own rights and a breach of the company's rights difficult considerations can arise as to whether the action should be on behalf of himself and other members or only on his own behalf.

4. We also consider that the fact that a wrong can be ratified by ordinary resolution is not a good ground for barring proceedings if in fact the wrong is not ratified but continues. We would refer to the observations on the *ultra vires* rule as being no protection to shareholders contained in the Cohen Report (Cmd. 6659), paragraph 12 (on which section 5 of the Act is based). We would also refer to the decision in *Danish Mercantile Co. Ltd. and Others v. Beaumont and Another* (1951) Ch. 680 that a company may decide to take proceedings for a breach of duty to it by a resolution at a general meeting.

ANNEX B

(See paragraph 37)

1. Dealing with the question of whether the Courts have taken a broad view on the general interpretation of section 210 we would refer to the following judicial comments:—

(1) In the first hearing of *Meyer's* case, Lord Cooper said (1954, S.C., page 391):—

"In my view the section warrants the Court in looking at the business realities of a situation and does not confine them to a narrow legalistic view." This was quoted with approval by Viscount Simonds in the House of Lords and Lord Denning in the same case (1958, 3 All E.R., page 89) stated:—

"(Section 210) is a new section designed to suppress an acknowledged mischief. When it comes before this House for the first time it is in accordance with long precedent that your Lordships should give such construction as shall advance the remedy."

(2) Jenkins, L.J., in *Harmer* (1958, 3 All E.R., page 698) following the opinions of the judgments in the House of Lords stated:—

"Section 210 is wide enough to cover oppression by anyone who is taking part in the conduct of the affairs of the company whether *de facto* or *de jure*."

2. Turning to the meaning of oppression, Lord Cooper in *Meyer's* case stated:—

"The truth is that whenever a subsidiary is formed as in this case with an independent minority of shareholders the parent company must if it is engaged in the same class of business accept as a result of having formed such a subsidiary an obligation so to conduct what are in a sense its own affairs as to deal fairly with its subsidiary."

This was quoted with approval by Viscount Simonds in the House of Lords and by Jenkins, L.J., in *Harmer*. Viscount Simonds in the same case used the dictionary definition of oppressive—i.e., burdensome, harsh and wrongful. This was followed by Jenkins, L.J., and Romer, L.J., in *Harmer's* case. It may, however, be noted that Lord Morton in *Meyer's* case (1958, 3 All E.R., page 74) stated " (the minority) cannot succeed in my opinion merely by proving that the affairs of another company are being so conducted, i.e., oppressively, even if that other company holds the majority of shares in the company, whereof the complainants are members and nominate the majority of Directors ". He found difficulty in that the conduct of the directors were sins of omission and not of commission, but reached the conclusion that the affairs of the company were conducted oppressively. On the other hand Lords Keith and Denning expressly stated that conduct which was merely inaction could amount to oppression and they and Viscount Simonds considered that there was misconduct of the affairs of the company.

Lord Keith said (page 85):—

" Misconduct in the affairs of a company may be passive conduct, neglect of its interests, concealment from the minority of knowledge that it is material for the company to know."

Lord Cooper in *Elder's* case said:—

" . . . Conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder . . . is entitled to rely."

Lord Keith in *Elder's* case spoke of oppression as " A lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members."

3. We would particularly stress the immediately preceding opinion of Lord Keith and Lord Cooper's reference to " the business realities of a situation ". It appears to us that they go beyond the strict interpretation of " oppression " which we believe the Courts are entitled to take. We consider that oppression should cover unfairness or broadly speaking any conduct, active or passive, which discriminates against a minority, or is prejudicial to their interests. We are supported in this view by the Report of the Company Law Amendment Committee of Northern Ireland (Cmd. 393). It should be noted in this connection that the pursuer failed in *Elder's* case on the ground that there was no oppression of him as a member, his complaint in substance relating to oppressive conduct to him as a director. While we respectfully agree that the decision was correct we consider a very real problem, particularly in private companies, was involved. We have considerable difficulty, however, in suggesting a remedy. Reference is made to the recommendation regarding " partnership cases " later. One suggestion which we advance with some hesitation is that in considering " oppression " and giving effect to a remedy the Court shall have regard to the conduct of the company in relation to its effect on the position of a shareholder who is or was a director or otherwise in the employment of or associated with the company, provided that shareholder has a beneficial interest in not less than, say, 10 per cent. of the issued capital of the company.

4. Turning to the third element in section 210—the just and equitable rule—the large number of cases where this principle has been considered are mainly prior to the Act, and it is not proposed to quote them. Reference, however, is again made to *Buckley*, page 455 *et seq.*, and to the types of cases in which " just and equitable " was considered. We think it fair to say that broadly speaking where a minority had another remedy, namely, at Common Law, the Courts were unwilling to apply winding up under the 1929 Act on the grounds that it was just and equitable. It is believed that following on the introduction of the new remedies in the 1948 Act since there was no definition of just and equitable there was some doubt as to whether the interpretation previously placed on this phrase would be largely followed in cases

arising under section 210 or for that matter under 225 (2). Jenkins, L.J., in *Harmer's* case (page 699) quoting with approval Lord Cooper in *Elder's* case said:—

" . . . Justice and equity which led to the grant of a winding up order have often been found in conduct reasonably capable of being described as oppressive . . . unfair abuse of powers and an impairment of confidence in the probity with which the company's affairs are being conducted as distinguished from mere resentment on the part of a minority at being outvoted on some issue of domestic policy. . . ."

5. Lord Jenkins also approved Lord Shaw's repetition in *Loch v. Blackwood Ltd.* (1924) A.C., page 783, of Lord Clyde's dictum in *Baird v. Less* (1924) S.C. 83, at page 92:—

" A shareholder puts his money into a company on certain conditions . . . that the business in which he invests shall be limited to certain definite objects . . . that it shall be carried on by certain persons elected in a specified way and . . . shall be conducted in accordance with certain principles of commercial administration defined in the Statute which provide some guarantee of commercial probity and efficiency. If shareholders find that these conditions or some of them are deliberately and consistently violated and set aside by the action of a member and official of the company who wields an overwhelming voting power, and if the result of that is that for the extrication of their rights as shareholders they are deprived of the ordinary facilities which compliance with the Companies Act would provide them with, there does arise a situation in which it may be just and equitable for the Court to wind up the company."

6. While there has been no restatement of the meaning of the just and equitable rule it would appear that there is at least a suggestion that if oppression is present a winding up under the rule would be justified. We do not think that is necessarily so and the converse that if it is just and equitable to wind up, oppression therefore is present, is certainly not the case. Lord Keith in *Elder's* case (1952, S.C., page 58):—

" Section 210 does not apply to all cases in which it would be just and equitable to wind up a company because some of these are cases in which it could not be said that there is oppression," and again, page 59, ". . . the question of absence of mutual confidence *per se* between partners or between two sets of shareholders, however relevant to a winding up seems to me to have no direct relevance to the remedy granted by section 210. It is oppression . . . that must be averred and proved. Mere loss of confidence or pure deadlock does not, I think, come within section 210."

APPENDIX XLVII

Memorandum by The Council of The Institute of Chartered Accountants of Scotland

The terms of reference to the Company Law Committee appointed under the Chairmanship of Lord Jenkins by the President of the Board of Trade are as follows:—

“To review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except insofar as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable.”

The Committee has invited evidence from the Institute on these matters and has listed subjects on which it specifically invites views. These subjects with our views on them are shown below. We have inserted in square brackets certain additional sub-headings of our own.

For the sake of brevity our memorandum is written in the first person plural. It expresses the views of the Council of the Institute or in some instances of a majority of members of the Council.

In the memorandum the Companies Act, 1948, is referred to as “the Act”, references to sections and Schedules are to sections of and Schedules to the Act and when the context so admits the expression “shares” includes stock.

Our recommendations on the headings and sub-headings in this memorandum which from our point of view are of major importance are summarised as follows:—

Consideration should be given to the possibility of applying to companies incorporated under the Companies Act the principles regarding *vires* which presently apply to bodies incorporated by Royal Charter.—1 (b).

The recommendations of the Gedge Committee on shares of no par value should, subject to minor reservations, be implemented.—1 (d).

The present prohibition of partnerships with more than twenty members should be abolished.—2.

Exempt private companies should continue to be exempted from filing a balance sheet and other documents with the annual return.—3 (b).

Directors’ powers and duties as regards fundamental changes in their company’s activities should continue unaltered.—5 (a).

Where, however, directors have received a proper offer for the whole or substantially the whole of their company’s undertaking and assets (as distinct from a take-over bid), they should disclose the position to the shareholders, who should then decide the action to be taken.—5 (b).

Where new shares are issued for cash they should be required to be offered *pro rata* to the existing equity shareholders.—5 (c).

The issue of equity shares carrying no votes or carrying only restricted voting rights should, for the future, be prohibited.—7.

The practice of registering shares in the names of nominees should not be prohibited, but a company should be empowered to require a declaration as to beneficial ownership.—11 (a).

Interests in associated companies should be defined and additional information supplied.—14.

Floating charges should be introduced into the Law of Scotland.—15 (c).

Fuller disclosure in relation to take-over bids should be required.—16.

Further information should be given regarding fixed assets in those cases where they are not stated in the balance sheet by reference to a valuation within the preceding 15 years.—21 (a).

Pre-acquisition profits of a subsidiary should not in general be available for distribution to the members of a holding company, but they should, in certain circumstances, be so available where the acquisition has arisen through an exchange of shares.—21 (b) and (c).

Section 161 of the Act should be amended as regards eligibility for appointment as auditor.—22 (a).

The form of the auditor's report should be shortened.—22 (b).

Exempt private companies should be required to appoint auditors who are professionally qualified.—22 (c).

1. Incorporation of Companies—Memoranda of Association

(a) *Requirements as to minimum number of members, and other conditions of incorporation*

Under section 2 (1) (b) of the Act the memorandum of every company must state whether the registered office of the company is to be situate in England or in Scotland.

There is no power to change the registered office from one country to the other. This can cause inconvenience in practice where a company is registered in the one country but it is in the other that its business is effectively managed and carried on. On the other hand the differences between Scots Law and English Law would undoubtedly raise complications if a change of registered office from one country to the other were to be allowed. We recommend that, if these complications can be overcome, the Act be amended so as to empower the Court to permit the transfer of the registered office from Scotland to England or *vice versa* on being satisfied (as is at present required on an application for reduction of capital) that the interests of the creditors would be adequately safeguarded.

(b) *Limitation of objects to those stated in the memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects*

The basic principle is that a company incorporated under the Companies Act cannot effectively do anything beyond the powers expressly or impliedly conferred upon it by its memorandum. This principle, we believe, was adopted for the protection of investors and creditors. The universality of a modern objects clause effectively goes against the spirit and intentions of the foregoing principle, and among the practical difficulties that a modern objects clause creates are—

- (i) perusal of a memorandum is unlikely to give any clear picture of a company's true field of activity;
- (ii) time and thought may have to be devoted to the relatively unproductive task of deciding whether some newly contemplated activity on the part of the company is within its objects clause or, if not, whether and how the objects clause should be altered; and
- (iii) the interests of third parties may be prejudiced and the company may be placed in serious difficulty if the objects clause is transgressed.

It follows that in our view the present type of "universal" objects clause gives no protection to investors under modern conditions, and far from protecting may even damage the interests of creditors.

We recognise that it may be much too simple—although the thought greatly appeals to us—to suggest a complete reversal of the present position by an enactment on the lines of empowering a company incorporated under the Act to do anything which a natural person could do provided that it is not specifically prohibited by the terms of its memorandum. It might, however, be found practicable to apply to companies the somewhat different principles regarding *vires* which presently apply to bodies incorporated by Royal Charter.

(c) *The company as a legal entity distinct from its members*—"one-man" companies

We have no fault to find with the present law on this subject.

(d) *Shares of no par value.* (Bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)

A Memorandum of Evidence submitted by the Council in March, 1953 to the Gedge Committee on Shares of No Par Value expressed the view that the issue of shares of no par value should be permitted and that their introduction would give rise to no fundamental difficulties: the Memorandum gave reasons for these views and contained suggestions as to points which should be dealt with by legislation on the subject. The views expressed in the Council's Memorandum were in fact in substantial agreement with the conclusions to which the Gedge Committee came, save that the Council expressed opposition to allowing shares of no par value to be issued for a consideration other than cash. We are now satisfied, however, in the light of the Gedge Committee's consideration of that question, that this is a right which should not be denied to shares of no par value. We accordingly welcome, subject to the following comments, the recommendations contained in paragraph 72 of the Gedge Committee's Report:—

(i) We are not convinced that, as recommended in paragraph 72 (5) of the Gedge Committee's Report, it should be permissible for shares of no par value to be partly paid; it seems to us that as partly paid shares are relatively rare at the present day it is unnecessary to permit the introduction of partly paid shares of no par value, except insofar as this may be required for a temporary period during which new shares are being paid for by instalments.

(ii) We refer under item 21 (c) below to the question of "freezing" reserves mentioned in paragraph 72 (10) of the Gedge Committee's Report.

In the various recommendations set out elsewhere in our present memorandum we have not attempted to detail the consequential amendments which would be entailed if the issue of shares of no par value were to be permitted.

2. Prohibition of Partnerships with more than Twenty Members

(Section 434 of Companies Act, 1948)

Restriction on the size of unincorporated partnership associations to 20 members originated in the Companies Act, 1862, and we understand that its original purpose was probably to repress the public mischief which might arise if trading were carried on by large and fluctuating associations so that persons dealing with them would not know with whom they were contracting. The restriction also reflects the view that a partnership association should be an association among persons not too numerous to be bound together by ties of mutual trust.

Where the existing restriction causes inconvenience the difficulty can be solved by the constitution of a number of separate firms under a common name, often with certain common partners, each firm observing the restriction to 20 partners. We feel that it is undesirable in principle to continue a restriction which can be readily avoided in this or other ways.

Since the Registration of Business Names Act, 1916, a means is provided by which those dealing with a partnership can ascertain with whom they are contracting where

—as would be the position in the case of a large partnership—the firm name had to be registered under that Act. Since each individual partner is liable for all the firm's debts it can be assumed that the greater the number of partners the better the financial security to those dealing with the firm. We are of the opinion that it can be left to the partners to decide when the stage has been reached that their numbers are such that they cannot be bound together by ties of mutual trust.

We hold the view that while a restriction to 20 members may have been reasonable in 1862, there is no justification for it now, in view of developments in the last 100 years. We can find no logical reason for setting a limit of, say, 50 and we consider that it would be to the general advantage if the present restriction were to be abolished. Doubtless if it be decided to remove the restriction under the Companies Act, consideration should also be given to abolishing the corresponding restriction under the Limited Partnerships Act, 1907.

We express no view on the position with regard to banking partnerships where the present limitation is (under section 429) to ten partners.

3. Classification of Companies

(a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*

We have no fault to find with the present Law on this subject.

(b) *Nature and merits of distinction between exempt and non-exempt private companies. (Sections 127, 129 of Companies Act, 1948)*

Section 129 prescribes the conditions under which a private company is exempted from the requirements of section 127 as to filing a balance sheet and other documents with the annual return. Section 129 accords with the principle recommended by the Cohen Committee on Company Law Amendment that the exemption under the 1929 Act from the requirement to file accounts should continue but that the scope of that exemption should be limited. In this connection the Cohen Committee, in paragraphs 50 to 53 of its Report, said, *inter alia*, that publication of the accounts of small companies would give large concerns valuable information about the finances of their smaller rivals. The Committee also referred to the fact that many small private companies are in competition with partnerships and individuals who do not have to make their accounts public. It was represented to the Cohen Committee that large numbers of private companies had been formed on the understanding that they would not be required to file accounts.

In the expectation that the present Committee on Company Law will wish to re-examine the issues involved, we have considered various possible alterations that might be made. It may be accepted that the removal or modification of the present exemption might possibly help to obviate some abuses, although in our experience abuses in this context occur very infrequently. In our view any such possible gain would be outweighed by the consideration that to interfere with the present exemption would be an undesirable infringement of a basic principle fundamental to the formation of exempt private companies.

In all the circumstances we consider that no change in this respect should be made.

On relatively minor points under this head we recommend that—

- (i) section 129 (2) (b) be amended so that employees and ex-employees would not be counted in arriving at the maximum limit of 50 debenture holders for an exempt private company;
- (ii) paragraph 6 of the Seventh Schedule be amended so as to refer to "shares or debentures" and thus enable a private company to be an exempt private company even if any of its debentures are held by a body corporate; and
- (iii) paragraph 6 (1) of the Seventh Schedule be so amended as to provide that where shares in a private company are held by a nominee of another private company which is itself an exempt private company that fact shall not operate to prevent the former company from being an exempt private company.

(c) *Unlimited companies and companies limited by guarantee*

We see no reason for any alteration in the present position.

4. Donations by Companies for Charitable and Political Purposes

It is a common practice for companies to make contributions in support of charitable (including educational) and welfare objects and organisations. Examples are donations to religious and welfare bodies and to hospitals, clinics and convalescent homes, from any or all of which the company's employees may benefit; the provision of scholarships and grants for the company's employees or others to assist them to follow courses of study, research or other educational activities at Universities or other educational institutions; grants to Universities and other educational institutions for the provision of new buildings and equipment, or for research or other educational purposes.

On the question whether the company's funds can properly be applied for such purposes we refer to what is said above under head 1 (b).

On the question whether the power to spend the company's money in such ways should be exercisable by the directors or whether the shareholders should be consulted, we take the view that the directors should have full powers to authorise the payments where they consider that such payments may result in benefiting or furthering the interests of the company or its employees or the industry of which the company forms part. We consider that, given the complexities of modern business conditions, it is impracticable for a large company to obtain on any specific question of this kind the views of more than a small fraction of its shareholders, and that even where such views are obtainable their diversity makes them ineffective for practical purposes: it must, therefore, be left to the directors to take effective decisions.

Whether or not similar considerations should be applied to contributions for political purposes is, we feel, a matter on which we, as representing a non-political body, should not express an opinion.

5. Exercise of Powers of Companies by Directors and Degree of Control retained by Shareholders

(a) *Fundamental changes in company's activities*

Where directors take steps to diversify their company's activities, even so as to change those activities fundamentally, they will sometimes be praised for their spirit of enterprise in their shareholders' interests and sometimes criticised for not first consulting their shareholders and allowing the latter to decide on broad policy.

It is no doubt good practice for the directors to give advance information to the shareholders and seek a mandate from the shareholders to proceed. Frequently, however, this is not practicable, since rival concerns in the industry in which the company is at present operating or in that into which it proposes to enter may use to the company's detriment the information about its plans which its shareholders would need if they were to be enabled to reach an intelligent decision on the question at issue.

Assuming that the change comes within the scope of the company's objects (as to which we would refer again to heading 1 (b) above) we consider that the directors, whose detailed knowledge of the circumstances puts them in the best position to decide, must be allowed discretion to adopt whatever course they think best in their company's interests. Having taken their decision and implemented it, they should, as at present, be obliged to disclose to the shareholders what they have done.

(b) *Disposal of undertaking and assets*

The considerations noted under heading 5 (a) above are relevant here also, at least where the disposal of part only of the undertaking and assets is in question. In such a case we consider that the matter must be left to the discretion of the directors.

Where, however, the question is one of the disposal of the whole, or of substantially the whole, of the undertaking and assets, then we consider that the directors should disclose the position to the shareholders so soon as the directors have received a firm offer by a reliable purchaser which the directors consider a reasonable one and that the decision should then be taken by the shareholders. As a corollary, we consider that the directors should consult the shareholders as to the way in which the company should deal with the proceeds of sale.

(c) Issue of shares

Where a company's Articles do not provide that unissued shares must first be offered to existing shareholders, difficult decisions may face the directors when there is a question of issuing authorised but unissued shares. Is it, for example, right for directors to issue relatively large blocks of shares without prior reference to shareholders even though the board may be legally entitled under the Articles to do so? If the new shares do not immediately become profit earning, the effect can be to reduce the existing rate when paying future dividends on the enlarged capital and also to diminish the net asset value per share. Further, the issue of the new shares may change the effective control of the company. The shares could be issued at a price less than the market was prepared to offer for them or the issue might deprive the shareholders of the opportunity of considering a rival bid for the control of the company.

We consider that where new shares are issued for cash they should be required to be offered *pro rata* to the existing equity shareholders, except insofar as the company in general meeting otherwise decides in relation to that particular issue.

So far as concerns issues of new shares for a consideration other than cash, we are unable to suggest a formula which would both prevent the possibility of a change in control as a result of the issue and avoid limiting the directors' powers in a way which could be detrimental to the company's interests.

(d) Borrowing money and charging property

We see no reason for any change in the present Law regarding the exercise by directors of the company's borrowing powers.

We consider that where the company's borrowing powers are exercisable by the directors they should have power to charge the company's assets.

(e) Lending money otherwise than in the ordinary course of business

We recommend that for the purposes of section 197 (loans to officers, etc.), a closer and more comprehensive definition of the expression "officer" should be attempted than the present inclusive definition contained in section 455. We refer further to this point under head 29 (c) below.

6. Directors' Duties

(a) Should their duties be stricter and more clearly defined, and if so, in what respects?

Directors' duties, both statutory and otherwise, are so many and so varied that it would probably be impracticable to list them comprehensively. We respectfully endorse the view of the Cohen Committee that "the great majority of limited companies both public and private are honestly and conscientiously managed".

Accordingly in our opinion the answer to this question is "no, apart from the respects envisaged by the draft Rules referred to under heading 16 below".

(b) Are Directors generally aware of the legal duties arising from their fiduciary position?

In our opinion the answer to this question is "yes" and accordingly we consider that no further action is required.

(c) Directors' and officers' dealings in their own companies' shares

In our view the present requirements as to disclosure go as far as is practicable.

(d) Disclosure of Directors' interests

Under section 199 (1) it is the duty of a director "who is in any way, whether directly or indirectly, interested in a contract or a proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company". The words quoted may be contrasted with the reference to "any material interests of the directors" in section 207 (1) (a) (information as to compromises with creditors and members).

It appears to us that while section 199 may be an excellent provision in theory it is in no sense a practical one. According to normal business practice the details of many contracts which a company enters into—e.g., day-to-day purchases of goods and materials—may not come up for consideration by the board of directors although they may involve large sums of money. In order, however, to comply strictly with section 199, directors would require to furnish and keep up to date complete lists of their holdings in other concerns from whom their company might buy or to whom it might sell.

We consider that section 199 should be amended on the lines of requiring directors to disclose "any material interest" in a contract or proposed contract which comes before the board.

(e) Should bodies corporate be allowed to be Directors?

Where a company has a controlling interest in another company we see no objection to the controlling company being a director of its subsidiary. In other cases we do not approve of a company acting as director of another company.

7. Shares with Restricted or No Voting Rights

The Act is silent on this subject, presumably because when it was passed very few companies had issued non-voting equity capital. In recent years, however, the practice of issuing non-voting equity capital sometimes in the form of a bonus or rights issue or in part satisfaction of a take-over transaction, has grown considerably, and in some companies only a small proportion of the equity capital carries a right to vote. It is not always sufficiently clear to the holder of non-voting equity capital that his holding does not carry votes. In this connection we consider that the mere presence of some symbol, such as a letter of the alphabet before the term "ordinary shares", does not adequately indicate the disability attaching to non-voting capital.

A corollary to this problem is the question of the voting power of preference capital. Normally it is provided that the holders of shares with preferential rights are not entitled to vote at general meetings unless the preference dividend is in arrear or the rights attaching to that class of share are to be affected. In some cases, however, preference shares carry full voting rights, so that the holder of a preference share has the same voting power as the holder of an ordinary share, with the result that a substantial portion of the total voting power is vested in the preference shareholders irrespective of whether or not the preference dividend is in arrear. Although the position regarding the voting power attaching to the various classes of shares is set out in the company's Articles, shareholders do not often refer to the Articles.

While we are not aware of much evidence of abuse of non-voting equity capital, there have been cases where control of a company has been obtained by the acquisition of a relatively small proportion of the equity capital, this being achieved by offering to buy only the voting shares without making a similar offer to the holders of the non-voting shares. Similarly control may be obtained in some cases by buying voting preference shares without buying the equity capital.

We consider that in principle the holders of every part of the equity capital should have a say in the running of their company's affairs. We also consider that it should be regarded as abnormal for preference shareholders to have voting rights of a kind similar to those of equity shareholders.

We accordingly recommend as follows:—

- (1) (a) For the future a prohibition should be placed on the issue of equity capital carrying no votes or carrying only restricted voting rights.
- (b) With regard to existing equity shares presently in issue and carrying no voting rights, or only restricted voting rights, the disabilities should be required to be clearly indicated by the inclusion in the title of the shares of the words "non-voting" or "vote restricted" as the case may be. This alteration would go some way to meet the objection to these types of shares and would avoid the unreasonableness of introducing retrospective legislation to render such shares illegal. In this connection we consider that the inclusion of the words "non-voting" or "vote restricted" in the description of the shares coupled with the banning of the issue of such shares in the future would tend to make non-voting shares so unpopular with the investing public that in many cases such shares might be voluntarily enfranchised.
- (2) Where preference shares carry full voting rights that fact should be required to be indicated by including the word "voting" in the title of the shares.

8. The Protection of Minorities

Adequacy of existing remedies. Winding up under the "just and equitable" rule (section 225 (2) of Companies Act, 1948); the remedy afforded by section 210

We offer no comment.

9. Protection of Special Classes of Shares

Modification of class rights (Section 72 of Companies Act, 1948)—getting rid of preference shares by winding up or return of capital

Section 72 in our opinion deals satisfactorily with the protection of different classes of shareholders where variations in their rights are being proposed and the company is to continue. Where, however, a scheme is promoted which has as one of its objects—avowed or otherwise—the "getting rid" of preference shares with their prior right to profits, we consider that even if liquidation is resorted to the preference shareholders should be entitled to receive the greater of—

- (i) the par value of the shares with any premiums authorised by the Articles, or
- (ii) the fair value of the shares, as at the date of winding up or return of capital, on the basis that the company is continuing.

The foregoing recommendations are not intended to apply to redeemable preference shares which are being redeemed in terms of the conditions on which they were issued.

10. Board of Trade Powers to appoint Inspectors

We are of opinion that generally speaking the provisions of the Act as regards inspectors appointed by the Board of Trade have worked satisfactorily in practice.

11. Disclosure of Ownership and Control

(a) *Nominee shareholders and debenture holders (including nominee holding companies)*

The practice of registering shares in the names of nominees is of great practical convenience and there are a number of good reasons for it. Examples are—

- (i) where shares are held as security;
- (ii) on the death of a beneficial owner securities in the name of, say, bank nominees can more speedily be sold to provide for estate duty;
- (iii) the need for transfers on the appointment of new trustees can be avoided by having the shares in the names of nominees.

We therefore consider that it would be wrong if the practice were prohibited.

There are, however, cases where the use of nominees can in certain circumstances be contrary to the public interest. An example of this in our view is where, without the knowledge of the directors of a company, control or near control of their company is obtained by the buying of blocks of shares over a period and putting them into the names of nominees. It seems to us that in principle directors are entitled to know for whom they work, that shareholders have a right to know who their fellow shareholders are, and that from the national point of view it may be desirable to ascertain whether the control of an important company is falling into foreign hands.

We have studied various methods of achieving *general disclosure* of beneficial ownership either by tracing the beneficial owner of shares through the registered holder or by requiring the beneficial owner to come forward and declare his interest. Each of these methods seems to us impracticable, either because it could be evaded or because it would impose an unreasonable burden on the companies, the nominees and the beneficial owners. Accordingly, while in favour of the principle of *general disclosure*, we are unable to suggest a method which in our opinion would satisfactorily achieve it and have therefore addressed ourselves to the possibilities of obtaining *particular disclosure*.

Our recommendation in this connection is that companies should be empowered to require a registered holder of shares which carry a vote, or confer the right to appoint a director or directors, to make a declaration, in a specified form, stating in respect of any or all of the shares of which he is the registered holder whether he is the beneficial owner of the shares and, if not, the name and address of the person on whose behalf he holds the shares. Where the person making the declaration is not himself the beneficial owner, the company would then require the person named as the person on whose behalf the shares are held to make a declaration similar to that recommended above. This process would be continued until the beneficial owner was ascertained.

The information obtained as a result of the exercise of the power to require disclosure would be recorded in a register of beneficial ownership which would be open for inspection in the same manner as the register of members.

We envisage that the power to require these declarations would vest in the directors, but that, by resolution of a simple majority, the shareholders of the class concerned should be enabled to resolve that the directors exercise the power.

The sanction for enforcing disclosure might well be the withholding of dividends and of the right to vote. It might also be necessary to impose penalties similar to those applicable under section 173 (3) (power to require information as to persons interested in shares or debentures).

Special provisions would no doubt be required to deal with such matters as bearer shares, shares held by private companies which while technically the beneficial owners were controlled by the members who were the real beneficial owners, and shares held by personal representatives or trustees.

It should be provided, in the case of companies registered in England, that information disclosed as a result of the exercise of the power should not be treated as affecting the company with notice of any trust.

We further recommend that—

- (i) all transfers of shares should in future be required to contain a declaration whether the transferee is the beneficial owner or is holding as a nominee; and
- (ii) an obligation should be imposed on any person who has signed a declaration of beneficial ownership to make a declaration to the company regarding any change in his beneficial interest in the shares.

We do not recommend similar provisions as regards debenture holders because we take the view that the risk of control of a company being obtained through debentures registered in the names of nominees is so remote that it can be disregarded.

(b) Control through nominee Directors.

We do not recommend any legislation in this connection.

12. Share Transfer and Registration Procedure

In our opinion the existing share transfer and registration procedures work satisfactorily so far as the companies themselves are concerned. We are aware, however, that in relation to companies with Stock Exchange quotations there are difficulties arising from Stock Exchange procedures and that these difficulties are being investigated. At the present stage, therefore, we offer no further comment under this heading.

13. Multiplicity of Directorships held by One Individual

We do not consider that it is desirable or practicable to place any limitation on the number of directorships that can be held by a single individual.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

We consider that in general the present system of carrying on business through subsidiary and associated companies is satisfactory.

So far as concerns the accounting of associated companies we offer the following comments.

Under section 150, where a company has subsidiaries, group accounts dealing with the state of affairs and profit or loss of the company and its subsidiaries must, with certain exceptions, be produced. Where, however, two or more companies jointly operate an associated company they can arrange that none of them controls the composition of the board of directors or holds more than half in nominal value of the equity share capital of the associated company. Accordingly, by virtue of section 154, the associated company is not a subsidiary company and its state of affairs and profit and loss need not figure in group accounts produced by any of the companies which together own it.

We consider that where a company holds more than, say, 25 per cent. of the nominal amount of the issued equity share capital of another company and the amount involved, while insufficient to create the relationship of holding company and subsidiary, is material in relation to the former company, the former company should be required to comply with the following conditions:—

- (i) the holding should be described separately in the balance sheet under the heading "Investment in Associated Company";
- (ii) dividends received (so far as credited to the profit and loss account) should be separately described in the profit and loss account;
- (iii) if the associated company's shares are quoted, the market value of the holding should be shown in the balance sheet;
- (iv) if the associated company's shares are not quoted, information should be supplied as to the amount of the associated company's paid-up capital, capital reserves and revenue reserves attributable to the former company's holding.

Where a company holds two or more investments in associated companies a statement covering the aggregate amounts should suffice.

15. Loan Capital

(a) Debenture and Debenture Stock

We offer no comment.

(b) Trust Deeds—Duties of Trustees and Receivers

See heading 15 (c) below.

(c) Registration of Charges

A matter of importance to Scotland is whether floating charges should be introduced into the Law of Scotland. We submitted a Memorandum of Evidence on this topic to the Law Reform Committee for Scotland and note that the suggestions which we made have found favour with that Committee. The Eighth Report of the Law Reform Committee for Scotland (Cmd. 1017), published in June 1960, expresses the view that the changes in the Law required to introduce floating charges into the Law of Scotland could be effected by amendment of the Act, and Appendix II to the Report contains detailed suggestions as regards such amendments. We respectfully agree with all the recommendations made by the Law Reform Committee for Scotland and urge that—

- (i) floating charges should be introduced into the Law of Scotland;
- (ii) there should be made applicable to Scotland provisions on the lines of section 95 (registration of charges created by companies registered in England), and of section 322 (effect of floating charge);
- (iii) receiverships should not be introduced into the Law of Scotland and the enforcement of floating charges should be effected by other means; and
- (iv) floating charges, if introduced into the Law of Scotland, should extend to heritage.

16. Take-over Bids

(a) Procedure

(b) Securing disclosure of information on which shareholders can form an opinion

(c) Functions of Directors

(d) Disclosure of identity of bidder

(e) The financing of such transactions

The Notes on Amalgamation of British Businesses prepared at the suggestion of the Governor of the Bank of England and issued in October 1959 set forth certain principles and a code of procedure which we would wish to support in every possible way. We recognise, however, that it would not be practicable, even if it were desirable, to give legislative effect to the whole of this code. So far as the subject is capable of being regulated by legislation, we consider that the draft of the Licensed Dealers (Conduct of Business) Rules, 1960, issued by the Board of Trade on 9th May, 1960, is an excellent approach, subject to the following observations:—

- (i) We wish to emphasise that it is normally material to the offeree to know the offeror's intentions as to the future conduct of the company and the effect of the take-over on employees. The draft Rules for Licensed Dealers do not require any such statement to be made and we appreciate that in some instances such a statement would be inappropriate or irrelevant. We consider, however, that the Rules should require that the offeror make a statement of his intentions in these respects or, if he is not prepared to do so, state that he is not so prepared.
- (ii) Practising Chartered Accountants commonly act as financial advisers to companies and often take a prominent part in the negotiations which result in a merger or take-over bid. It is part of their professional functions to value shares, and the accountant fills the role of "man of affairs" and "general adviser" to many people.

For these reasons we recommend that—

- (a) practising Chartered Accountants be recognised under section 15 of the Prevention of Fraud (Investments) Act, 1958, as dealers in securities; and
- (b) paragraph 1 (b) of the draft of the Licensed Dealers (Conduct of Business) Rules, 1960 (or any analogous Rules) be altered to include the following words: "If you are in any doubt about this offer you should consult your stockbroker, bank manager, solicitor or accountant."

We also recommend that there be made applicable to take-over offers a provision on the lines of section 40 of the Act (expert's consent to issue of prospectus containing statement by him); it would seem particularly desirable in take-over offers that such a provision should apply to any statement purporting to be made by an accountant or auditor, or to figures stated to be audited figures, to ensure that they are appropriately used in the context of the offer.

(f) *Disclosure of Directors' interests—compensation for loss of office (sections 191–194 of Companies Act, 1948)*

(g) *Application of provisions regarding compulsory acquisition of shares of dissenting minority (section 209 of Companies Act, 1948)*

We consider that sections 191–194 deal adequately with the disclosure of directors' interests and compensation for loss of office, and likewise that section 209 deals adequately and fairly with the compulsory acquisition of the shares of a dissenting minority.

17. Prospectuses—Statements in lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders

(a) *Adequacy of protection afforded to investors by existing law*

(b) *Usefulness and necessity of the existing provisions*

(c) *Certificates of exemption (section 39 of Companies Act, 1948)*

We are of opinion that the present requirements in relation to prospectuses, statements in lieu of prospectuses and offers for sale operate satisfactorily. We have dealt under heading 5 (c) above with the issue of shares to existing shareholders.

18. Control over Business of Dealing in Securities

We offer no comment, apart from what is said under heading 16 (a) to (e) above.

19. Unit Trusts and "Open End Mutual Funds"

We offer no comment.

20. Reduction of Capital and Purchase by a Company of its own shares

We see no necessity to alter the present position.

21. Accounts

Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies? Are all the existing provisions necessary and useful in present-day conditions?

Subject to the comments made below, our answer to these questions is "Yes".

(a) *Revaluation of fixed assets and use of any resulting surplus*

The accepted methods of treating fixed assets in balance sheets are by reference to—

(i) the historical cost of the assets;

(ii) a revaluation of the assets either by the directors or an independent valuator, or, possibly, by reference to index numbers.

The merits and demerits of each of these methods have been widely discussed for many years and no unanimity with regard to the questions arising has as yet emerged. Annex A to this Memorandum contains a statement in this connection which the Council issued to members of the Institute in 1953. We remain of the opinions expressed in that statement.

We have considered whether the time is ripe for any further legislation on the subject. In our opinion it would be neither desirable nor practicable to require by statute any form of revaluation of fixed assets. Nevertheless we consider that it would be appropriate for the Act to require some better description of fixed assets than is presently requisite.

We accordingly recommend that, unless the fixed assets are stated in the balance sheet by reference to a valuation made within the preceding 15 years, every company should be required, in addition to complying with the existing requirements of the Eighth Schedule in relation to fixed assets, to give separately, on the one hand, figures for those fixed assets which were acquired within the preceding 15 years and, on the other, figures for those fixed assets which were acquired earlier. We do not think it necessary, however, to make similar sub-divisions of the figures for aggregate depreciation.

We are of opinion that a surplus which emerges on a revaluation of fixed assets should not be available for distribution in cash to the shareholders.

(b) Share Premium Account

We have had before us the suggestion that there should be a general widening of the purposes for which a share premium account can be applied, but in the time available to us for preparing this Memorandum we have not had sufficient opportunity of giving this suggestion full consideration.

For the present, and for the reasons outlined under heading 21 (c) below, we recommend that the purposes for which a share premium account may be used under section 56 (2) should be extended to include a provision on the following lines:—

“The share premium account may, to the extent of a dividend received by the company from a subsidiary company, be applied to reduce the cost of the investment in the subsidiary company where—

- (i) the share premium has arisen on the issue of shares by the company in exchange for shares in the subsidiary company;
- (ii) the subsidiary company has become a subsidiary company wholly by reason of the exchange of shares; and
- (iii) the dividend has been paid out of profits earned before the date of the exchange of shares.”

(c) Use of pre-acquisition profits of subsidiaries

There is general agreement among accountants on the principle that where a holding company receives a dividend from a subsidiary declared out of profits earned before its acquisition such dividend should not be treated by the holding company as available for distribution to its shareholders, since it represents a reduction in the worth of the holding company's investment. Most modern opinion has it that this is a rule of practice only and not of law, but it is considered by some that the provisions of paragraph 15 (5) of the Eighth Schedule of the Act were intended to impose a restriction on the treatment of such profits.

We recommend that, to remove doubt on the matter, the principle should be incorporated in an amendment to the body of the Act. The new section should refer to dividends received from a subsidiary company and not to profits attributable to the subsidiary's shares, since it is only on the distribution of the profits that the question of treatment in the holding company's accounts arises. The provisions of paragraph 15 (5) of the Eighth Schedule, insofar as still required in connection with the statement under paragraph 15 (4), should be amended accordingly.

We consider that the exception under paragraph 15 (5), which is taken to cover the case of an internal transfer of shares within a group, should be provided for in the new section.

There is one type of amalgamation where it is thought that the strict application of the principle is unreasonable. This is where the consideration for the purchase price of the subsidiary's shares is not cash but wholly the issue of new shares of the holding company. In the ordinary case of such a transaction, whether it consists of the formation of a new holding company to acquire the shares of two or more amalgamating companies or whether it is a take-over by one company of another (the consideration being in new shares instead of in cash), the shareholders of the group remain substantially the same before and after the transaction. It is thought to be illogical that the revenue reserves previously available for distribution to shareholders by way of dividend should not remain so available after the amalgamation, as is the case if it is not permissible for the holding company to treat as profits available for distribution by way of dividend to its shareholders any dividends received by it out of the revenue reserves of the subsidiary at the date of amalgamation. We therefore recommend that, subject to the restriction referred to below, such dividends be excluded from the prohibition in the new section.

Where such an interchange of shares takes place it frequently happens that the nominal amount of new shares issued is substantially less than the value of the shares of the new subsidiary acquired. If, in this case, the directors of the holding company, in issuing the new shares, take account of the full value of their acquisition, a share premium arises in the holding company (*Head v. Roper* [1952] Ch. 124) and the investment in the new subsidiary appears in the holding company's balance sheet at its full value. Any dividend, therefore, paid by the subsidiary out of pre-acquisition profits would, if treated by the holding company as revenue, result in a reduction in the worth of the investment in the subsidiary company below the amount at which it is stated in the holding company's balance sheet. This conflicts with the general principle referred to above.

To avoid this difficulty a practice is growing up by which the directors of the holding company regard the shares of the company acquired as having a book value less than their full value. This book value may be equal to the nominal amount of the paid-up capital issued in exchange or may be intermediate between that amount and the full value. Since the investment in the new subsidiary appears in the holding company's balance sheet at less than its full value the directors can treat a pre-acquisition dividend as revenue in the assurance that the worth of their investment remains more than its book value. This practice has resulted in the issue by directors of holding companies of shares the issue price of which has been deemed to be substantially less than their full value.

We consider that it is not desirable and should not be necessary to resort to such an artificiality and that the difficulty which has been overcome by these means should be avoided by an extension in the permitted applications of the share premium account.

Our recommendations in this connection are as follows:—

- (1) We recommend that the total value of shares issued by one company in exchange for shares in another company which becomes a subsidiary wholly by reason of such exchange shall in the books of the former company, be treated as having a value equal to the full value of the shares acquired.
- (2) We recommend that a share premium arising on the transaction shall be available to write down the book value of the investment in the subsidiary as recommended under heading 21 (b) above.
- (3) We recommend that dividends paid by the subsidiary out of pre-acquisition profits shall not be available for payment of dividends by the holding company unless, and only to the extent to which, the book value of the investment in the subsidiary has been so written down.
- (4) Arising from recommendation (1) above, we appreciate that in some cases, particularly where preference shares are issued in exchange for similar shares, the value attributed to the shares issued may be less than their nominal value, so that the shares will thus be issued at a discount. We therefore recommend

that section 57 be amended to permit, in such circumstances, the issue of the shares at a discount without either the authority of the company in general meeting or the sanction of the Court. It appears to us that the severe restrictions imposed by section 57, however necessary in the case of issues for cash, were not intended to apply to special circumstances such as these.

We offer the following further comment on these recommendations—

- (i) In the case of the formation of a new holding company to amalgamate the interests of two or more undertakings we contemplate that the amount of nominal capital issued would not exceed the total issued capital and capital reserves of the individual undertakings (adjusted to take account of the difference between the book value and market value of the net assets). The share premium account will then in general be not less than the total amount of these companies' revenue reserves and will thus fully cover any distribution of pre-acquisition profits.
- (ii) Where a subsidiary is acquired for a consideration consisting partly of shares and partly of cash or other assets each part of the consideration should be deemed to acquire a *pro rata* share of each item of capital and reserves of the subsidiary. The portion of the revenue reserves deemed to be acquired in exchange for the new holding company shares would then be available in accordance with the above recommendations; the balance would be frozen by the general rule as to non-distribution of pre-acquisition profits.
- (iii) If the above recommendations are carried into Law we do not expect that they will result in any great change of policy on the distribution of pre-acquisition profits except possibly in the first year of new holding companies. The effect of them will, however, be immediately seen in the group accounts of companies concerned where the appropriate proportion of the share premium account in the holding company's balance sheet will be dealt with in the consolidated balance sheet at a revenue reserve.

(d) Description of Reserves

Paragraph 4 (1) of the Eighth Schedule requires in relation to the balance sheet that "the reserves, provisions, liabilities and fixed and current assets" shall be classified under headings appropriate to the company's business. This provision therefore fails to deal with certain items which cannot readily be classified under any of the specific headings quoted. An example of such an item is future taxation based on profits actually earned. The general practice is tending towards showing future tax as a separate item—neither as a reserve nor as a liability—but, as indicated above, paragraph 4 (1) of the Eighth Schedule does not specifically permit this to be done.

We accordingly recommend that paragraph 4 (1) be amended so as to provide that any item which cannot appropriately be classified under any one of the headings mentioned in that paragraph shall be separately classified and described.

We also recommend that it be made necessary to show separately special reserves created in accordance with special provisions in the company's Articles.

(e) Definitions of profits

The word "profits" frequently appears at various stages in accounts from the gross manufacturing surplus to the final balance after making provisions for tax. We consider that the word "profits" should not be used until the stage is reached when all charges, including depreciation, have been provided for. We see no objection, however, to the use of a description such as "profits subject to tax" where net profits after provision for tax are also shown. While this greater care in the use of the word "profits" would be advantageous, we do not consider that legislation on the subject would be appropriate.

(f) Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948

There can be no adequate reason on purely accountancy grounds for the exemptions afforded by Part III of the Eighth Schedule. As matters stand, however, the auditor can be placed in a somewhat invidious position in relation to a company to which that Schedule applies. Under the Ninth Schedule it is said that his certificate as to "a true and fair view" is to be "subject to the non-disclosure of any matters (to be indicated in the report) which, by virtue of Part III of the Eighth Schedule to this Act, are not required to be disclosed." Nevertheless, it is difficult to see how in any sense "a true and fair view" can be produced where, for example—

- (i) the disclosed results are distorted by exceptional items and changes in the basis of accounting;
- (ii) profits have been arrived at after the transfer of unspecified sums to or from reserve.

All the exceptions contained in Part III of the Eighth Schedule to the Act were, we recognise, introduced on grounds of public policy to which considerations of accountancy principles were made to yield. If it is decided that it is in the public interest that the present position should continue then we would recommend the revision of the Ninth Schedule so as to require the auditors to state in their report in the case of a company entitled to the benefit of Part III of the Eighth Schedule whether in their opinion the balance sheet and profit and loss account of the company "are properly drawn up so as to disclose the state of the company's affairs" at the date of its balance sheet and its profit or loss for the financial year then ended "so far as is required by the provisions of the Act applicable to" the class of company concerned.

[(g) Other points on Accounts]

[(1) Trade Investments]

We have considered whether "trade investments" (which are referred to in paragraphs 8 (1) (a), 11 (8) and 12 (1) (g) of the Eighth Schedule) should be defined in the Act. We do not think such a definition desirable, as there should be scope allowed here for the directors' and auditor's discretion.

We are of opinion that, insofar as the amounts are material, in relation to trade investments which do not fall to be treated as investments in associated companies or in subsidiary companies, information should be required to be given in the manner recommended under heading 14 above as regards investments in associated companies.

[(2) Interest payable]

In relation to the profit and loss account, paragraph 12 (1) (b) of the Eighth Schedule provides that there shall be shown the amount of the interest on the company's debentures and other fixed loans. We consider that in addition, and as a separate item, there should be shown, if material, interest on loans of a temporary nature, such as, for example, bank overdraft.

[(3) Profits or losses of subsidiaries where there are no group accounts]

Under section 150 (2) (a) group accounts are not required where the company is, at the end of its financial year, the wholly owned subsidiary of another body corporate. Even where group accounts are not required under this subsection, however, there is under paragraph 15 (4) (b) of the Eighth Schedule an obligation to state the amount of the subsidiaries' profits or losses.

It appears to us that, in those cases where under section 150 (2) (a) group accounts are not required, there is no reason why the statement as to subsidiaries' profits which paragraph 15 (4) (b) requires should be given. Presumably the reason why group accounts are not required in the circumstances envisaged in section 150 (2) (a) is that they would serve no useful purpose since there would be no outside shareholders.

The same reasoning would appear to apply to the statement of profits or losses of subsidiaries for which paragraph 15 (4) (c) provides.

22. Audit

(a) *Qualifications and appointment of auditors*

Under section 161 (1) a person is not qualified for appointment as auditor of a company unless either—

- (a) he is member of a body of accountants established in the United Kingdom and for the time being recognised for the present purpose by the Board of Trade; or
- (b) he is authorised by the Board of Trade either as having similar qualifications obtained outside the United Kingdom, or as having obtained adequate knowledge and experience in the course of his employment by a member of a body of accountants recognised under (a) above, or as having before 6th August, 1947, practised in Great Britain as an accountant.

The bodies presently recognised under (a) above are the three Institutes of Chartered Accountants in the British Isles and The Association of Certified and Corporate Accountants.

We recommend that—

- (i) the bodies presently recognised under section 161 (1) (a) be named in the Act, the power to vary the list being exercisable by the Board of Trade by Statutory Instrument subject to affirmative resolution procedure; and
- (ii) the power of the Board of Trade to authorise persons having similar qualifications obtained outside the United Kingdom be moved from sub-paragraph (b) to sub-paragraph (a) of paragraph (1) of section 161.

The adoption of recommendation (i) would be in conformity with other legislation passed since the Act. The adoption of recommendation (ii) would avoid including, in the same category as unqualified accountants, overseas accountants with high qualifications.

(b) *Duties and responsibilities of auditors*

We consider that the duties and responsibilities of auditors should be neither extended nor diminished. We do, however, think that the manner in which auditors express their conclusions in their reports to the shareholders of companies is not at present satisfactory. The normal form of report under the Act has been criticised as over-long, over-cautious and unclear to the layman, but in view of the heading to the Ninth Schedule—"Matters to be expressly stated in the Auditors' Report"—many accountants have taken the view that they are bound to deal *in extenso* with all the relevant matters contained in the Schedule.

On the basis of the wording of the present Ninth Schedule—and ignoring for the moment the amendment to that Schedule suggested under heading 21 (f) above—we recommend that section 162 (1) and the Ninth Schedule be amended on the following lines:—

Section 162 (1)

The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office, and the report shall contain statements as to any matters mentioned in Part I of the Ninth Schedule to this Act on which the auditors have not been satisfied or on which they are unable to form an opinion, as the case may be, and shall contain statements as to the matters mentioned in Part II of the said Schedule.

Ninth Schedule

Part I.

Matters deemed to be stated in the Auditors' Report, unless the contrary is expressly stated.

1. That they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.
2. That, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.
3. That the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns.
4. That, in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Act in the manner so required.
5. In the case of a holding company submitting group accounts that, in their opinion, the group accounts have been properly prepared in accordance with the provisions of this Act.

Part II.

Matters to be stated in Auditors' Report.

1. Whether, in their opinion—
 - (a) the company's balance sheet gives a true and fair view of the state of the company's affairs as at the end of its financial year; and
 - (b) the profit and loss account gives a true and fair view of the profit or loss for its financial year,or, as the case may be, the balance sheet and the profit and loss account give a true and fair view as aforesaid subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act are not required to be disclosed.
2. In the case of a holding company submitting group accounts whether, in their opinion, the group accounts give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company, or, as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act are not required to be disclosed.

(c) Exemption of "exempt" private companies from the provisions of Section 161 of the Companies Act, 1948

Subsection (1) of section 161 provides that no person shall be qualified for appointment as auditor of a company (other than an exempt private company) unless he fulfils certain conditions. We recommend that this exception in favour of exempt private companies should be removed. Auditing is a highly technical function and an audit carried out by a layman may be worse than no audit at all since it may discourage members from questioning the correctness of the accounts. We consider that public policy requires a professional audit for all companies.

[(a) Other points relating to auditors]

[(1) Notice of change of auditors]

We are of the opinion that an auditor's power under section 160 to require a company to circulate a statement by the auditor should be reinforced by empowering the auditor to require the company to send out a two-way proxy.

We are further of the opinion that the notice which, in terms of section 160, is to be given to the retiring auditor should also be sent to the proposed auditor.

[(2) Appointment of auditors]

Section 159 (1) provides that "every company shall at each annual general meeting appoint an auditor . . .". This seems, however, to be in conflict with the automatic procedure required by subsection (2) whereby a "retiring auditor . . . shall be appointed without any resolution being passed . . .". Further, subsection (2) seems to apply even where the directors have under subsection (6) filled a casual vacancy in the office of auditor.

In our opinion section 159 should be amended so that—

- (i) at the first annual general meeting of a company, or at the annual general meeting following the filling by the directors of a casual vacancy in the office of auditor, a resolution regarding the appointment of an auditor should be submitted; and
- (ii) where an auditor appointed at a general meeting is to continue in office for a further year, a formal re-appointment should not be necessary.

23. Provisions as to Returns

So long as the true ownership of shares can be concealed by nominee holdings, we see no necessity for the disclosure in the annual return (as is at present required by paragraph 5 (a) and Part II of the Sixth Schedule) of particulars of shares transferred by persons who have ceased to be members.

24. Company and Business Names

Effectiveness of present provisions (see sections 17 to 19 of Companies Act, 1948, and the Registration of Business Names Act, 1916); similarity of names; misleading names

We have no evidence of any need for any change.

25. Foreign Companies

We do not recommend any change.

26. Internal Management and Administration

(a) Annual and other general meetings

[(1) Holding of meeting "in each year"]

By section 131 every company is required to hold an annual general meeting "in each year" and by section 148 (1) accounts are required to be laid before the company in general meeting once at least "in every calendar year". It would appear from *Gibson v. Barton* (1875) L.R. 10 Q.B. 329, that the expressions "year" and "calendar year" both mean the period from 1st January to 31st December.

Strong reasons of practical convenience may suggest that a company which has been accustomed to hold its annual general meeting in, say, December should change to, say, the ensuing January.

We suggest that a company should be empowered in suitable cases, and subject to such conditions as the Board of Trade may prescribe, to dispense with the necessity in a particular calendar year—

- (i) to hold an annual general meeting; and
- (ii) to present accounts.

[(2) Notice to auditors of meeting]

Since, under section 162 (4), the auditors are entitled to attend any general meeting of a company, we recommend that section 133 (3) be amended so as to require the agreement of the auditors where a meeting is called on shorter notice than that specified in the Act or in the company's articles.

[(3) Documents to be circulated to shareholders, etc.]

Under section 158 (1) the shareholders are to receive a copy of the balance sheet "including every document required by Law to be annexed thereto". The directors' report (which by section 157 (1) is to "be attached to every balance sheet laid before the company in general meeting") is by section 163 specifically excluded from the documents required to be annexed to a company's accounts.

In our opinion the directors' report should not be divorced from the circulated accounts and section 158 should accordingly be amended so as to require the directors' report to be circulated with the accounts.

We recommend there be required to be included among the documents required to be circulated to the shareholders a list of the directors at the date of the report (showing any changes since the date of the previous report).

It has been suggested that a copy of a company's accounts must be sent to heritable bondholders and mortgagees of assets of the company by reason of section 158 and the definition of "debenture" in section 455. Such a requirement was presumably not intended, particularly as applied to private companies. We accordingly suggest that the Act might be amended by narrowing the definition of "debenture" as applied to section 158 so that the requirement to send accounts should be confined to members and debenture holders not being heritable bondholders or mortgagees of assets, or, alternatively, that accounts need be sent to heritable bondholders and mortgagees of assets on demand only.

(b) Mode of passing extraordinary and special resolutions

We see no objection to the present position.

(c) Securing proper disclosure of information in circulars seeking proxy votes

At present under sections 134 (a) and 141 and under paragraph 50 of Table A it is necessary in giving notice of a general meeting to specify—

- (i) in the case of special business, the general nature of the business, and
- (ii) in the case of an extraordinary or special resolution, the intention to propose the resolution as an extraordinary or special resolution.

In practice considerably more information is usually given by public companies than the Act requires. It would appear to be desirable, however, that shareholders should have the right to be put in possession of proper information. Accordingly we recommend that the best of current practice should be recognised by providing that, whether or not proxy votes are sought, notice of any special business or of any extraordinary or special resolution should be accompanied by such information, if any, as is necessary to enable the shareholders to appreciate the nature of the special business or to judge the effect of the resolution.

(d) Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g., by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company

We have no recommendation to make in this connection.

27. Winding Up

Since our recommendations under this head are on relatively minor matters we have set them out in Annex B to this memorandum.

28. Problems of Administration and Enforcement of the Law

In particular, are any difficulties caused by provisions which appear obsolete or inappropriate in modern conditions?

Apart from the suggestions put forward elsewhere in this memorandum we have no suggestions to offer under this head.

29. Any other Matters Within the Terms of Reference

[(a) *The directors' report*]

We have considered the provisions of section 157 (1) as regards the directors' report.

We suggest that—

- (i) when the report is circulated with the accounts (as to which we would refer to heading 26 (a) (3) above) it should be permissible to refer in the report to the proposed allocations of profits shown in the accounts without setting out any figures in this connection in the report itself;
- (ii) unless the information is given elsewhere in the accounts, it should be made necessary to provide in the directors' report particulars regarding any additional capital issued during the period under review and the circumstances in which such capital was issued; and
- (iii) in a group the report should cover the group and insofar as figures are given they should be the figures for the whole group, although there would be no objection to showing the figures of the holding company as well as those of the group: at present it would seem that the report could be confined to the holding company's figures and could accordingly mean very little.

[(b) *Publication of directors' names*]

[(1) *Business letters*]

Section 201 (1) requires every company to which that section applies to state particulars with respect to its directors in, *inter alia*, most of its business letters.

Section 201 applies to—

- (a) companies registered after 22nd November, 1916;
- (b) companies incorporated abroad which had not established a place of business within Great Britain before 23rd November, 1916; and
- (c) companies licensed under the Moneylenders Act, 1927, whenever incorporated.

At the present time there are many companies in existence which were registered before 23rd November, 1916, and which have now no real connection with their original founders: some of these companies have in fact even been bought over purely to avoid the necessity of disclosing the names of the directors on the company's letter headings and other literature. In all cases, however, the names of the directors can be ascertained by reference to the Registrar of Companies.

23rd November, 1916, is now over 43 years ago and we feel that the relevancy of that or any other date is due for reconsideration.

We take the view that there is little to be gained—and much inconvenience and unnecessary expense entailed—by the publication of directors' names and therefore recommend that such publication should no longer be required. We would, however,

exclude exempt private companies from this proposal and suggest that exempt private companies, whatever the date of their incorporation, should be required to disclose the names of their directors on their business letters.

[(2) *Trade catalogues, trade circulars and show cards*]

Section 201 (1) requires every company to which that section applies to state particulars with respect to its directors "in all trade catalogues, trade circulars, show cards and business letters on or in which the company's name appears and which are issued or sent by the company to any person in any part of Her Majesty's dominions".

We have referred above to business letters. So far as the other documents are concerned, the provisions of section 201 (1) are largely ignored in practice, even if it can be assumed that the publication of the directors' names is only required where the full name of the company appears. We see no reason for requiring the directors' names to be disclosed at all in such documents and suggest that section 201 (1) be amended accordingly.

[(c) *Definition of "officer"*]

The definition in section 455 is as follows:—"officer," in relation to a body corporate, includes a director, manager or secretary". This does not purport to be, and clearly is not, exhaustive. For example, an auditor is, at least for some purposes, an officer. And Article 136 of Table A indemnifies "every director, managing director, agent, auditor, secretary and other officer". The inclusion of "agent" seems to indicate that the category of officer may be much wider than the definition in section 455 would suggest.

In the case of charges under, for example, section 328 *et seq.* (offences antecedent to or in course of winding up), it may be of concern mainly to the prosecutor and the accused whether the latter is or is not an officer. But the question sometimes has to be determined in the ordinary course of management of a company. In particular, section 197 requires disclosure in the annual accounts of any loans made to any officer, and both directors and auditors may have to determine whether a person is or is not an officer. For the purpose of this section, at least, an exhaustive definition would be desirable.

We realise that while the introduction of an exhaustive definition would clarify the position for the purposes of section 197 it might raise problems in relation to other provisions of the Act. Fundamentally, the difficulty seems to us to arise from the use of the same term "officer" in different contexts and in possibly differing senses.

[(d) *Retirement of directors under age limit*]

We have considered the working of section 185 in its application to those who have attained the age of 70.

In our opinion a date should be fixed as from which contracting out of the provisions of section 185 should not be permissible and any then existing arrangements for contracting out should cease to be effective.

We recommend that as from the date suggested above—

- (i) any provisions affecting retirement of directors in rotation be applicable only to directors who have not yet attained the age of 70;
- (ii) every director be required to retire at the annual general meeting following his seventieth birthday; and
- (iii) no person who has attained the age of 70 be capable, without re-election, of continuing to hold office as a director for more than two years after his election or re-election.

[(e) *Disclosure of directors' remuneration*]

We consider that section 198 (1) should be amended so as to require a notice in writing from each director covering all emoluments, pensions and compensation

receivable by him, together with the amount of all benefits chargeable in his hands to United Kingdom tax.

Whereas under section 196 (2) expenses have to be included as remuneration insofar as they are charged to United Kingdom tax, the estimated money value of other benefits has to be disclosed whether they are taxable or not. We consider that only benefits which are charged to United Kingdom tax should be required to be disclosed.

July, 1960

ANNEX A

[See heading 21 (a)]

Accounting in Relation to Changes in the Purchasing Power of Money

STATEMENT ISSUED IN 1953 BY THE COUNCIL TO MEMBERS OF THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF SCOTLAND

1. The "historical cost" basis which is so widely used in the measurement of profit has proved satisfactory when the value of money is steady or is changing slowly. On the other hand the limitations of this basis are evident and serious in periods of rapidly changing money values. The experience of the post-war years has demonstrated a clamant need for new conventions and methods which will compute the profit element in terms of current monetary costs as distinct from historical costs. Accountants in many parts of the world have been actively engaged in seeking appropriate solutions to this problem. In particular, much attention has been given to the treatment of depreciation and to the valuation of stock, which are probably the two most important single factors involved in this question. While steady progress has been made in the development of new methods, the advance has so far been carried out almost entirely on the theoretical plane and little or no evidence is yet available of the effectiveness of new techniques applied over a period to practical cases. Since the development is still at the theoretical stage it is not surprising that considerable divergence of view prevails amongst accountants as to the new conventions which will best meet both inflationary and deflationary movements.

2. The Council's view is that until some of these divergencies have been resolved on the basis of practical experience it is clearly inappropriate for a professional body to advocate to its members the adoption of any particular method. On the other hand, the Council holds the view that the accountancy bodies, singly and collectively, should now urge their members to take an active part in promoting the practical application of new conventions, and should give collective support where possible to practical experiments and research.

3. Insofar as the position of an auditor is concerned, the Council is of opinion that what constitutes "a true and fair view" of the state of the affairs of a company and of the profit for a stated period must always be a matter for decision in relation to the facts of a particular case, but that there is no reason in principle why an auditor should qualify his report on accounts by reason only of some disclosed departure from the basis of "historical cost".

4. The Council would welcome experiments by individual undertakings which have as their objective the presentation of accounts in which all items in the trading and profit and loss account are expressed in pounds sterling of the same purchasing power. The problem arises not only in the presentation of the results of each year or other financial period, but also in the presentation of the results for a number of financial periods, particularly where it is desired to establish trends. The desirability of showing in the balance sheet the capital employed expressed in pounds sterling of the same money value also merits consideration. The importance of the problem varies as

between one undertaking and another. What can or might be done should only be decided after very careful consideration of the facts of each particular case. Where there is a departure from the basis of "historical cost" (whether in the body of the financial accounts or by way of supplementary figures or statements) what has been done and the basis adopted should be clearly shown.

5. It is considered that in the field of management accounting it is eminently desirable, in many cases, that account should be taken of changing money values. Failure to do so in times of progressive inflation may well create a complacent attitude not in the best interest of any undertaking as a continuing concern. In management accounting many statements are prepared only for the guidance of those engaged in the day-to-day administration of the undertaking and the planning of its future activities. The values to be used in these cases should be those which will most realistically reflect the outcome of the trading operations of the undertaking and its financial stability.

ANNEX B

27. Winding Up

(1) Powers of liquidator—winding up by the Court

In a winding up by the Court the liquidator is empowered under section 245 (1) (c), with the sanction of the Court or the committee of inspection, to appoint a solicitor to assist him in the performance of his duties.

We see no necessity for this sanction and recommend that section 245 (1) be amended accordingly.

(2) Powers of liquidator—Members' voluntary winding up

In a members' voluntary winding up section 303 (1) (b) enables the liquidator to exercise without sanction *inter alia* the power to appoint a solicitor conferred by section 245 (1) (c). Under section 303 (1) (a), however, the liquidator requires the sanction of an extraordinary resolution of the company to exercise the powers conferred by the under-mentioned paragraphs of section 245 (1) which deal with—

- (d) payment of any classes of creditors in full;
- (e) compromise of claims against the company; and
- (f) compromise of calls, etc.

We consider that the power referred to under paragraph (d) (like the power to appoint a solicitor) should be exercisable by the liquidator without sanction and as part of his normal duties.

We recommend that section 303 be amended accordingly.

(3) Account of liquidation proceedings—members' and creditors' voluntary winding up

Under sections 289 and 299 the liquidator must, where a winding-up continues for more than one year, "lay before" a meeting of members (in the case of a members' voluntary winding up) or meetings of members and creditors (in the case of a creditors' voluntary winding up) an account of his acts and dealings and of the conduct of the winding up during the preceding year. Similar provisions apply to the final meetings under sections 290 and 300.

We consider that unless—

- (a) in the case of a members' voluntary winding-up, the members in general meeting; or
- (b) in the case of a creditors' voluntary winding-up, the committee of inspection otherwise determine, the notice calling the meeting should be required to be accom-

panied by the liquidator's account and his estimate of the likely outcome of the liquidation.

We recommend that sections 289, 290, 299 and 300 be amended accordingly.

(4) *Audit of liquidation accounts—members' and creditors' voluntary windings up*

We recommend that the Act should be so amended as to require that, unless the committee of inspection or the members by ordinary resolution (as the case may require) otherwise determine, the liquidator's accounts be submitted for audit to a person qualified under section 161 for appointment as the auditor of a company.

(5) *All classes of winding up—advertising for claims*

In the case of a winding up by the Court, section 264 provides for a time to be fixed within which creditors are to prove their debts or claims, or to be excluded from the benefit of any distribution made before the debts are proved. We recommend that the Act be amended to confer on the liquidator in the case of a members' voluntary winding up, and on the liquidator with the sanction of the committee of inspection in the case of a creditors' voluntary winding up, the right to fix a time, being not less than four months from the date of intimation by the liquidator, within which the creditors are to prove their debts or claims against the company, or to be excluded from the benefit of any distribution made before the debts are proved.

(6) *Accounts to date of liquidation—all classes of winding up*

It is notable that there is nothing in the Act which requires the production by a company of audited accounts for the period from the date of the last balance sheet presented to the members up to the date of the liquidation.

We recommend no alteration in the Law in this respect in the case of a winding up by the Court or a creditors' voluntary winding up, but we recommend that in the case of a members' voluntary winding up it should be made obligatory to send to the members and (except in the case of an exempt private company) also to the Registrar a copy of audited accounts covering the period from the date of the last balance sheet submitted to members up to the date of liquidation.

(7) *Notice by liquidator of his appointment—members' and creditors' voluntary windings up*

We recommend that section 305 be amended to require the liquidator to publish notice of his appointment in a newspaper circulating in the district where the company's registered office is situate in addition to the publication in the *Edinburgh Gazette*.

(8) *Proxies and affidavits*

Before a creditor can vote at a creditors' meeting in the case of a creditors' voluntary winding up in Scotland he must produce an affidavit to prove his debt. We consider that having regard to the limited time that is frequently available it is unreasonable to insist on an affidavit. We take the view that a creditor should be entitled to vote, either in person or by proxy, if he shows *prima facie* evidence of a claim. There should be a right of appeal to the Court in the event of a dispute.

(9) *Winding up by the Court in Scotland*

We suggest that the procedure for winding up by the Court in Scotland be reviewed with a view to securing, if possible, greater speed and reduction of costs as compared with the present procedure.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
EIGHTEENTH DAY

Friday, 17th March, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN

MR. L. BROWN, F.I.A.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKENNON, Q.C., M.B.E.,
T.D. (*Questions 6212 to 6418 only*)

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. HENRY BENSON, SIR THOMAS ROBSON, MR. P. F. GRANGER and
MR. F. M. WILKINSON *called and examined*

6212. *Chairman:* Gentlemen, the Committee is very much obliged to you both for your memorandum of evidence and for coming to help us further today.

Before we begin, may I for the purpose of our record read your names and descriptions. Mr. Henry Benson—you are a member of the Council of the Institute of Chartered Accountants in England and Wales and you are Chairman of its Parliamentary and Law Committee. Is that right?—*Mr. Benson:* That is correct.

6213. Then Sir Thomas Robson—you are a past President of the Institute, a member of the Council and of the Parliamentary and Law Committee: and Mr. P. F. Granger—you are Vice-President of the Institute and a member of the Parliamentary and Law Committee. You, Mr. F. M. Wilkinson, are the Deputy Secretary of the Institute. Is that right?—*Sir Thomas Robson:* That is so.

Chairman: The Committee has studied and will study again your valuable memorandum which, as one might expect from its source, is a model of clear

arrangement. It covers a great deal of ground and raises a number of points; but the matters with which we would primarily concern ourselves this morning are the matters of accountancy which arise, and accordingly I will ask Mr. Lawson to open the discussion.

6214. *Mr. Lawson:* Mr. Benson, it is I suppose correct that in general the Institute supports the principle of historical cost accounting for the preparation of annual accounts?—*Mr. Benson:* In general, yes.

6215. It would I think be helpful to the Committee if you could outline very briefly how this method operates in determining the amounts of profits available for distribution, distinguishing between revenue profits and capital profits, and in particular I think it would be very interesting if you could indicate the extent to which estimates of value enter into the calculation.—Broadly speaking, revenue profits are the profits derived after writing off depreciation on the fixed assets on the basis of their historical cost. Capital profits are those arising on realisation over and above the

book value of the fixed assets. Broadly speaking valuations do not enter into the preparation of balance sheets except to the extent of the valuations of the current assets. That should be qualified in one respect; a valuation is of course made in appropriate cases of shares in subsidiary companies or in associated companies, and sometimes the fixed assets themselves are written down if they are clearly overvalued. That of course involves an element of valuation.

6216. Could I first of all take the question of current assets? I am right in thinking, am I not, that that is not so much a valuation as an assessment of the figures which are carried forward from one year to the next, to see whether they are overvalued? There is no question of writing up?—That is so. It would be unusual, and usually improper, to write up. It is not so much a valuation as an assessment of correct carry-forward of what has been spent on current assets. But there is an element of valuation in things such as the value of debts and to some extent the question of valuation of stock comes into the picture.

6217. Yes, I think that is clear, thank you very much. Now to what extent in your experience do businesses depart from this general principle of historical cost? For instance, it is correct, is it not, that certain produce companies for example value their stocks on the basis of selling prices where there is a free market in the commodity?—That is so, but those cases are comparatively few in relation to the whole; and usually they only relate to particular circumstances, for example where a produce company wants to get the whole of the results of a particular crop into a single year's accounts. But the number of cases where historical cost is departed from for the purpose of stock valuation is comparatively rare.

As to the extent to which businesses depart from the principle of historical cost, I think that is sometimes departed from in two ways. It is true as a general principle, but as I mentioned earlier, it is appropriate in some cases to write down the historical cost of shares in subsidiary and associated companies, fixed assets

and goodwill. In other cases, companies take the view that they should write up their fixed assets, and do so.

6218. Apart from those particular examples—and I am coming in a moment to this question of writing up fixed assets—apart from those cases, those so far as you know are the only departures from historical cost?—*Sir Thomas Robson:* There are other examples in the valuation of work in progress and stocks. Mr. Benson cited the seasonal crop. There are other types of company which do also depart from historical cost, such as those engaged in long-term contracts where they feel it necessary to bring in a modest amount of profit in each year related to the actual activity of the year. Those are the exceptions. As Mr. Benson has said, the general practice is that you depart from the general principle of cost only if some part of the cost is irrecoverable.

6219. Now if I may come to a point which has been causing us quite a lot of difficulty, we have had a lot of evidence about this question of valuation of fixed assets. Most of the evidence refers to the valuation of long-life assets such as land and buildings. There seems to be, as far as we can judge from the evidence, less enthusiasm for valuations of plant and machinery except perhaps such machinery as may have an exceptionally long life: the reasons for this are fairly obvious. There is a very high rate of depreciation on machinery as a rule. Any undervaluation tends therefore to work itself out of the accounts fairly quickly. I think witnesses have mostly taken the view that this is rather a separate problem, but on long-life assets we have had quite an amount of evidence and different views. Could you please tell us what your view would be about that? First of all, is it correct that you would feel there is not much case for writing up plant and machinery?—*Mr. Benson:* My personal view is that it is really impossible to contemplate except in somewhat unusual circumstances; and until the taxation allowances are brought into line with the written-up figures that usually would be a fatal bar to writing up plant and machinery. I think that there would be objections to endeavouring to segregate the mass of fixed assets between what is

long life and what is not long life and to require the writing up of some of them and not the writing up of others; but in any case I think the whole thing is conditioned by the question of taxation allowances. It would be an intolerable burden on a great many companies if assets were compulsorily written up, long life or otherwise. That would not necessarily apply of course to land, which is not subject to taxation allowances.

6220. Of course the allowance on buildings is so much smaller, the impact would be much less, would it not?—But the physical difficulty of deciding what is a long-life asset, when you have a factory full of plant, would be extremely difficult.

6221. I see that. I would like to keep our minds as far as we can on the subject of long-life assets, while accepting your point that it may in practice be difficult to distinguish those assets from others which are part of the equipment of the factory. Could we then first of all consider what would be the appropriate accountancy procedure for long-life assets in times of stable or relatively stable prices? In what circumstances, if any, would you say that it would be advisable for a company in such circumstances to value its fixed assets?—As you were good enough to let me have a preview of some of these questions, Sir, I can think of six circumstances in which a revaluation might be appropriate. Perhaps if I were to give those to you it might help the situation.

The first is with a debenture issue where the issuing house requires the fixed assets to be written up in order to present a particular picture to the debenture holders. That is sometimes done and might be appropriate.

The second case is on an amalgamation where it is desired to put the fixed assets of both companies on a similar basis.

A third case is when shares in a subsidiary are bought and the fixed assets of that subsidiary are included in its books on a historical cost basis and it is desired to write them up to give expression to their current values. In such cases the cost of the shares probably greatly exceeds the book value of the assets.

A fourth case is where a company is sufficiently strong that it believes it can overcome the burden of taxation allowances based on historical cost and not on revalued figures—and we have such cases as I.C.I. and Unilever.

A fifth case is if you had unused capital assets awaiting sale, or if the company was about to go into liquidation.

There is a sixth case about which I am a little uncertain but which I believe is a fair case where it might be done; namely a company which has capital assets earning a very small profit return, but the capital assets can be realised readily and used for an alternative purpose. Just to make that sixth point clear, you might have a case such as public houses in a brewery company.

6222. We have heard quite a lot about that case. But it is curious how often witnesses have referred to public houses and one wonders therefore whether it is not rather exceptional to that type of case.—I think it is exceptional. All I was trying to do was to quote every case in answer to your question where it might be appropriate. But I do not think any of those six heads cover the general run of commercial and industrial activity. They are the exceptions rather than the rule.

Sir Thomas Robson: There was another exception made in the inter-war years quite frequently where there was what appeared to be a permanent shrinkage in the earning capacity of the fixed assets, so permanent in the view of those responsible, that the depreciation charges would always involve the company in a loss—shipping companies one has in mind, which had bought their vessels at very high prices after the First World War. In those cases companies felt that in order to give the management a fair chance of making a profit in relation to the existing market values of ships, they should go to the Courts and have the capital written down by such an amount as would enable them in turn to bring the ships down to a reasonable value, and thereafter provide depreciation on that written down amount.

6223. How far in that type of case would you feel that the company is really obliged to write its assets down, and either therefore refrain from paying

dividends or go to the Court for a capital reduction?—From an accountancy point of view we would regard a depreciation charge based on the amount at which the asset is carried in the books as being a necessary expense in arriving at the results for the year, and therefore as long as ships were carried in the balance sheet at a very high amount we would regard it as necessary for depreciation to continue to be provided on that very high amount in arriving at the revenue results, and therefore the amount available for dividend might be nil.

6224. Taking it one step further, supposing revenues were not enough to cover depreciation on book value, would you want to qualify your auditor's certificate?—I can remember cases of that type where auditors did during the inter-war years qualify their report by reference to the excessive values at which the fixed assets were carried under the then existing conditions. Let me emphasise that these were very exceptional cases where the conditions were so obvious that the auditors, even without the knowledge of valuation that a shipping expert would have, were nevertheless able to form an opinion.

Mr. Benson: The condition precedent is a permanent loss of capital.

6225. And you judge that in a sense by seeing whether the revenue would be likely to bring a profit after depreciation?—*Sir Thomas Robson:* That would be a relevant factor.

6226. *Mr. Brown:* Is the underlying thought that it should not be necessary to build up, by depreciation, the original cost but the actual cost of replacement?—No. I think the factor in people's minds was that, over the effective business life of the asset, the revenues should be such as to amortise the amount carried in the balance sheet, and if that amount was excessive or there was no hope of being able to effect that amortisation over the life of the asset, then the directors would feel it was time to go to the Court and get leave to reduce the amount at which the assets were carried in the books. I do not think the factor of replacement entered in, in those days, to anything like the extent that it has come into people's minds in recent years.

6227. *Mr. Lawson:* Coming back to Mr. Benson's six points, I have not retained them all in my head, but would I be right in thinking in some of those circumstances there is a need or a desirability of writing the assets up in the accounts so they would appear in the balance sheet? In other cases it would be optional whether the figures should be incorporated in the balance sheet or dealt with by way of a note?—*Mr. Benson:* I had in mind that in all cases they would be incorporated in the books. It is very rare in my experience for notes to be attached to the balance sheet giving this sort of information.

6228. We have had quite a lot of evidence from people who have said one could do it either way, and on the whole they rather like the note. For example, in the case of, I.C.I. or Unilever, it could have been done by note and the depreciation charge might have continued on historical cost.—That would be totally wrong, Sir. I think it would be wrong to imply to the shareholders and the public the fixed assets have a certain value, however arrived at, if depreciation was not written off relative to that value, because that would show an untrue and unfair figure of the profits.

6229. It would depend how it was worded. I have seen quite a number of accounts where this sort of statement appears, "the replacement cost of our fixed assets is £x compared with a book figure of £y, and they are insured for £x."—I think it is an undesirable note in that form because I do not think it gives the whole picture. I would like to draw the Committee's attention to the recommendations my Council has made on prospectuses on this point, which is in the Institute's handbook of recommendations we have furnished to the Committee. We point out that if that sort of information is given relative to fixed assets, then there ought to be corresponding information as to the additional depreciation which is applicable to the higher value; and also as to the crippling effect that might have by reason of the fact that taxation allowances are based on the historical cost, not the written-up figures.

Mr. Lawson: That makes it very clear. You are against it really. You either should put the valuation in the accounts or not refer to it at all.

6230. *Professor Gower:* Would that apply where it is freehold property?—Yes, Sir, except that freehold land is not of course subject to depreciation.

6231. That is why I asked.—My answer was really directed to the point that I see great difficulty in segregating fixed assets—writing up some and not others.

Sir Thomas Robson: I think we should bear in mind that in the normal case the earning power displayed by the accounts is the best index of value for fixed assets from the standpoint of the company, and the abnormal case where a company has a particularly valuable freehold site, for example, which is not producing revenue but is known to be exceedingly valuable, might be an example of where it would properly be treated in a note.

6232. *Mr. Lawson:* Could we come to that point now? It is I think fairly clear that in a great many businesses the assets are really specific to that business and the valuation, if you wanted to have a value of the assets, really is dependent to a very large extent on the earning capacity of the business. That is so?—*Mr. Benson:* Yes, Sir.

6233. Particularly with specific assets. We have had the point put to us and I think it applies more to non-specific assets, for example shop property, that shareholders or their advisers rather like to test the performance of the management by comparing the profit with the capital employed in the business and that for that purpose it is desirable to have a valuation of fixed assets.—The difficulty is to know on what basis the fixed assets should be valued. Would it be the going concern value—whatever that means—realisable value, replacement cost, or replacement cost less depreciation? It is extremely difficult to give an answer to the question without knowing what basis of valuation would be adopted.

6234. I suppose the only test of value from that point of view is what the asset

would fetch.—It is difficult. You come back to the point Sir Thomas has just made, that in the great majority of cases the value of fixed assets is dependent on the profits earned from the business.

6235. A point that is made on the other side is, suppose the people who are now running the business are running it extremely badly, the shareholders might stimulate somebody else to come along and take over the business and make much more out of it than they did, because the assets in the proper hands would earn much more?—The difficulty of that is that if they are running a business badly the profits are probably pretty low and the value attributed to the fixed assets would be in some measure determined by those low profits. The accounts therefore would still not give the picture the public expects.

6236. Turning to the question of inflation, do you think there is anything to be said for the view that, now prices appear to be relatively stable after a very long period of inflation, it might be useful to have some kind of general revaluation of assets, or in particular of long-life assets in balance sheets?—Have you in mind a compulsory revaluation?

6237. I was going to ask that, whether it should be compulsory or voluntary, with perhaps some method of stimulating compliance in cases where it is appropriate. In some cases one imagines it would be impracticable.—Could I make again one of the points I made earlier, that I think a compulsory revaluation of fixed assets is really quite out of the question, unless and until the taxation allowances are brought into line. Therefore, if one is contemplating a compulsory revaluation one would have to think in terms of a complete revaluation, such as happened in France and Belgium, where the fixed assets are revalued and the taxation allowances adjusted and that is applied to the whole economy. But that is so vast a subject I really would not care to give a firm view at the moment.

6238. Would there not be, quite apart from taxation, some difficulty about the compulsory revaluation, in the sense of taking care of the rights of preference shareholders?—There are immense

difficulties, apart from preference shareholders. The first basic difficulty is, on what basis would the revaluation be made, if it is to be compulsory? There certainly are not enough valuers in the country to deal with the situation. You have referred to the difficulties with preference shareholders whose dividends might be imperilled, and there are innumerable cases where other interests would be imperilled.

Sir Thomas Robson: You might even get to the point that debenture holders might be prejudiced. There are all kinds of aspects right outside the field of general accountancy.

6239. As far as your view goes, you would think in practice it would be difficult to have compulsory revaluation?

—*Mr. Benson:* Yes, Sir.

6240. But do you think it is a desirable thing for companies to do if one had it in a voluntary way, or had something to stimulate it? Do you think more people ought to write their assets up than are now doing so, having regard to this long period of inflation?—I believe it is entirely a matter for each board to make up its own mind, in the circumstances of its particular case. But I come back to the point that the bar to any general voluntary revaluation is the present system of taxation allowances.

6241. I am surprised you make quite such a big point about that as far as buildings are concerned.—I accept, Sir, it does not apply to land, and to a very much lesser extent to buildings; but in the normal industrial business the great bulk of expenditure is on plant and equipment.

Mr. Lawson: From other witnesses we have heard a good many objections to writing up plant and machinery.

6242. *Mr. Watson:* Mr. Benson, if you have two companies with a chain of shops owned freehold, and one has revalued those at present-day values and the other has not; would you append the same auditor's report to each balance sheet?—Provided the balance sheet and the accounts made quite clear the basis which had been adopted for valuation and the basis of depreciation—normally speaking, yes, Sir. The point being that provided the accounts are quite clear as to the basis on which they have been drawn up and

provided the basis is consistently adhered to, I do not see any objection to giving the same report.

6243. Those people who support the idea of writing up fixed assets, claim that by that means it is more easy to see whether the company is being profitably run or the assets put to the greatest advantage.—In certain cases that is perfectly true.

6244. You accept that?—Certainly, in certain cases.

6245. *Mr. Lawson:* It has been represented to us by some witnesses that by reason of what they term undervaluation of fixed assets, due mainly to inflation, many balance sheets do not show a true and fair view of the state of affairs of the company, taking the words in the ordinarily accepted sense of the word. I was wondering whether you could let us have your views on that. Do you think that the present position is satisfactory or do you think some change is needed either in the method of showing fixed assets in the balance sheet or in the wording of the audit report?—*Sir Thomas Robson:* The words "true and fair" were introduced into Company Law as a result of the recommendations of the Cohen Committee which, as regards this particular matter, based their recommendation largely upon a recommendation made by our Institute. In that recommendation we defined the function of a balance sheet in a certain way which I think you will find in paragraph 98 of the Cohen Committee's report.

We have in the years which followed since we gave that evidence considered the whole matter again from time to time, and as recently as October, 1958, we issued our recommendation 18 which is before the Committee and in paragraphs 3 and 4 in that recommendation we re-define the function of the balance sheet not very differently from what is stated in the Cohen Committee's report. Our view is that the words "true and fair" must necessarily be read in relation to that definition of the function of a balance sheet. If I might trouble the Committee, that definition reads as follows:

"The function of a balance sheet is to give a true and fair view of the state of

affairs of the company as on a particular date. A true and fair view implies an appropriate classification and grouping of the items and therefore the balance sheet needs to show in summary form the amounts of the share capital, reserves and liabilities as on the balance sheet date and the amounts of the assets representing them, together with sufficient information to indicate the general nature of the items. A true and fair view also implies the consistent application of generally accepted principles. Assets are normally shown at cost less amounts charged against revenue to amortise expenditure over the effective lives of the assets or to provide for diminution in their value. The balance sheet is therefore mainly an historical document which does not purport to show the realisable value of assets such as goodwill, land, buildings, plant and machinery; nor does it normally purport to show the realisable value of assets such as stock in trade. Thus a balance sheet is not a statement of the net worth of the undertaking and this is normally so even where there has been a revaluation of assets and the balance sheet amounts are based on the revaluation instead of on cost."

That I think is the answer of the Institute to the criticism of the use of the words "true and fair".

6246. May I test that by quoting one example about which we have had a great deal of evidence. It is the case of an associated company in which the holding is less than 50 per cent. so that the figures do not come into the consolidated accounts. Now it can happen and does happen, as we all know, that companies of that sort may earn large profits and distribute only a small part of them to the parent company, and the value of the holding may be seriously undervalued. And it is said that, if no explanation of the circumstances is given in such a case, the accounts do not give a true and fair view? On your definition as you have just read I think you would say that is a true and fair view, but later in another recommendation you I think have implied that further information ought to be given in that type of case.—That is so—paragraph 47, recommendation 20.

6247. Is that not an exception from the definition you have just read?—I do not

think it is an exception. It is an indication that a balance sheet may need to be accompanied by supplementary information in regard to special matters. Just as the balance sheet of a holding company taken by itself is inadequate as a presentation of its state of affairs unless it is accompanied by the group accounts—the consolidated accounts of itself and its subsidiary companies—so in an exceptional circumstance like the one just referred to, additional information may be required.

Mr. Benson: The number of cases where associated companies do in fact have an overriding effect on the balance sheet in my experience is extremely small.

6248. Yes, but I gave that as an example because the point has been put to us even more forcibly about land and buildings. Of course it is much more difficult to deal with, but in answer to Mr. Watson's question you said that provided the facts were stated—and I am sure that is the common view—you would accept the balance sheet either on the historical cost or with revaluation, as a true and fair view.—Yes. As far as associated companies are concerned we have made the recommendation Sir Thomas has mentioned. But there of course it is comparatively easy to give helpful information to shareholders because one has the profits of the associated company which can be disclosed.

6249. I was wondering whether there are not several purposes of accounts. There is the purpose of the historical cost accounts, which must be necessary to show the rights of shareholders, the availability of profits for dividend and so forth. Is it not arguable that the accounts, through notes or otherwise, should in addition try to provide the shareholders as far as practicable with information that would enable them to judge the prospects of the business and the efficiency of its management?—Certainly the shareholders are entitled to have information. The difficulty is to provide it in a form which is fair and which they can assimilate, and indeed which one can quantify.

6250. I think we would all agree with that.—*Sir Thomas Robson:* I think one must bear in mind too that accounts for

shareholders, which are primarily a report of stewardship by the directors, should not be overloaded with detail to the extent that the shareholders cannot digest what is there. There is a danger of which one is conscious from time to time, in drafting notes to help the shareholders, if one puts in too much detail they do not appreciate the essential point one is trying to make. Those responsible for presenting accounts are in a dilemma all the time of trying to present adequate information without overloading them.

6251. I think that must always be so. But it has been put to us that investment is now becoming a specialised field and that investors increasingly depend on experts for advice, and that the whole science of investment is becoming much more a matter for specialists who are able to absorb more information. — *Mr. Benson*: In the discussion we have had so far great emphasis has been laid on the balance sheet. I believe a greater emphasis is necessary on the profit and loss account than on the balance sheet. I think it would be helpful, but by no means do I believe it should be made compulsory, if many companies showed after they had arrived at the net profit after taxation, the additional sum it is necessary to set aside for replacement of assets at their replacement value. Information of that sort would be of abounding interest to shareholders; and I would like to stress that the emphasis should be in that direction rather than on the artificial writing up of the assets in the balance sheet.

6252. That is a very interesting point and in fact recommendation 15 of the Institute did recommend that. It has been followed rather less than one would have thought.—I believe much greater emphasis is necessary on that point than on the revaluation of fixed assets.

6253. May I come back to my main question: do you not feel there is some danger of the public misunderstanding the use of these words, a true and fair view? Are not people inclined to take them at their face value? They are not going to read recommendation 18 of the Institute and so on.—*Sir Thomas Robson*: I think there is no doubt that the public need education in the meaning of accounts. I

think the understanding of accounts by the public, over my business life, has increased very considerably. But there is no doubt that some people still falsely think a balance sheet is a valuation of the company's affairs at the particular date. But I think we must, to help the shareholders, give an opinion as to whether the accounts are right, using the word 'right' very loosely; and whatever term one uses in that way will be open to misunderstanding by some of the less well-informed shareholders. It still seems to me that the words "true and fair" are as appropriate as any others which we have considered.

Mr. Benson: I would be very sorry to see the words "true and fair" disappear because I think they are engrained in the profession now and it would be a pity to destroy that.

6254. May we now come on to another topic and that is the treatment of any surplus which may emerge on valuation of fixed assets. That is a problem causing difficulty not only to us but apparently in the Courts as well. You state in your evidence, paragraph 138 I think it is, that any such surplus should be dealt with on sound accounting principles which do not permit an unrealised surplus to be treated as available for distribution in cash or specie. There I take it you are referring to the surplus over and above the original cost, are you not?—*Sir Thomas Robson*: Those words are used very loosely and they are sometimes intended to refer to the surplus over the amount at which the asset is carried in the balance sheet, and sometimes over the original cost.

6255. Yes, it does show that you are referring to the gross figure.—The surplus that would arise on revaluation would be the excess over the amount at which it is carried in the balance sheet.

6256. Supposing you had a situation where the valuation was above the original cost—looking at that in two parts, there is first the part of the surplus which brings the book value up to original cost: in other words the amount of depreciation that has been written off in the past. Would you say that should be available for distribution in cash to the shareholders?—We are influenced by our reading of Company Law cases in

days gone by and we all recollect the rule that excessive amounts previously provided for depreciation can properly be restored to revenue account; and to the extent that the depreciation is excessive because people have under-estimated the effective lives of the assets, then clearly I think the accountant would agree that the depreciation should and could be restored to the revenue account. So far as a revaluation merely reflects inflation, I think there might be more room for argument and one would not want to be very dogmatic about it. But broadly the accountant would be more in favour of regarding as a distributable surplus that part of the surplus on revaluation which arose from the writing back of depreciation than he would be of that part which arose by reason of inflation.

6257. Is it your view that if as a matter of law an unrealised surplus could be distributed in cash, that would place the auditor in a very difficult position in cases where distribution would clearly be unsound financial policy, even though permitted by the law?—It would call for a decision by the auditor. He would have to make up his mind whether to qualify his report. I would hope that he would feel it his duty to do so. I would also hope that one of the results of your Committee and its work would be that unrealised surpluses should clearly be stated to be not distributable as a matter of law. At the moment we do not know where we are. We have one decision by the Scottish Courts and another recent decision by the English Courts, which are in conflict, and we would very much like to know where we are.

6258. And you would like to have the decision on the basis that any surplus over the original cost should not be available for distribution?—Yes, on the grounds that otherwise the shareholder would be at the mercy of unscrupulous directors, without any real defence.

Mr. Benson: There might have to be safeguards if the asset was subsequently realised, or subsequently written off by means of depreciation charges against profit and loss account.

6259. Yes, because that would in fact realise the profit which had been anticipated. When the asset is sold or written off that profit becomes realised?—Yes.

6260. Your own suggestion, I think I am right in saying, is that you see no objection to an unrealised surplus being used for the issue of bonus shares?—That is correct.

6261. In this connection many points have been raised by witnesses. One is that this treatment of fixed assets results in a higher annual charge for depreciation without any corresponding increase in Inland Revenue allowances for tax purposes. In the case of a highly geared company this would have an adverse effect upon the interests of preference shareholders, and also perhaps to a lesser extent the ordinary shareholders as far as the amount available for dividend is concerned. Do you think in these circumstances any safeguards are required? Should there be a resolution of shareholders at meetings in appropriate cases, something of that kind?—I myself have not considered what safeguards there might be, but clearly if the preference shareholders' position is likely to be imperilled there should be some safeguards to secure they were not imperilled unfairly. As far as the ordinary shareholders are concerned, of course if you do provide effectively for depreciation on replacement values, the proportion of profits that can be distributed can usually be proportionately higher than if depreciation is written off on the basis of historical cost.

Sir Thomas Robson: Because you are increasing your effective reserves.

6262. Yes, I see. It may be that we might have to consider that particular aspect in relation to the protection of minorities generally.—I think the preference shareholder would obviously have grounds for complaint if he, being entitled to repayment of capital and to his dividends in currency of the old value, was to find depreciation charged against him on the basis of new values.

6263. Then it has been suggested that it is illogical to make any distinction

between a surplus which is available for the issue of shares and a surplus which is available for dividends. The point has been made that as a matter of law shares should be only issued for full value. Why should not a surplus be distributed to shareholders if cash resources are available? Moreover, it is said that there may be a subsequent reduction of capital with the leave of the Court, which in practice might amount to the same thing as distributing the surplus to the shareholders in the first instance.—The essential difference as I see it is that the use of surplus for payment of dividend involves the company in parting with an asset, whereas its use to increase capital has no effect whatever on the total value of the underlying assets available for the shareholders and the creditors. Any error of valuation in the case where dividends are paid must deplete the resources; whereas in the other case, so far as the company itself is concerned, it merely increases the amount shown on both sides of the balance sheet. It seems to me there is an important distinction between using a valuation surplus for paying a dividend and merely writing up the share capital on the one side and the asset on the other.

6264. *Chairman*: What would you say of bonus debentures which were fashionable many years ago?—Their issue would involve the danger of the assets being depleted.

6265. They were usually paid off next day, and you did not have to pay any surtax.—That is open to the objection that other creditors' interests may be adversely affected.

6266. *Mr. Mackinnon*: This rather follows the pattern of share premium account and capital redemption. You are allowed to capitalise those by the issue of shares and only shares, and I imagine you would apply the same principle to unrealised surpluses?—Yes.

6267. *Mr. Richardson*: And in both those cases the amount standing to the credit of the account is not distributable in cash?—That is correct.

6268. *Mr. Mackinnon*: Your recommendation would extend that principle?—Yes.

6269. *Mr. Lawson*: Finally it is said that if it is lawful to distribute a capital profit, it is not always practicable or desirable to distinguish between a realised and an unrealised profit. The reason for this is that no capital profit may be distributed unless, as a result of a valuation, the capital of the company is found to be intact. If for example 10 per cent of the assets are realised at a profit, their availability for distribution will still depend upon a satisfactory valuation of the remaining 90 per cent. Have you any views on that?—These things of course are all matters of degree and of consideration of the whole of the circumstances by the directors. One would like to see that the directors should always play for safety on a matter of that kind and, if there were any doubt, not distribute.

Mr. Benson: I do not think there is any difficulty in distinguishing between a realised and an unrealised profit.

6270. One can imagine marginal cases. Of course in a great many cases you are dealing with a situation where a business is prosperous, its earnings clearly justify the figures at which the fixed assets stand in the balance sheet, and if a fixed asset is sold at a profit you would regard that as realised profit without going into too much detail of valuation of the remaining assets.—If the company's accounts are showing substantial profits it is comparatively simple to form a view.

6271. And there you would advise safety?—Yes.

6272. *Professor Gower*: A case has been raised by one of my legal colleagues. Suppose a company bought 1,000 shares for £1,000 and sold 500 of them for £1,000, what is the capital profit to distribute?—I think the arithmetic is £500.

6273. On the other hand you could in fact distribute the remaining 500 shares, in which case you would be distributing the equivalent of £1,000?—I am not quite clear about the question.

6274. You agree, if you distribute cash it would be £500, but would you not agree, if you distribute, instead of £500 the remaining 500 shares in specie, that would be equivalent to a distribution of £1,000, because obviously they are worth £1,000 too?—Yes, but I still do not think I have understood the point.

Professor Gower: It would appear that in cash all you can distribute is £500, whereas, if you distribute in kind, you are distributing something worth £1,000, and this seems on the face of it to be strange.

6275. *Chairman:* If you regarded the shares as assets, surely the whole block of shares would have appreciated. They would originally have cost £1,000. Less the amount that has been sold, what you have then is the same.—I think I see the point now, Sir. Out of what reserve are you going to distribute the 500 shares you retain? You can give away your assets, certainly, but you have to give them away out of some reserve. If you are going to give away shares you must also debit something on the other side.

6276. *Professor Gower:* I am not sure there is anything in it myself.—I do not think there is.

6277. *Mr. Mackinnon:* Do you feel, if you were having to examine a distribution on the basis that it was an unrealised capital profit based on revaluation, the situation would be a very sticky one if the law permitted that, because you could not tell whether that revaluation was justified. There would be matters of argument and questions of rather fraudulent operations by directors. That is, I understand, your objection to distributing unrealised capital profit, broadly speaking.—There are those difficulties, but it really comes back to a much more fundamental point, not a theoretical point but a practical point; namely that the distribution of an unrealised capital profit is undesirable in itself. Long experience and practice shows that to be so.

6278. I think the only point I would like to get clear is, if that is true, why

should you have a £1 share, which the creditors are entitled to assume has had £1 paid for it, issued as a fully-paid bonus share against each £1 of unrealised capital profit? That is the sort of difficulty, I feel; the unscrupulous director could get unscrupulous valuations and then blow up the paid-up capital by bonus issues.—I think that goes back to the point Sir Thomas made on the issue of bonus shares. It keeps the money in the company and so protecting the creditors' position. The only way it could be taken out would be by a reduction of capital.

6279. *Chairman:* You start with a sum which is available for dividend or available for distribution as a capital profit. Whether it is a realised or unrealised profit you start with a sum which is distributable as profit of some kind amongst the shareholders?—Theoretically, yes.

6280. *Mr. Scott:* Is not your point that an unrealised surplus should only be distributable if you take the second stage and the profit is put back into the company by the shareholders? Is not that really the argument? An unrealised profit should not be distributable except on the terms that it is immediately put back?—*Sir Thomas Robson:* Accepting the view the Chairman put, you have to start with a distributable profit of some kind, our argument would proceed on your lines. I am afraid as accountants we do not quite start in the way in which the Chairman did. Accepting that as the legal view, we would argue on your lines.

6281. *Professor Gower:* Would there not be something to be said for meeting Mr. Mackinnon's point, by providing that the balance sheet should show what part of the share capital has been issued for cash and what part by way of bonus issue?—At the time when the bonus issue was made there is of course full disclosure in the annual accounts of that year. If one thinks in terms of a company with a 50-year life with all kinds of ups and downs, issues for cash, issues of bonus shares, one would not want to give a great deal of detail year by year on things which happened many years ago.

6282. You could give the total number of shares issued for cash or other consideration and the number issued as bonuses.—There is no particular merit in that, once it is done. If at the time the issue is made the shareholders have had the facts before them and made their decision, that should be sufficient.

6283. But what about the creditors? —The creditor is more concerned with the assets available for paying him, and he would look at the other side of the balance sheet and see the assets are included at a valuation, and if he were inclined to be doubtful he would want to make some enquiries before extending credit.

6284. *Mr. Mackinnon*: Of course, in fact, it is a principle of the existing law that a company does get £1 or £1's worth for a £1 share—you would accept that to this extent that principle could be abrogated?—I think so, and of course one has to have in mind that you may recommend shares of no par value. That may affect your consideration of the matter.

Mr. Benson: You suggested that the principle would be abrogated if £1 capital was represented by an unrealised surplus?

6285. The principle is that £1 in cash or kind should have been received by the company for every £1 put out in capital.—Received or earned.

6286. It is basically received. If you issue shares, normally you get £1 in cash or a £1's worth in kind.—Yes, but the company could earn profits and capitalise the revenue reserves in the form of shares.

6287. But in that case it has clearly got the cash, which it retains.—I doubt whether there is any real difference in theory between that and a genuine increase in value of one of its assets.

6288. I do not think there is any difference in principle. All I say is, why should there be a difference between using the cash to pay up a share and distributing the cash to shareholders—that is the way the point is put against you. But you say that commercially

this is a sound approach, and that commercially it is thoroughly unsound to allow distribution in cash of an unrealised surplus?—Yes, Sir, we stand quite firm on that.

6289. *Mr. Lawson*: Turning to another subject, you suggest the accounts should indicate concisely the way in which the amount of stock has been computed. You go on to say that if that is not practicable the accounts should contain a note in the form of a declaration that the amount has been determined for the whole of the stock at the balance sheet date on bases and by methods of computation which are considered appropriate in the circumstances of the business and have been used consistently. I wanted to ask you first about that kind of additional statement. I do see your difficulty, particularly I suppose as regards consolidated accounts where accounts are brought together from subsidiary companies in different countries with different methods of accounting and different bases of valuation. To give a precise description might be a rather lengthy document. It may not really be practicable because it requires so much paper. Is that so?—It may require a great deal of paper, and it is unlikely it would then be of real help to the shareholder.

6290. Does that only arise in the case of consolidated accounts?—No. It could happen in the case of big companies which have very diverse interests. It could readily apply there.

6291. Do you think this note really adds anything? The Act already says that stock must be valued on a consistent basis, or something to that effect, does it not, and presumably directors will always act on the basis they consider appropriate in the circumstances, if they are doing their job properly? Do you think it adds anything?—Yes, for this reason: it makes the directors, and the auditors by virtue of their report, state two things affirmatively—first, that the basis is appropriate, and secondly that the basis has been consistently adopted. The need to state both things affirmatively is extremely valuable.

Sir Thomas Robson: The whole of our experience indicates that the importance

of those two elements in balance sheets is not sufficiently recognised, and anything which can be done to bring those points home to directors and others will be a good thing to do.

6292. That is quite clear. We had a discussion with the representatives of the Scottish Institute about this. They were not very enthusiastic about disclosing the basis of stock valuation. They felt that we should try and get practice on a more uniform basis, particularly on this matter of overheads. I did in a note I sent to you draw attention to a comment in the Courts in the *Duple Motor Bodies* case; the Report of that case stated that the Special Commissioners had found that the accountancy profession as a whole was satisfied that either method, with or without overheads, would produce a true figure of profit. How do you feel about that?—The quotation from the Special Commissioners' Report rather oversimplifies the view of the accountancy profession. We have recently re-issued a document of our own on the treatment of stock-in-trade. We issued it as recently as November last and we there bring out that the circumstances of businesses differ tremendously and what may be appropriate in one business as a basis on which to take stock is not necessarily appropriate in another. But that does not mean that, without having regard to its own particular circumstances, a business can just say "we will take this particular method of treating our stock as appropriate for us". We have tried to emphasise in that document that each business must examine its own circumstances very carefully, the nature of its business and the nature of its stocks and the way they are manufactured or dealt with, and form an opinion as to the basis on which the accounts would best present a true and fair view of the state of affairs and the profit. In some businesses undoubtedly overheads ought to be included. In some businesses a greater degree of overheads should be included than in the past. There are some types of business where long experience of those concerned indicates that it is far better for them not to include overheads.

Therefore we feel this is a matter which ought to be left to the discretion of directors and auditors, provided there is com-

pliance with the two principles Mr. Benson mentioned just now.

Mr. Benson: Could I also make the general point that it is not practicable to crush the differing methods of computing profits in different businesses into a single mould; that would be bound to fail.

6293. Do you think it would be fair to say your view is this, that assuming it would be desirable to get a little more uniformity into the method of valuing stock, the right way would be to accept your recommendation and prescribe in the Act that people should say precisely what they have done?—I believe that would be a tremendous step forward in company administration.

6294. Now coming if I may to the question of disclosure generally, do you agree that investment is becoming a much more scientific exercise than previously and that there is therefore a demand by stockbrokers and other advisers on investments for the maximum amount of information in annual accounts? It may be sometimes too much and they might become too long, but in general that is the trend?—There is a demand but I would like it countered with the observation made earlier this morning, that it is extremely important not to drown the real value of the accounts with detail or with information which does not really add to the shareholders' knowledge. It would be a great mistake, I think, to add a great deal to the Eighth Schedule for the purpose of providing information which, when it was incorporated in the annual accounts, would be likely to confuse rather than to help the shareholders.

6295. I would now like to ask you some questions about the Eighth Schedule which was based on the Institute's recommendations at the time; and the questions I would like to put to you are taken from the current recommendations of the Institute. I have added one or two which are recommendations by the American Institute which have not been adopted here, and one or two from evidence we have had. First, do you think it is practicable or desirable to require some additional information about pension funds in the accounts?—I do not think it is necessary to incorporate it in the Eighth, or some similar, Schedule, by

reason of the complexity of the problem. I think it is adequately dealt with by the Institute's recommendation on this subject and the auditor's duty to say the balance sheet is true and fair.

6296. The trouble about the Institute's recommendations, as you know, is that whereas the great majority of companies do follow them, they have no force; and the auditor cannot insist on them, can he? —He can refuse to give an unqualified report. If the information is not shown, any auditor who signed the balance sheet would do so at his peril.

Sir Thomas Robson: I think it should be borne in mind that the auditors of the vast majority of public companies, and indeed of the vast majority of private companies, are members of our Institute or of the other chartered bodies and would pay a good deal of attention to the recommendations which have been put out by the Institute. I should be inclined myself to leave it to their reliance upon those recommendations.

6297. Then, long-term rental agreements, we have had some evidence about that. It is becoming increasingly popular for companies to get some other financial institutions to build their factories and then rent them instead of owning them. If investment analysts and others want to compare the performance of one business with another and see how much capital is employed, it would be a help to know the rents paid. That is how it is put.—*Mr. Benson:* The Institute has on its programme a proposal to study this and a recommendation may be issued in due course. I question whether in fact the information would provide the comparison which has been called for, and in a great many cases the provision of this information might be extremely difficult. I am thinking of big industrial businesses with agreements all over the world; but it is a subject the Institute has under consideration.

Sir Thomas Robson: It is within my knowledge that in the United States there is a great deal of discussion going on with regard to this matter, and I do not think they have yet found a solution which they regard as wholly satisfactory.

6298. The next is one we have already touched on and that is information about companies where the shareholding is below 50 per cent. We have had a tremendous amount of evidence on this. Do you not think the Schedule should require some further particulars?—*Mr. Benson:* I think a case could be made where they are material. This is entirely a personal view, I do not know what the Council's view would be; but if the holding was 25 per cent. or more (up to 50 per cent. which would bring it into the subsidiary class) it might well be appropriate to disclose similar information to that which is now required under paragraph 15 (4) of the Eighth Schedule for non-consolidated subsidiaries.

Sir Thomas Robson: That would be a requirement to deal with those companies in the aggregate, if the parent had a number of interests of that kind.

6299. Do you take the view that the essential figures to give would be those which you referred to, the profit for the year and the accumulated profit?—*Mr. Benson:* Yes, Sir.

6300. Rather than the assets? A number of witnesses have suggested that a summary of assets should also be given. The difficulty I feel about that and I would like your views, is that the assets are not really accessible to the man who holds an investment.—There is also the danger that the balance sheet of the company holding these associated companies would be confused with subsidiary detail. There is the further point, of course, that if the shareholder is really desirous of pursuing the point he can always go and look at the file of the associated company concerned.

6301. Can he? Are you suggesting that the names of these companies should be included in the accounts? There is no provision at present for that.—I had not thought that the names would necessarily be shown but if it came to that point and it was of importance he would ask at the general meeting what the company was.

Sir Thomas Robson: Of course, he could not get the information from the file if the company were a foreign company.

I would have thought myself it might be desirable that there should be information on the lines of paragraph 15 (4) of the Eighth Schedule presented in the aggregate and that it might be well to leave it at that and see how it works.

6302. Yes. Another point, which the Americans deal with, is the long-term loan. One does not have very full particulars about those, does one?—*Mr. Benson*: No. We have made a recommendation on that, I think it would be a good plan if an appropriate paragraph was inserted in the Eighth Schedule based on the recommendation.

6303. We could look up your recommendation.—That is my personal view. My Council have not pronounced on that point.

6304. Then there is the position where material amounts of assets—particularly reserves, available profits and so on—are held overseas and the parent company cannot get them because of restriction on movement of funds.—In this case also we have made a recommendation. Again, I do not think it is suitable for inclusion in the Eighth Schedule, it is something which must rest on the words "true and fair". It is a subject on which both Sir Thomas and I have had a great deal to do in recent years and I think we are both in agreement that it would not be practicable to make a satisfactory legal requirement in the Eighth Schedule; but information certainly must be shown under the true and fair rule.

6305. I imagine that is pretty generally understood?—Yes, Sir.

Sir Thomas Robson: We are rather afraid if you were to introduce something into the legislation obliging directors to say a good deal more than is now specified in the Act they might claim they were justified in not showing any more than is precisely stated in the amended law, whereas if you leave it as it now is the auditor has better scope for presenting his argument in favour of fuller disclosure to them.

Mr. Benson: It does raise political considerations sometimes in overseas territories and the way the information is expressed is very important.

6306. The next one is the question of investment allowances. You have made a lot of recommendations about taxation, including treatment of allowances. Do you not think figures about these allowances should be given?—Here again the Institute has made specific recommendations under heading N.19, paragraph 40. Those are generally understood and generally followed. It is an extremely complex matter. There would be great difficulties in defining what should be shown and again I think it is adequately dealt with at present under the Council's existing recommendation.

6307. Another question which we have put to some of our industrial witnesses is the question of capital expenditure. The Eighth Schedule at present requires you to state merely the amount of contracts outstanding which can be quite a silly figure. That is to say, you may have placed a contract for the foundation of the building and not for the building itself. It has been suggested to us it would be useful to require figures to be given for expenditure for which authorisation had already been given by the board.—It is extremely desirable that that information should be given. The difficulty I see is how to define it for the purposes of an Act. Our Council has recommended that the information should be shown, and most companies go to great pains to explain what their capital plans and proposals are. The difficulty I see is defining what should be shown; if you confine it to expenditure approved by board resolution, board resolutions in appropriate cases will not be passed.

6308. In principle you agree with such disclosure?—Yes, Sir.

6309. Do you think the voting rights of shares should be given in the accounts or a statement whether there are non-voting shares?—We made a recommendation about non-voting shares and that is already in our written submission to you. I can see that a case could be made for showing all the voting rights by a note in the accounts.

6310. What do you feel about names of the subsidiary companies? Quite a number of witnesses have asked that the names of subsidiary companies should be

included in the accounts. It would be a long list in some cases.—*Sir Thomas Robson*: It would need a business directory for some of the large business organisations in this country and many of them would include a long list of dormant companies which are not operating and have no commercial significance at all. I would be inclined to think it would not serve a useful purpose.

6311. Quite a number of witnesses have pressed it upon us. It is something we have to look at. You would feel it would be cluttering up the accounts too much to have it in the accounts?—I would.

Mr. Benson: I would definitely oppose it in the accounts.

6312. Quite a number have done it voluntarily but where the number of companies are not so numerous.—And they are very selective (in the best sense) as to what they show. They show the main companies, the ones which they think are of general public interest.

6313. *Mr. Scott*: Would you oppose compulsory disclosure of subsidiaries simply because it was unnecessary and cluttered up the accounts or because some directors might wish not to show the names of subsidiaries? Is it really an inconvenience?—My view is it would clutter up the accounts without any corresponding advantages. There are some cases where a company may wish to carry out a secret process and until it is at a stage where it is commercially viable would not want the name of the company to be disclosed at all. That would be, I think, a proper case where it should not be shown even on the file.

6314. And for overseas subsidiary companies sometimes too?—It is very important sometimes that they should not be disclosed because of overseas connections or political difficulties.

6315. *Mr. Brown*: Do you think that a subsidiary company should disclose by whom it is controlled?—*Sir Thomas Robson*: You have the same kind of point which has just been made by Mr. Scott with regard to overseas companies. There are a number of countries where foreign companies are not allowed to be registered

as the shareholders of the whole of the share capital of companies in those territories; disclosure is therefore not made of the fact that companies in those territories are subsidiaries of British companies. It would be to the great detriment of British trade if we were to introduce some such requirement.

6316. It might only apply to British companies?—That is so. Since, however, the accounts of all companies subsidiary to a British company whether British or foreign have to be consolidated with those of the British holding company under our Act, the general practice is to try to introduce uniformity into the descriptions and wording used in the accounts of the companies overseas as well as those at home. I do not want to overstate them but I think there would be possibilities of danger if you were to insist on the name of the parent company appearing on the balance sheet of every subsidiary. It would have advantages in some cases, I agree.

6317. *Chairman*: I suppose if you left it to the discretion of directors it never would be disclosed?—It is in some companies now, not to any great extent, but it is done in some companies now. I have seen a balance sheet of XYZ Company and in brackets underneath (Subsidiary company of the ABC Company) or (A wholly-owned subsidiary company of the ABC Company). That is often done in the United States. You will find that subsidiary company accounts which are signed on this side of the Atlantic for the use of United States holding companies very often have that kind of subscription on them.

6318. *Professor Gower*: You said you object to this information cluttering up accounts. It is accounts and not the directors' report?—*Mr. Benson*: Yes, Sir.

6319. *Mr. Lawson*: May I come to the question of turnover. You say that you think turnover should be disclosed unless the directors consider the disclosure is likely to be misleading or harmful to the company. If the directors of one company decided that it would be harmful to disclose its turnover is not that likely to lead to the competitors of that company

saying they cannot disclose either? Supposing this Committee were to decide that it was really not practicable to have a let-out of that kind which way would you feel it ought to go? Would it be your view that disclosure should be compulsory in all cases or that there should be no compulsion at all?—I am afraid there can only be one answer to that question. If there are cases where it would be harmful, as my Council believes is the case, then the only possible answer is to say that no disclosures should be made. But I would not like that answer to be read out of its context; our Institute believes that turnover should be shown in all cases except where it is misleading or harmful. We believe it is perfectly reasonable to trust most boards of directors to construe that fairly; that provision appears in certain other places in the Act and I know it has not been abused.

6320. Would you say in cases where it is not disclosed the directors should note in the accounts why it is not disclosed?—I am reluctant to give a quick answer because the feeling I have is that if they gave the reason it would probably disclose the very thing they wanted fairly to conceal. I think some form of words could be found which would make it clear why turnover was not disclosed.

6321. The difficulties I feel about it are that there are so many people who take a very strong view that it is harmful to their business to allow their competitors to know their turnover. It may be a mistaken view. We know in America the harm that is done, if any, is much less than people thought before turnover was generally disclosed, but nevertheless I think you would agree the view prevails quite widely?—On reflection, I think that probably if they gave the reason why it was misleading or harmful that would be adequate for the purpose.

Mr. Lawson: I am afraid if we leave it like that very few companies, except the very large ones, would disclose their turnover; very large ones can do it because they have so many products that it gives no information to their competitors at all.

6322. *Mr. Lumsden:* Would it be at all practicable to apply the rule that Board

of Trade exemption must be obtained if they do not wish to disclose it?—I am reluctant as a general principle to increase the very onerous duties of the Board of Trade to act as policeman. I think it is much better to put the full responsibility for these things on the auditors and directors where it fairly belongs.

6323. *Mr. Brown:* Where disclosure is likely to be misleading or harmful to the company would you object to putting in the words "unduly harmful"?—I would have no objection.

6324. *Mr. Lawson:* May we come to quite a different subject. Are you satisfied about the present wording in the Eighth Schedule of the definition of capital and revenue reserves or do you think we ought to try to have some different method, for example, divide the reserves into those which are legally distributable and those which are not?—I am not clear whether there are any reserves which are not legally distributable except share premium accounts and capital redemption reserve funds. As I understand the law at present—I am very far from clear on it—I am dubious whether there is any reserve which is not legally distributable except the two I have mentioned. If that is so then there would be no point in the second part of your question.

6325. There would be something to be said in that case for simplifying the thing altogether and not having two classes of reserves. Is there any reason why you should have two classes?—I am in difficulty here because my personal, private view is they are not of much value. I do not think that would be generally accepted by my Council.

Sir Thomas Robson: I think that if the legal position is that there is no difference between the right to distribute unrealised surpluses and the right to distribute realised surpluses there is no real distinction in law apart from share premium and the redemption reserve funds between capital and revenue reserves and there would be no real point in continuing the distinction in the Eighth Schedule. But from an accountancy point of view I think we would feel that accounts should still be drawn in most companies in an endeavour to distinguish the accountancy

view of a capital reserve and the accountancy view of a revenue reserve. The Institute did in its recommendation N.18 put out a recommendation about capital reserves, which I may summarise briefly by saying that the term should be used to describe reserves which either for statutory reasons or because of the regulations of the company or other legal reasons are not free for distribution, or reserves which although legally distributable are regarded from a practical point of view by the directors as not available for distribution at the balance sheet date. I think from an accountancy point of view even if the requirements of the present Eighth Schedule were modified the accountant would still want to put to capital reserve items of that kind.

Mr. Benson: Could I make this point? If the law is clarified so as to make it clear what is legally distributable and what is not, then I am sure that the balance sheet should segregate what is legally distributable from what is not.

6326. *Mr. Watson:* That would create two forms of capital reserve?—If that were done then I think the existing definition would want modification entirely, and possibly scrapping.

6327. *Mr. Lawson:* It might be there is no need for definition in the Act, it is something which could be left.—Yes.

6328. As regards depreciation, is it your view that where the Eighth Schedule talks about depreciation that that is the figure which should be calculated by reference to the balance sheet value of the assets; that is to say, either the historical cost or if the assets have been written up, that written-up value?—Yes, Sir.

6329. And it does not mean, as some people have suggested, depreciation calculated upon some hypothetical figure of replacement value?—It does not mean the latter.

6330. So you would see no objection to our making that clear?—None at all.

6331. Have you any views about disclosing more information about the basis of calculating depreciation? In particular is there anything to be said for requiring the companies to say whether

they are operating the straight line or the reducing balance method?—I am sure nothing would be gained by saying whether they were operating on a straight line or reducing balance basis.

Sir Thomas Robson: At first sight your proposition sounds as if it might bring out some very startling figures for the benefit of the shareholders, but in a well-established undertaking where the volume of capital expenditure is going on fairly regularly from year to year the difference in the effect on the profit and loss account between the straight line method and the reducing balance method is not very great. It is great in the first year when the expenditure is incurred. It works itself out if you are spending substantial amounts of money year by year. If you give information to the shareholders that you are using one method or the other it does not help them to any great extent to understand the accounts better. Therefore, following the point we made earlier of not cluttering up the accounts with detail, we would not recommend it.

6332. But it has been put to us that there are certain companies—they may be the exception—where there is a large amount of capital expenditure incurred at a particular time, say an oil refinery, and thereafter there might be no appreciable capital expenditure for quite a long time; then the amount spent does not even itself out in the way you suggested. Do you think there would be anything to be said for disclosure of method in those cases or is it not worth while?—*Mr. Benson:* There may be particular cases where it might be important but usually they are so obvious it is not necessary to explain it. A general provision that this should be disclosed I am sure would be quite valueless.

Sir Thomas Robson: One has had cases, particularly overseas, where there have been special taxation allowances given on capital expenditure which were only given provided the company adopted a particular method of depreciation in its accounts. The Canadian Government up to a few years ago used to give very big allowances to armament manufacturers in the year in which they incurred capital expenditure but only on condition that

those allowances were made effective as depreciation and from the ordinary accounting point of view some disclosure of the special nature of the depreciation in those years was needed. But that is incidental, I think, to the use of the words "true and fair" to which we have already referred.

6333. There might be the odd case where an auditor might feel it should be disclosed and that would be under the true and fair view?—Yes.

6334. You refer to the fact that you regard it as illogical to disclose the aggregate of auditors' remuneration in the case of consolidated accounts, bearing in mind that for some of the subsidiary companies the remuneration may be fixed in general meeting so that figure is not included. The alternative to that, I suppose, would be to say that the full amount of auditors' remuneration should be disclosed in the consolidated accounts. Would you have any objection?—*Mr. Benson*: We would be generally opposed to it because it selects one particular item only and it is really discarding the substance for the shadow. There are two other difficulties; one, it is sometimes difficult with overseas companies to know who the auditors are—there are syndics, commissaires and the like and you really do not know where you are. There is a second point, Sir, very often the figure shown is misconstrued and it is believed that the whole of the sum shown is paid to the auditors of the holding company; this is quite misleading and somewhat embarrassing. There have been comments in the Press which have been extremely unfortunate.

6335. Your recommendation, if I remember rightly, is that you should merely disclose the remuneration of the auditor of the holding company?—Yes, Sir.

6336. Do you think the Act ought to contain a definition of fixed assets?—We believe that the definition which has been laid down in the Institute's own recommendations—the actual reference is N.18, paragraph 31—is really adequate for the purpose. It has worked satisfactorily in practice. I do not think any difficulty has been caused by lack of definition.

6337. The difficulty that I perhaps foresee is that if we have to define capital profits then it really involves the definition of fixed assets?—Yes, Sir, but in general I think our clients have had no practical difficulty in deciding what are fixed assets for the purpose under the Institute's recommendation. There are, of course, certain assets which I might call twilight assets which are neither one thing nor the other: associated companies is one example; subsidiary companies have not all the characteristics of fixed assets and it is for that reason that I am doubtful whether a more precise definition is on balance going to be a good thing.

6338. We are in difficulty if capital profit has to be dealt with differently from revenue profits. What is your view about revenue losses, if you get an accumulated revenue loss? The legal view today, is it not, is that you can go on distributing dividends out of current earnings without making good that loss?—I have always been unclear about that particular point. I believe there is such a decision but it seems to me that it conflicts with another one that if you pay dividends out of current profits when you have losses brought forward you may be paying dividends out of capital and for that, as I understand it, the directors may be personally liable. If the capital has been encroached upon by losses, then, whether it is legally permissible or not, I think the auditor would take the view that dividends should not be paid under any circumstances.

6339. In my experience the directors in those circumstances go to their lawyers who say it can be done and the auditor is in a difficult position.—As far as I am concerned I would invariably qualify my report if it was done whatever happened; I think it would be wrong.

6340. *Mr. Mackinnon*: Would you suggest we should consider amending the law to stop that?—Yes, Sir.

Sir Thomas Robson: A possible approach to the matter would, of course, be to say that where losses are sustained which in fact encroach upon the capital it should be possible to treat that as reduction of capital in the accounts without going to the Court. In which case you start the

next year with a clean sheet without having had to go to the Court to obtain permission to reduce the capital because the plain fact is if you have a capital of £100,000 and you sustained a loss of £50,000 at the end of the year your effective capital is only £50,000. Whether you go to the Court for consent to reduce or not, from a practical point of view your assets have already been depleted. There might be quite a lot to be said for companies being required to go to the Court for reduction of capital only when it involved the paying out of money or the distribution of assets.

6341. *Mr. Watson*: Would you apply that proposal universally to all companies?—I see no reason why not.

6342. If it had been in operation at one time it would have been rather embarrassing to the investment trust companies in this country who as far as I remember at one time took capital losses and showed them in their balance sheet indicating that a certain part of the capital had in fact been lost by realised sales and continued to pay dividends out of current earnings both on preference capital and in quite a number of cases on ordinary capital as well. Is there an exception there which you would be prepared to give?—I would not see any need for exception in the example you mention.

6343. You think that that should not have been allowed to be done, as you see it now?—I think that there is a case for saying that where losses are sustained then those losses might be applied as a reduction in the company's capital on its own balance sheet without going to get permission from the Court. Applying that to the case you cite those capital losses which were sustained would be deducted from the share capital and instead of it being a capital of £100,000 it would be a capital of £50,000.

Mr. Benson: Was the capital loss a realised capital loss or only a temporary diminution in the value of investments?

6344. No, I was referring to realised capital losses.—I support Sir Thomas in that respect. If a realised loss of capital is incurred I think it is important it should be recognised and dealt with before any distribution is made to shareholders.

Sir Thomas Robson: In our accounting recommendations to our members about the way in which a balance sheet should be presented (paragraph 15 of recommendation N.18) we recommend that where there is an adverse balance on the profit and loss account it should be shown as deduction from the share capital although we recognise under the law the share capital cannot be reduced without the consent of the Court. We try to bring out the facts by showing the capital as it legally is and showing the adverse balance on profit and loss account as reduction from it on the same side of the account, instead of showing as used to be done in years gone by, an adverse balance on profit and loss account as an asset on the right-hand side of the balance sheet.

6345. That is exactly where the realised losses of the investment trusts appeared as an asset. Have I got it right, if this sort of thing were to develop again you would suggest that the directors automatically applied the realised loss against the capital?—I would suggest that should not be prohibited by law as it now is.

6346. *Mr. Brown*: A shareholders' resolution should be required perhaps?—Yes.

6347. *Mr. Watson*: Then the £1 share becomes 15s. or 10s.?—Yes.

6348. *Professor Gower*: Might this not present difficulties where there were various classes of share? The Court can ensure that reductions are fair between various classes. If you allow it to be done privately might there not be practical difficulties?—I think there may well be a point there where the rights of the shareholders are not exactly clear.

6349. *Mr. Lumsden*: Would it not also involve a question whether there might not be unrealised capital profits in the other assets? It would raise the whole question of revaluation of assets, would it not?—My feeling is if you are showing that loss in the accounts you are showing that your capital has been depleted to that extent and therefore it is reasonable to recognise it as such.

6350. *Mr. Watson*: Would you qualify that by saying you would have to have

decided that there was no possibility of recovery?—You are now on the subject of unrealised losses rather than realised losses. I thought you were speaking of realised losses.

6351. I am still speaking of realised losses. Is it not true to say that a petition for a reduction of capital is usually made when the board have decided that the capital has been irretrievably lost?—Lost or no longer represented by available assets, I think are the words.

6352. In the case of an investment company it might be reasonable that optimism should prevail and they would hope they would recover that loss?—In such a case the directors would no doubt decide that the proper course was to carry it forward.

6353. I gather from what you said earlier that in these circumstances they would be precluded from paying dividends out of their current earnings?—An investment trust should not be affected by that consideration.

6354. That is what I wanted to get quite clear.—The investment trusts under their constitution are not allowed to distribute capital profit in dividend. Their practice is to distribute in dividends some part of their income without regard to whether they have capital profits or capital losses.

6355. So that we can regard them as being an exception to this?—They are in a special class, I think.

Mr. Benson: I would like to stand on the general principle that if the accounts show that losses have been incurred which have encroached on the paid-up capital, then dividends should not be permitted as long as that situation continues to exist.

6356. *Mr. Lawson:* If we were to adopt that it would be simplifying things quite a bit because it would do away with this distinction there is today between circumstances in which you may distinguish revenue and capital profits. It might save definition. You would not allow revenue profit to be distributed unless the capital was intact?—I was on a slightly different point. When it is realised and established and shown in the accounts that part of the

capital has gone I do not think revenue profits should be allowed to be distributed until the capital has been made good.

6357. *Mr. Richardson:* Would you not say in practice in 999 cases out of 1,000 that is the position which obtains today?—I would say the percentage is even higher. I agree with that.

6358. *Mr. Lawson:* Then it has been suggested that the annual accounts should state the profits for the past five years. The point is of some importance because of what you say in paragraph 145 of your memorandum about the differing opinions which are held as to what should be included in the amount shown as the profit or loss of a year. Profits going back five years are not at present on record and having regard to the fact that capital is now nearly always raised by rights issues to shareholders one wonders whether you think there is anything to be said for such a statement?—I am myself much in favour of the proposal with one reservation and that is I would prefer to see it confined to companies which have a quotation, and I would prefer to see the sanction imposed by the Stock Exchange making it a condition of a quotation. I think that is the right way of dealing with it as they do with other information. I am a little reluctant to see a legal requirement for all companies and I think it would be sufficient if it were shown by quoted companies.

6359. We have asked the Board of Trade to carry out for us a sample enquiry into the position as regards the auditors of exempt private companies in view of the submissions which have been made to us by a number of people, including yourselves, that exempt private companies should have properly qualified auditors. I will not trouble you with the details of the result of that sample but broadly the effect is that something like 90 per cent. of the present exempt private companies have auditors who are qualified under section 161. Would you see any difficulty in the recognised bodies dealing with such additional work as would be thrust upon them if all companies were required to have their accounts audited by qualified auditors?—There would be no difficulty.

6360. Could I now turn to some other points of auditing. I am slightly troubled by your proposed new wording as regards the auditor's report on banks and insurance companies. Do you think there is really anything much wrong with the balance sheets of banks from the point of view of a true and fair view? I know, of course, they do not show separately the provision they make for contingencies, but looked at purely from a true and fair view of the state of affairs of the bank is there anything much wrong with its balance sheet?—The question is whether any balance sheet can show a true and fair view if you have very large concealed reserves, particularly reserves which fluctuate widely; I am thinking particularly of the disclosure of the comparative figures.

6361. I think the disclosure of the changes is rather a separate point. I was going to come to that on profit and loss. But looked at purely as a statement of the balance sheet a bank must, if it is conducting its business properly, make large provisions of this kind. Would it help if there were a top limit? Supposing the undisclosed provisions should not be more than x per cent. of the assets or of the deposits; with such a limit, would you feel strongly about signing the balance sheet as true and fair?—I would not myself like to sign one. I am thinking of a particular case, a bank which showed the existence, but not the amount, of a contingency reserve in its account for many years. Over the years that I dealt with it, the contingency reserve fell from £5,000,000 to £5,000. The question of whether the bank could carry on was in doubt. In fact, for political reasons it was in peril. It did carry on but it would be quite wrong to think that over a period one could say that the balance sheet was true and fair when the bank had that enormous fluctuation in the contingency reserves which was not known to the public. I would be very reluctant to agree to a provision which required one to say that a bank balance sheet was true and fair without the reservation which we have suggested.

6362. *Chairman:* Under paragraph 23 (2) of the Eighth Schedule you may approve as true and fair accounts of

banking companies which are exempt even though the accounts do not disclose the full position because of the statutory exemptions?—Yes, Sir.

6363. That paragraph makes them, artificially, true and fair?—Yes. We wanted to make the report in such cases a more satisfactory document; that was the purpose of our submission.

6364. *Mr. Lawson:* Do you think it would in any way weaken your authority if we adopted your suggestion, that is to say, the fact that you have to sign a balance sheet as being true and fair, does that not give you certain power to insist on certain things being dealt with in a particular way which could legally be dealt with in a different way?—I am not quite clear.

6365. Do you not as auditors derive more strength from the fact that you have to say the balance sheet is true and fair? To take a specific example, if a bank were to transfer out of secret reserves sums into its profit and loss account in order to cover its expenses, would you not then perhaps be inclined to say I will not sign that. It is legal under the Eighth Schedule, but I am not prepared to sign that because that goes beyond the length to which I am willing to go in using these terms true and fair?—I do not think our position would be undermined by our proposal.

Sir Thomas Robson: I agree with Mr. Benson on that.

6366. In paragraph 202 of your memorandum you state that there is a difference of opinion on your Council as regards the proviso that the auditor of an exempt private company may be a person who is a partner of an officer or servant of the company. In view of that difference of opinion do any of you wish to add anything to what is said in your written evidence?—*Mr. Granger:* There was a difference of opinion in Council and I think it is very fairly set out in our memorandum. I think it is fair to say that even those who disagreed with the present position admitted that there has been no evidence of any abuse. On the other hand, in the United States they have been pressing this question of independence even so

far as to disallow the auditor of a company whose shares are quoted on a Stock Exchange from holding any shares in the company which he audits. Otherwise I have nothing additional to say on this particular point.

6367. In America the position is different because the auditor is appointed by the board?—*Sir Thomas Robson*: In some companies, not all. Auditors of some of the biggest are appointed by the stockholders.

6368. Another small point on auditing. In paragraph 200 you state that the auditor of a holding company should have power to require such information and explanations as he thinks necessary from the auditors of subsidiaries of the company. I am sure that is a convenient thing for the auditors of the parent company. Do you think there could be circumstances when a legal provision of that kind might be embarrassing for the auditors of the subsidiary company who, after all, are appointed by the shareholders?—*Mr. Benson*: It could be embarrassing under particular circumstances. The law might require, if the Committee accepts this point, that the directors of the holding company shall procure that the auditors of the holding company shall be enabled to obtain this information.

6369. Putting the onus on the directors?—*Yes*.

6370. *Mr. Brown*: Is not there a question of ethics here? The right for the information to be given the majority shareholders and not the minority?—*Sir Thomas Robson*: The majority shareholder has the means of getting it through his representative on the board so the question of ethics hardly applies in that particular respect. What is wanted is that his auditors shall be able to satisfy themselves that the information is being dealt with fully and fairly because they have the responsibility of signing consolidated accounts.

Mr. Benson: I do not think we really mind how it is expressed provided the right is reserved for the auditor of the parent company to secure proper information.

6371. *Mr. Lawson*: Thank you. May I come now to the extremely difficult question of share premium account and its related problem of pre-acquisition profits. You were good enough to send us a supplementary memorandum and the Committee are, I know, very grateful to you for the time you have devoted to what is a most difficult matter.

We have had some discussion with other witnesses. It may interest you to know that the representatives of the Scottish Institute were inclined to agree with your conclusion about pre-acquisition profits but they were not very happy about the suggestions you had made about the use of the share premium account in other cases. I would like to take the share premium account first if I may. You say that as a general principle the share premium account should be regarded as being in the nature of contributed capital but that there are circumstances in which it is appropriate to depart from that general principle. Do you mean by that that there are circumstances when the share premium account should not be regarded as capital or do you mean that there are circumstances in which the directors could in effect reduce the capital by the writing down of the share premium account without the prior consent of the Court?—*We mean the latter*.

6372. How would you deal with this type of situation with no par value shares? Would you allow some part of the amounts subscribed for them to be put to an account which could also be used in the same way as the share premium account?—*In the case of no par value shares we would not expect to see some part of the paid-in capital segregated. For the purpose of our submission we would expect to see paid-in capital treated in exactly the same way as share premium account*.

6373. Is there any reason why par value shares should not be treated in the same way so as to reduce the amount of capital?—*Below the par value of the shares?*

6374. *Yes*.—*So long as par values are retained as part of the company law, I think that would be wrong*.

6375. You state that it should be lawful to reduce the share premium account to eliminate the amount of the goodwill item which would otherwise be included in the accounts of the company and/or its group accounts as a result of the acquisition, in exchange for an issue of shares to which the premium relates, of a business or goodwill or of interests in a subsidiary; and to make a corresponding reduction when and to the extent that it becomes necessary, in the amount at which the shares are carried in the books of the company. The following points have been taken against that proposition. Firstly, it is not clear what you mean by goodwill. If, for example, the physical assets of the newly-acquired subsidiary are worth more than their book values, would this excess be included in your definition of goodwill? Or would you write up the assets?—I think the amount of goodwill is quite clear. It is excess of the purchase consideration over the net book value of the tangible assets as carried in the books of the subsidiary company. That will not necessarily mean the value at which they were carried in the books of the subsidiary before purchase because a holding company can and sometimes does write up the fixed assets. Goodwill will therefore be the surplus of the consideration paid over the net book value of the assets of the subsidiary as recorded in that subsidiary company's books.

6376. In some cases it could include an element of tangible asset if the directors so choose; it depends on how the directors deal with the situation?—*Sir Thomas Robson:* It would depend on how the directors deal with it, yes. If the directors do not have the physical assets of the subsidiary revalued at the time of purchase then the goodwill element would be measured by the difference between the purchase price of the shares and the net book amount of the tangible assets in the accounts of the subsidiary company. If, on the other hand, as some companies do, they have the physical assets revalued at the date of acquisition then the goodwill element would be the difference between the purchase price and the net value as determined by that valuation.

6377. Yes. I see. Then it is said that the shares in the newly-acquired subsidiary might be resold and then a profit might emerge. What would you do about that? Would you say that it should go to reinstate the share premium account or not?—*Mr. Benson:* Normally, but not necessarily always, I would reinstate the share premium account or take the surplus to capital reserve. I do not think it would give a true and fair view if there was an immediate realisation and the surplus was distributed, bearing in mind that some part of the cost had been written off against share premium account. That would be covered by the reservations which we make in our supplementary memorandum that the use of the share premium account should require the consent of the company, and the overall provision that a true and fair view should be shown.

6378. One has to be fairly precise about that otherwise you get close to distributing the share premium account. —There is a risk.

6379. It is something you have to look at?—Yes.

Sir Thomas Robson: The Committee should be aware that if one endeavours to tie this up too tightly in the law it may be very difficult to operate. It may be that those shares are held for a number of years and the good-will element gets mingled with additional goodwill purchases and realisations and over a series of years it might be very difficult indeed to determine the extent to which any capital profit arises from the previous writing down out of share premium account and the extent to which it arises from other sources. It is for that kind of reason, because we see difficulty in determining over a long period of years whether the profit arises from reducing the share premium account, that we have tried to interpose the safeguards we have mentioned in our memorandum.

6380. It would be too complicated to require that before capital profits were distributed the share premium account should be reinstated to the figure it originally was; it could be reinstated out of revenue profits?—That might be quite unreasonable unless you could

relate them to the new transactions and to relate them becomes for the reasons I have indicated very complicated over a long period.

6381. Then it is said that as a matter of general principle all assets, including goodwill, should be carried in the balance sheet at their full value, represented by their cost less depreciation or amortisation out of profits. It is said that the full capital employed in the business should be disclosed so that the earnings can be related to that capital and a judgment formed as to the achievements of the management. In other words, is it right that the board of directors should be able to buy a new company, admittedly by issuing their own shares, at a very high price, and then straightaway write it down?—There is a very strong difference of opinion on that subject. Some companies hold the view which you have just indicated. Others hold very strongly the view that the sooner they can eliminate an item of goodwill from their balance sheet the healthier the balance sheet will be. In the United States I believe there is a generally accepted principle of amortising goodwill over a period of years without regard to whether the earning capacity has increased very considerably in the meantime. There is at least one client of my firm which holds so strongly the view that it is undesirable to have intangible items in his balance sheet that he asks us to put in a separate paragraph in our auditors' report stating there is no such item in the balance sheet. There are very strongly held divergent views on this subject and I think the Institute's view is that it would be much better that the matter should remain flexible.

Mr. Benson: May I make two points. Firstly, it is often entirely a matter of chance how much a goodwill figure is, depending on the market valuation of the shares issued at the time the transaction took place. So it is entirely an artificial figure and varies from day to day as the prices of the shares vary. The second is that the figure shown is only a partial figure anyhow because if one is going to put in goodwill at all one ought to put in the goodwill attributable to shares of the holding company already in issue, as distinct from the shares

issued for the purposes of acquiring the subsidiary company. It is a highly artificial figure in any case and the general view of most responsible directors is that they are anxious to eliminate artificial figures of goodwill which really have no meaning.

6382. *Mr. Mackinnon:* I can understand goodwill where it is pure goodwill in the sense that the underlying net assets acquired in the subsidiary do not balance the price paid; that is true goodwill like the goodwill with which you may open the balance sheet on the formation of a company. But it does seem to me there is a big distinction between that goodwill and what I call the amount that is represented in goodwill by the difference between the true value of the underlying assets of the subsidiary acquired and the book value at which they are taken over. I can well follow about wanting to get rid of the first element of goodwill but I do not quite see that the same arguments necessarily apply to the second part of it. I do not know if you have any comments to make?—Have you in mind that the goodwill of the first kind is the difference between the purchase price and the net assets of the subsidiary?

6383. That is the consolidated balance sheet figure for goodwill.—Yes. You are not in difficulty with that. Could you explain the amount about which you are in difficulty?

6384. The figure about which I am in difficulty is whether you should unfreeze the share premium account to the extent to which it is balanced by true assets in the subsidiary as opposed to being balanced as it were by a goodwill element.—It would not be freed to the extent of true assets, that we do not recommend at all. It is the goodwill element only.

6385. *Mr. Lawson:* I was not clear on that. In your answer to me on that I thought you said that the goodwill element was arrived at by taking the differences between the amount of shares issued and the book value of the assets but I think Mr. Mackinnon's point is that the book value of the assets may be an understatement of what those assets are really worth.—We would be satisfied provided the assets were properly valued and

carried into the books at a proper valuation. Some companies do, in fact, when they acquire another company, have the fixed assets of the subsidiary written up to their current valuation at acquisition. Others take the view that it is absurd to value the fixed assets of a subsidiary on one basis when all their own assets are on another. I accept the difficulty. It is one of the problems with which we have been faced.

6386. May I just ask one more on this question. You say in paragraph 277 (c) (iii) "the accounts should disclose the manner in which the premium has been applied". I take it that means just in the year in which it occurred?—Yes, Sir.

6387. You would not want to carry the statement on every year?—No, Sir.

6388. The same paragraph states that the accounts should contain statements by the directors and by the auditors that, in their opinion, having regard to all relevant circumstances, the treatment adopted is consistent with the presentation of a true and fair view of the state of the company's affairs. I suppose there is slight difficulty about that in view of what you said just now about differing views held about goodwill. One board of directors, I suppose, would think that the true and fair view is best shown by having goodwill as nothing; another board might think it is something which might have to be written off in ten years?—*Sir Thomas Robson*: The basis on which the fixed assets are included in the accounts has to be shown and if this is stated as cost to the group then normally the inference drawn would be there had been some revaluation of any assets held by the subsidiary at the time of acquisition. If it is shown as at cost to the individual companies which had acquired the assets the opposite inference would be drawn. You will see if you refer to published accounts that there are distinctions in wording which deal with these matters.

6389. In the case of pure goodwill, for example, might you not have to continue in your accounts a statement to the effect that sums had been paid and goodwill had been written off?—*Mr. Benson*: The Act is already clear about goodwill. It does not require any goodwill to be shown

to the extent that it has been written off. There seems to be in the 1948 Act tacit approval to the desire to get rid of goodwill as fast as possible; and it is the same point which you find in our submissions here.

6390. *Mr. Brown*: You spoke of your scheme here giving flexibility. Do you mean that where after merger the directors and the auditors decided that certain reserves were available for revenue purposes that at a later date they would be free to change their minds and determine some other amount of such reserves?—*Sir Thomas Robson*: Where I was speaking of flexibility was in connection with the choice between a revaluation of the physical assets and accepting the book amounts in the various subsidiary companies.

6391. Do you not think at a later stage directors and auditors could change their minds on this point?—Certainly. If the directors were to decide that in the interests of uniform accounting throughout the group they should have the physical assets of all the companies in the group put on a common basis there would be nothing inappropriate in my view in their doing so and setting up the consequences in the accounts.

6392. And accordingly the effect on pre-acquisition profits?—I do not see the effect on pre-acquisition reserves. Those would be capital. In our view an appreciation of the physical assets would be capital profit anyway.

6393. Your scheme is that notes on the accounts should show the pre-acquisition reserves which are deemed to be revenue and so marked and so certified by the directors and the auditors. Since the facts on which judgment is to be applied as to how these figures are to be broken up are best known at the time the merger occurs, would it not be simpler to determine this once and for all and get shareholders' approval then and state the revenue reserves?—*Mr. Benson*: On the point you put, I think that is right that the pre-acquisition profits once determined would remain as such.

6394. Can you not have a shareholders' resolution instead of having it carried

forward year after year which is, I think, your scheme?—I think the intention of our scheme was to show them as revenue reserves but I think we said—do not allow them to be used without the shareholders passing a resolution.

6395. You would have a shareholders' resolution straightaway saying they shall be deemed revenue reserves and may be so used?—What we had in mind was that shareholders should not give a blank authority straightaway. The shareholders might change and it is more important that the shareholders at the time when the reserves are used should exercise the authority; the other course makes it more open to the directors to deal with reserves in any way they think fit. We thought there should be some sanction imposed.

Mr. Brown: On the other hand, the facts on which judgment should be made are fixed ones and would be lost in the past.

6396. *Mr. Lawson:* As I see it what you are saying is that pre-acquisition profits should not normally be regarded as available for revenue purposes from the standpoint of the holding company but that experience shows that there are circumstances in which it is appropriate to depart from this general principle. Then you go on to say the difficult problem is to determine who should be responsible for authorising the departure. Is there not really an earlier and even more difficult problem, defining the circumstances in which it is appropriate to depart from the principle and how would those responsible recognise the circumstances when they saw them?—That is the whole problem. There is no doubt that it is a subject on which the Council of the Institute will wish to make recommendations in due course. But there are certain factors which seem to me to be important and if I could mention them it might help to clear the air. It seems to me that the sort of conditions which must exist must be some or all of the following things. There must be wholly, or to a material extent, an issue of shares. That is to say a substantial proportion of the shareholders of the acquired company should become or should have the right to become shareholders of the acquiring concern. The second is that there should

normally be some common interest between the groups. Not necessarily, but normally. Thirdly, a merger implies some continuity of management. Fourthly, there should normally be prior discussion, but not necessarily prior agreement, between the boards of the companies. I do not know if the Committee has had a chance of studying the bulletin issued by the American Institute where I notice that they have the same considerations in mind. It is all those circumstances, and any others peculiar to the deal itself, which make the decision possible.

6397. Do you think there is anything in connection with size? Do you think this should apply when a very large company buys a small business or should it be a genuine merger?—I do not think so. So often the merger takes place because the giant wants the management personnel of a small concern. That has been our own experience here. I notice the American Institute makes exactly the same point. "Relative size of the constituents may not necessarily be determinative especially where the smaller corporation contributes desired management personnel."

6398. Is that document available somewhere?—It is *Accounting Research Bulletin*, No. 48, issued in January, 1957.

6399. Have you in your experience known many cases where there has been a need after a merger for the use of the pre-acquisition profits for the dividend? The point has been made to us that when these mergers take place directors on both sides are frequently very anxious to see that these pre-acquisition profits are not frozen and can be available but in fact it is very seldom anybody needs to use them?—*Sir Thomas Robson:* I cannot say that I have known any case where they have been used but I can think of one where there was an intention to use them for perfectly proper purposes but the directors were advised that under the 1948 Act it was not legally allowable and therefore the company dropped the plan. I have no doubt whatever that in the 1930's, before the passing of the 1948 Act, when companies were formed as amalgamations in order to meet the difficult industrial conditions that were then prevailing, pre-acquisition profits may well have been

used for dividend purposes. Of course, the law was different then from what we believe it now to be. There is no doubt whatever that in devising merger schemes very often those who formulate the schemes have to take into account as a major point the relative size of the revenue reserves of the companies that come into the schemes and sometimes the company with the biggest revenue reserve is selected as the company to acquire the others, merely for the reason that there is a big reserve of revenue profits in that company which under the law can be used for the payment of dividends. We feel that it is undesirable that the legal requirements should be so tight that the choice of the company which is to be the acquiring company as distinct from the acquired should be forced into a straitjacket by reason of the revenue reserve of an acquired company being frozen in all circumstances. We would much prefer that the choice of which company is to be the acquiring company should be determined on commercial and business lines.

6400. Would your point be helped at all by the suggestion you made yourself earlier about having a simpler method of reducing capital in the cases where the capital has been lost. That is to say, if the shares were bought at far too high a value because there was later a substantial fall in market prices, they would be able to mark the book value down?—*Mr. Benson*: I do not think so. I do not think the arithmetic would work out satisfactorily because one would want to see pre-acquisition reserves as revenue reserves at the time of the merger. I think the decision has to be taken at the time of the merger.

6401. That was Mr. Brown's point. Why?—Because it is the first balance sheet after the merger that is one of the critical documents in the whole proceedings.

6402. If it was known that the share premium account could, by a simple resolution of shareholders, be used to write down any losses which were effectively incurred would not that be as good as saying that the company had pre-acquisition profits available?—I think it is the consolidated balance sheet which

would be the difficulty. One would want to show the pre-acquisition reserves as revenue reserves in the consolidated accounts which is normally what the public looks to. That presupposes that the share premium account is reduced by the amount of the pre-acquisition reserves at the time of the merger.

6403. It is purely presentation.—But it is the presentation which the public requires in these particular cases. It is the particular point of showing these reserves as revenue reserves in the first accounts after the merger.

6404. That really leads to Mr. Brown's point. You really take the view that this treatment of the reserves should be settled at that time?—From the point of view of the presentation in the accounts they should certainly be shown at that time as revenue reserves. Our only reservation as far as I recollect is that they must not be used for distribution to shareholders or to relieve losses without specific authority of the company. I myself would have no objection to that authority being given at the time of the merger if that was thought right. Paragraph 286 (c) (i) of our supplementary memorandum recommends that on each occasion when pre-acquisition reserves of the company are effectively used for revenue purposes by a holding company such use must be authorised. What we had in mind was the use by way of dividend to the shareholders of the holding company or the writing off of ascertained losses of the subsidiary.

6405. But how would you deal with your share premium account in the meantime because what slightly troubles me is the position of the man who gives credit to the parent company on the basis of a large share premium account; then at a later date profits are brought in from the subsidiary so the share premium account disappears in writing down the shareholding of the subsidiary?—I feel that the creditor, or whosoever it is who examines the accounts, would look to the consolidated accounts because one of the purposes of the merger would be consolidation. He would therefore see from the very beginning that pre-acquisition profits were shown as profits available for distribution.

6406. He would understand?—I think he would. If you have two large insurance companies—and that is where it has cropped up in practice—who have merged it would be very astonishing if a large part of the revenue reserves of one of them disappeared on consolidation. That would happen unless these proposals were accepted.

6407. *Mr. Brown*: You mention insurance companies. Where do pre-acquisition secret reserves come into this?—They would follow the same lines as the disclosed reserves.—*Sir Thomas Robson*: On *Mr. Brown's* earlier point I think our motive in making the suggestion in the form in which we put it forward was that from the shareholders' point of view it was desirable that they should take a decision at the time when the assets were going to be depleted. That is why we thought it better that you should wait until the point where the assets were going to be used in order to provide the parent company's dividend rather than that the shareholders should give their sanction at the time of a new amalgamation when everybody had high hopes of the future and when you might get the sanction very easily. If you wait until it actually has to be used it would mean the circumstances were rather different, and the shareholders might apply a more critical mind to the matter before they gave their consent to a resolution.

6408. There is the opposing view, that at the time of the operation the shareholders would have to agree or else not get a dividend, whereas at the time of the merger they might be more objective.—Our view is as I have stated it.

6409. *Mr. Lawson*: You would think it quite wrong, would you, if you were to leave this difficult problem to the Board of Trade?—*Mr. Benson*: Yes, Sir.

6410. That would fill you with great regret?—Yes, Sir.

Sir Thomas Robson: I think the Board of Trade, as *Mr. Benson* said earlier, has a difficult enough task in dealing with matters of disclosure under the Schedule, and when you get on to these matters which you have just been discussing, you are really discussing matters of policy. It

would be unfair to place upon Board of Trade officials responsibility for endorsing in effect the policy decisions of a board on dividend matters; that should rest fairly and squarely on the board of the company.

Mr. Benson: With the safeguard of the auditors.

6411. *Mr. Mackinnon*: I have only one question I wanted to ask and it is on your supplementary memorandum, in paragraph 277 (c) (i) you say: "subject to all the following conditions: (i) the right to make such a reduction shall have been reserved in the terms of issue of the shares at a premium" and I just did not quite follow myself why you were placing that additional provision?—Only so that the shareholders in agreeing to the issue should know exactly what the intentions of the board are.

6412. This would assume that the issue had had to go to the shareholders in the first place, would it not?—Yes. Is your point really that they would not necessarily have to be consulted about the issue? We have made other recommendations on that.

6413. They dovetail?—Yes, Sir.

Sir Thomas Robson: This is germane to the person who receives the offer of the shares and it is a condition on which he accepts them. It does not mean that you would necessarily have to go to the shareholders of the company as a whole.

6414. Why should he be specifically consulted and not your own shareholders?—*Mr. Benson*: I think the point is a fair one. But our attitude is that if you are going to allow this we felt that it ought to be known and approved of at the time.

6415. The circumstances and the whole arrangement should be publicly proclaimed?—Yes, precisely that. It is one of the greatest safeguards in company administration in any event.

6416. *Mr. Brown*: One small point with regard to the qualification of the auditors. Why do you want the recognised bodies to be specified in the Act?—*Sir Thomas Robson*: We felt that as in so many Acts of Parliament and in other measures establishing parliamentary companies and

boards there are requirements included which specify the qualifications of the auditors, there was a case for having a similar clause in the Companies Act. It might help to close the list of those persons who are eligible for appointment once and for all, apart from very special circumstances in the event of Parliament being persuaded to agree to an alteration. If there were a list in the Companies Act, then future changes in the list of persons qualified would be less subject to pressure on particular departments of Government than might be the case if the provisions are left as they now are. I do not mean for one moment to suggest that we are dissatisfied with the present list of bodies approved by the Board of Trade under the Act. I think that broadly would be the view.

Mr. Benson: And the fact that a Government department on its own is subject to a great many pressures which it is sometimes extremely difficult to resist; a Government department must be particularly careful not to appear to do hardship to minorities. We think that might cut across the basic principle of ensuring only competent people may audit.

6417. *Mrs. Naylor:* Mr. Benson, your Council have considered the problem of protecting investors who deposit money with hire purchase companies or for mortgaging property or to make loans. I read with interest your submission, and I wondered if you could amplify your suggestion at all. Had you in mind the

idea of annual or half-yearly prospectuses for what are in effect a kind of tap issue of something that is not very far from a debenture?—*Sir Thomas Robson:* This is a very live matter at the present time, and I think we are all conscious of the fact that there are many companies advertising for deposits, and offering superficially attractive terms to depositors, without any real information being given to the depositors to enable them to judge of the validity of the advertisement. We feel that there is a real need for a separate investigation of the conditions on which such people should be allowed to put out advertisements. We have not ourselves attempted to formulate a suggestion as to what should be done, but we feel there is a need for something to be done, and that a special inquiry should be made into it.

6418. *Chairman:* I think, gentlemen, those are all the questions we have to ask, and it only remains for me to say thank you very much indeed for coming and helping us this morning. I think we have had a very profitable session.—Thank you very much.

Mr. Benson: I have one other point which I might ask permission to mention, and that is that we would like to make a minor variation if we may in the submission shown in paragraph 205(b). I do not think I need trouble the Committee with it now, but if I might just say what I have said for the purposes of the record, and hand in a submission to the Secretary?

(The witnesses withdrew)

SIR NUTCOMBE HUME, MR. HUGH SAUNDERS, MR. A. A. SHENFIELD and
MR. C. P. COTTIS called and examined

6419. *Chairman:* Before we begin, gentlemen, will you introduce yourselves?—*Sir Nutcombe Hume:* Mr. Cottis is the secretary of the company law committee of the Federation of British Industries. I am the chairman of that committee. Mr. Hugh Saunders is a deputy managing director of the Rio Tinto Company, a member of the committee, and a member, Sir, of your profession. Mr. Shenfield is economic director of the Federation of British Industries.

6420. We are very much obliged to you for your memorandum which the Committee has considered, and also for coming here this afternoon to help us further. You begin in your memorandum by raising the question as to why a holding company should not be the sole shareholder of its subsidiary. You recognise, of course, that that is a departure from the traditional notion that apart from corporations sole a company is an aggregate of individuals and you found your case on

practical necessity really?—That is all, Sir. We realise that such a rule would involve a fundamental change in the theoretical basis of company law, but it is for convenience. The Federation of British Industries has many members who are big corporations which in fact are an aggregation of a parent and many subsidiary companies; and it is administratively inconvenient to have a second shareholder who is a mere nominee or cipher.

6421. Is there not a difficulty too about the status of the company as an exempt private company, that you bring in someone other than a beneficial owner of the shares?—Yes. We refer to that later in our memorandum.

6422. There is a method of getting over that, but you would say that is another unnecessary artificiality?—Precisely.

6423. On this question of wholly-owned subsidiaries, what would you say to the idea of making the wholly-owned subsidiary unlimited so that the holding company is liable without limit for the subsidiary's debts as the sole shareholder in it?—I do not think there would be any serious objection to such a liability being placed upon the parent in the case of the wholly-owned subsidiary, for in practice I think that in any reputable group of companies the parent does in fact accept a moral responsibility for the obligations of its wholly-owned subsidiaries, but where of course there is a minority interest one would be bound to answer your question in the negative.

6424. In the latter case it would become very complicated, would it not, because the liability would have to be proportionate?—Precisely. In the case of the wholly-owned subsidiary, out of hand and speaking personally, I see no real objection to your proposition.

6425. The astute operator could get himself out of the liability by seeing to it that the subsidiary ceased to be wholly owned by the transfer of one share, or something of that sort.—The Companies Act will never wholly circumvent the astute operator, and we must recognise that fact.

6426. I am afraid that is true, but these points have been put because it is said

of these holding companies—"This is a wholly-owned subsidiary, why should there be another member", and so forth. They really identify themselves so closely and completely with the subsidiary company that the latter becomes really a mere department of the former, and this kind of suggestion would approximate to the reality of the situation.—I agree.

6427. Then passing from that, another point on holding companies and subsidiaries. Do you think a holding company ought to be required to disclose in its accounts the names of its subsidiary companies, and some idea of their activities?—No, I do not think that should be the law. It has however become customary except in those cases where the disclosure of the name of a subsidiary has some trading disadvantage.

6428. What about the subsidiary company disclosing the fact that it is the subsidiary of a holding company; that is, the other way round?—In what circumstances? In its literature or note-heading?

6429. *Mr. Brown:* In its accounts.—These are the accounts which would be lodged with the Company Registrar by reason of the fact that it has a corporate shareholder. Those are presumably the only accounts that it would ever have to disclose publicly.

6430. *Professor Gower:* It would also have to send them to the shareholders.—It would only have one shareholder under the proposition we are discussing now. We are still talking, Chairman, about the wholly-owned subsidiary?

6431. *Chairman:* Not necessarily I think.—The partially-owned subsidiary, the subsidiary in which for the sake of argument the parent holds 51 per cent.

6432. It might be extended to a case where there was control of the majority of the shares.—In the wholly-owned subsidiary I see no point in your question, if I may say so with respect.

6433. Why?—It lodges its accounts with the Company Registrar, and nowhere else, and if you are suggesting that it would be appropriate for the AB company to say that it is a subsidiary of the CD company I do not think that has any merit at all.

6434. You do not think the public are entitled to know with whom they are dealing?—The public in the shape of the creditors, because there is no other public?

6435. *Mr. Bingen:* Customers?—They would be debtors.

6436. *Chairman:* There are creditors and potential creditors as well.—I would not have thought so.

Mr. Shenfield: Is this linked with the earlier proposition that liability of a wholly-owned subsidiary should be unlimited.

6437. No. The proposition is simply whether, to gratify the curiosity of the public, it should be made known that AB company is not an independent entity but is controlled by another company.—If it were linked, then perhaps there might be some logic in it that might cause us to think again.

Sir Nutcombe Hume: We are talking about two things at once, are we not? I understood you to be pursuing the thought of the wholly-owned subsidiary. In that case it seems to me that there is no point in laying down in the law that the wholly-owned subsidiary in its accounts, which are lodged with the Company Registrar, should disclose that it is a wholly-owned subsidiary of somebody else.

6438. Pausing there, would you agree that this piece of information is one which the public dealing with a subsidiary might reasonably expect to have put before them?—No, quite definitely. Why in a company which is in the sole ownership of one man? Why should you? I suppose you could find out by examining the register that it belongs to one man. No, I would not have thought that was a point, but with the partially-owned subsidiary there may be a point in what you say.

6439. What do you say about the partially owned?—I think that does merit some consideration. We have not addressed our minds to this, and speaking on behalf of the Federation I am bound to say it is a question to which I would have to reserve the answer.

6440. It is not a point of any very great importance. We have these points to put on various topics we are looking into, and the fact that we put to you a proposition does not necessarily mean that we think it is a good one. We want to test it by getting an opinion.—I appreciate that.

6441. *Professor Gower:* You would agree if the suggestion, which I gather you approved of, namely that the holding company should be liable for the debts of the wholly-owned subsidiary, were implemented, there would be a very strong case for saying that you should disclose who the holding company was, otherwise the liability of the holding company would be nugatory because nobody would know who to sue.—With respect, Professor, you have put words into my mouth. I did not approve of the suggestion. I did not object to it. I think if it were left solely to me I would not introduce that into the law. If you feel that you would like to make such a recommendation, I do not think we would raise our voice against it. In any event if the subsidiary wants to obtain credit in the ordinary course of business and it has an advantage in obtaining such credit by saying: "I belong to I.C.I.", then let them do it. If they care to refrain from giving that information, and they are judged on the colour of the eyes of the man who represents them, they may not get the credit, and that is their fault.

6442. *Chairman:* Perhaps we could pass to another one. You do not seem much impressed so far. You supported the views expressed by the Gedge Committee on shares of no par value. What I want to ask you about that is if you have any view as to the practicability or desirability of having no par value preference shares?—Out of hand I personally see no objection to it. If the statutes of the company in question lay down that the preference capital has no par value, but that on a winding up the shares are entitled to x shillings and that in the ordinary course of its business they are entitled in priority to all other forms of capital to y shillings and pence per annum as dividend, it does seem to me a par value has no particular significance. I think our short answer to your question

is we see no objection to the no par value preference share. Some document has got to describe what are the rights of the holders of that share.

6443. You see no particular objection to it but no particular point in it?—Exactly.

6444. Then if we might pass to another unrelated point that comes in your memorandum under the heading classification of companies. I gather you are in favour of the retention of the exempt private company?—We are.

6445. And you take that view because you do not in effect see any harm in the exemption from filing of the accounts?—The majority of the members of the Federation of British Industries favour the continuance of the exemption provisions in the present Companies Act. We have one member who has said that because it helps assessment of the credit standing of any company the filing of its accounts would be advantageous; but the balance of advantage, as we see it, is in favour of retaining the present provisions. The administrative difficulty of causing exempt private companies to lodge their accounts, strikes us as being very great indeed—250,000 sets of properly audited accounts we mention in our memorandum, and we believe that figure to be fairly accurate.

Mr. Cottis: Those of our members that are exempt private companies I think value the privilege that it gives them very highly indeed.

6446. Why do they value it?—The administrative conveniences, the avoidance of printing the accounts and particularly in some cases of larger companies, the privilege of keeping balance sheets secret.

6447. They have now to prepare their accounts and balance sheets year by year.—Yes.

6448. And they have to have them audited by an accountant as the law now stands (not necessarily an auditor qualified under section 161 of the Act). Having got these balance sheets and these accounts so nicely prepared, what is their objection to putting them on public view?

—Just the inconvenience I have mentioned plus perhaps that their competitors, particularly those abroad, would to that extent be put in a better position.

6449. It is giving things away to competitors really, is it?—In the case of those of our larger members who are exempt private companies, I think that would be a fair statement of their view.

Sir Nutcombe Hume: I think there is a degree of prejudice here. I am after all in my private capacity the chairman of a company which invests in private companies. I have never in my experience, and I think I can say this without fear of contradiction, met a man who said to me: "I am not going to admit you as a shareholder because as a result of doing so, I will cease to be an exempt private company." This is largely prejudice I think. But the administrative difficulty is colossal. I would not have thought it was worth putting it into the Companies Act simply on the grounds that it would be very difficult to arrange that such a provision was complied with.

6450. *Mrs. Naylor:* What about the annual returns which the Act now requires from these companies?—To start with, as we say later on in our memorandum, a very large number of companies have not got, and need not have, fully audited accounts; as long as they are accounts which are accepted by the Inland Revenue as being adequate for tax purposes that is sufficient. And moreover timing is a problem. I have some experience of the small private company, and it would put upon them a very considerable addition to their administrative and overhead charges if they had to comply with a rigid regulation that within x months of the end of their year they should prepare accounts certified by a member of the accountancy profession, to be lodged with the Company Registrar and so on; and it seems to me that the administrative difficulties and expense of that would exceed any value gained from doing so. I am expressing a personal opinion.

6451. *Professor Gower:* What you are saying is that at the moment exempt private companies do not comply with the law; because they have to prepare profit and loss accounts, they have to be

audited, they have to be sent to the members prior to the annual general meeting, which has to be held once in every year at intervals of not more than 15 months; and what you are saying is they do not do it.—I think that is a fair comment.

6452. They ought to do it and is there not something to be said for making sure they do do it?—You have knocked my off stump out of the ground.

Mr. Shenfield: If it involved employing properly qualified accountants it would be extremely difficult.

6453. According to the Committee's information about 90 per cent. of exempt private companies already employ properly qualified auditors.—I am surprised that the percentage is so high.

6454. *Chairman:* That is the result of a sample enquiry which has been made by the Board of Trade for us to see how the matter stood from that point of view.—

Mr. Saunders: I always feel in this country when you find an institution which is working one wants to question very carefully before you decide to change it or to do away with it. Probably many of us would feel that. One has the partnership on one side, and one has what one might call the fully-fledged public company on the other and I believe that the private company is placed in between the two, particularly in the case of what one might call family businesses where there may be many members of the family who do not want and indeed may not be able to take the same close interest that a partner would take in the business, but yet have, by inheritance or in some other way, an interest in it. I think that to prevent that being possible—to require that either you must be a partner or you must be a public company—is probably going to work to the disadvantage of business, because it may tend to develop more partnerships, which probably would be very much better if they were run as exempt private companies. That is why I believe that it is better to leave the situation as it is now and not to impose too much by way of returns and burden on the exempt private company, because I believe it would on balance be a disservice.

6455. It is put again on the other side that if the exempt private company were made to file its accounts, there is more likelihood that the little private company would comply with the law about accounts and would keep them up to the mark, if you see what I mean.—Yes. It is tremendously in the interest of the members of the private company that that does happen, and they are primarily the people who are concerned.

6456. Apart from creditors.—Creditors, yes. It is not as if there were a body of shareholders whose interests were not being looked after, and I just feel, as my chairman feels, that one may try to achieve perfection and may introduce a burden which may more than outbalance the benefit.

6457. Yes. I do not know that we can profitably carry this discussion much further.—I have made the point.

6458. There are the two views, and the question has attracted a surprising amount of interest one way or the other, and the Committee of course will have to decide, and in deciding they will have regard to the point you make, which is of course eminently sound, that where it is suggested a long standing law which apparently has worked moderately well should be repealed, the onus is on those who support that proposition. On the other hand it is said that people who take the advantages of limited liability ought to discharge the liabilities of that state.—I agree.

6459. Then the next point I wanted to ask you about is under the heading exercise of powers of companies by directors and degree of control retained by shareholders. On that I understand your view to be that on a sale of the company's undertaking, or a substantial part thereof, the prior consent of the shareholders should be obtained, or more accurately, as you put it, the transaction should be effected conditionally, the condition being that the company's consent in general meeting should be obtained. I think that is your attitude on that?—*Sir Nutcombe Hume:* Right.

6460. And as to a substantial part you take, say, more than half. I follow that, but I do not think you say anything of

your view about fundamental changes in the company's activities. Have you any view on the question whether the company in general meeting ought to give prior consent to a fundamental change in the company's activities?—We realised when we made this reply it was a difficult one, and we were very anxious not to try in any way to usurp what is the duty of the Parliamentary draftsman here. The Federation believes that if a company substantially, or fundamentally, to use the words here, changes its activity, or disposes of a substantial part of its business, the shareholders should have the opportunity of voting upon that matter. When you ask me what is a fundamental change, it is rather difficult to answer, I must frankly confess. A man who has never made anything but saddles to go on horses' backs decides one day he wants to make seats for motor-cars; is that a fundamental change, or is it not? I suppose it is. To sum up, what we have tried to say is that to be on the safe side it is as well for companies to carry their shareholders with them if they want to do those kinds of things.

Mr. Shenfield: Perhaps we might say that there ought to be provisions in the law safeguarding the rights of the shareholders where the fundamental change in activity involves the disposal of a large part of the assets, but where it does not involve that then it may be undesirable for the law to make provision.

Mr. Saunders: I think one of the problems that a board of directors in England is faced with is knowing beforehand whether something which they are contemplating is going to develop into a fundamental change in their activities, because very often out of small things great developments emerge. I think it would be quite wrong that directors, in addition to the commercial considerations that they have to apply in considering a new project, should be faced with the question: "Is this going to result in a fundamental change in your activities, in which case before you do it you must get consent." Because it might be that the thing would not go forward, and it might well be that they could not tell at that stage. I think that the idea of fundamental change is a very much harder thing than

when you are talking of a clear-cut disposal of a substantial part of your undertaking.

6461. Perhaps we could get at it this way, by being more specific and making it any transaction involving a fundamental change. Some specific sale or purchase to which you could apply or not apply the adjective "fundamental", if you see what I mean, because I quite appreciate your difficulty. To take the same example with the saddles and motor-car seats, you might have an intelligent employee in your saddlery who observes that a motor-car seat from the manufacturing point of view is not so very far removed from a saddle, and that the machinery that you have to make your saddles could without great cost be adapted to make motor-car seats, and the managing director is pleased, and he says: "All right, George, you give it a trial" and he works it out into a bigger thing than the original business. That is the type of case where you feel difficulty, and I think everyone feels difficulties of that sort on this proposal. On the other hand most people agree if it could be done it would be quite a good thing to do. Is that a fair statement?—*Sir Nutcombe Hume:* I think we would agree with that proposition, if it can be done. On the question of disposal of the assets and the undertaking, or a substantial part thereof, you could I suggest have a more precise definition of what that means.

6462. It would be easier to pin it down to the particular transaction.—Quite so.

6463. I do not know that we can carry that much further. Then we have had a good deal of discussion on the question whether, on an issue of shares for cash, they ought, saving all just exceptions, to be offered in the first instance to existing shareholders.—That is a difficult one. I would be sorry to see that enshrined in the law personally, because there are cases in which the issue of shares for cash to a selected new shareholder would be a great advantage to the existing shareholders.

6464. *Mr. Brown:* Could their consent not be obtained?—Yes, but it would mean the disclosure conceivably of a transaction which would be better not

disclosed in the interests of the company concerned. I would plead for the law as it stands today not to be altered in that regard. I do not see that it would be an advantage, to make that compulsory. I do not know personally of any abuse, certainly of no substantial abuse of the rights that exist today.

6465. *Chairman:* You see the argument is, of course, as you perfectly well understand, that you have, say, 500 existing shareholders holding all the ordinary share capital, and then if somebody else is let in he may completely alter their position, both as to control and as to dividends.—That, Sir, is in the hands of the original shareholders in the sense that they could have denied to the company the authorisation of unissued capital. They did it with their eyes open. They left a balance of unissued capital in the hands of the directors. They may have done it without realising what they were doing, but none the less that was the point at which they should have said: "No unissued capital. You must come back to us for permission to increase the authorised capital." If there is authorised but unissued capital, to say that it shall be the law of the land that that unissued capital if it is to be issued for cash shall as a matter of law be offered in the first instance to the existing shareholders I think would create more difficulties than it would solve.

6466. Then, you see, you would make the rights of the shareholders depend on the accident whether the amount of capital likely to be required was over-estimated or not when the company was formed.—I would agree with that.

6467. If you had to raise fresh capital, then, of course, the shareholders would have to come in under the Act to resolve on the increase, and they could then make their terms as to a *pro rata* offering.—I agree. I admit that this remedy is a very rough one, but I can see difficulty on the other side. Suppose a company has a block of unissued capital, and has the opportunity of securing a shareholder, and as a customer, shall we say, Marks & Spencer, who say: "If we may take up 50,000 shares of your company you can reckon we shall buy your product." Is any board of directors going to say to

them: "You must not do it"? The directors seeking to do their duty on behalf of the company as a whole see in this a wonderful opportunity of securing a new customer, but under the suggestion now made they would be prevented from doing it.

6468. All they would have to do then surely would be to send out a notice of meeting to the shareholders explaining what they intended and seek approval by resolution.—If they had to seek special permission to issue shares to AB & Co., how might that affect them *vis-à-vis* their other customers? It is not always very wise, and I can speak from personal experience in the group of companies with which I am concerned, to advertise to the world that you are securing a customer of a certain type, because there is a possibility that other customers will say: "I see they are starting to do business with AB & Co. who are our competitors, and therefore we will no longer deal with them." This is a very difficult problem, as a practical matter.

6469. And it comes down to publicity which may wreck your whole scheme, I suppose?—Exactly.

6470. Or one might add delay which will involve the other party going off.—I do not attach so much importance to the delay point as to the first point you made.

6471. Then it would be right, would it not, in such cases to report the matter to the shareholders?—It may very well be so, but without necessarily going to the point of mentioning the names of the people concerned. To secure raw material supplies, or even the services of an individual, it might be an advantage to allow the subscription of a block of capital; although I do not put these points very high amongst the reasons for our suggestion.

6472. Would you look with any more favour on a provision of this sort—that is to say the offering of shares, issued for cash, *pro rata* to shareholders—if it was in the articles rather than in the Act itself?—I suppose my answer must be yes, because the articles can be more easily altered than the Act.

6473. It has been suggested in the course of our discussions that a sort of

half-way house on some of these things, which are thought desirable but are hardly suited to permanent legislation, might be to deal with them in a new Table A, which would be a pointer to people concerned as to the kind of provisions well thought out articles ought to contain. Do you think there is anything in that idea?—I think there is quite a lot in that idea. I am not quite sure whether you are seeking here to deal with an abuse which has been represented to you. I am not personally conscious of this particular right having been abused to any material extent.

6474. *Mr. Bingen*: There has been a case, not of abuse in the sense of anything immoral or illegal, but where a company has decided to issue a block of 40 per cent. of its shares well below market prices. You know the case I am referring to. I think it is because it has arisen and that it is unfair to the existing shareholders that this issue has been raised with this Committee.—Yes, I would agree.

6475. The shareholders might have agreed.—By and large I would have thought it was wrong to put this provision into the law. The Chairman's suggestion of having it in Table A might, I think, be a very satisfactory compromise although it is likely that the majority of companies having their own articles would probably omit such an article.

6476. *Chairman*: Yes, the expert company solicitor streamlining his draft articles would very likely take out this as unnecessary.—Yes.

6477. But such a provision was actually in Table A down to the 1948 Act. It was taken out, I understand, over some question of tax on bonuses, so it must have been thought at one time to have been not wholly unreasonable.—*Mr. Cottis*: This point was discussed at some length in the meetings of the Federation's committee, and it was decided in the end that, though we realised that the power could be misused, it was not practicable to make any rule about it.

Sir Nutcombe Hume: The taxation decision which has recently been given on giving options to employees, may have some effect on this. I noticed only yesterday in the newspaper that one quite

well-known public company has decided to give to its employees an opportunity to buy shares.

Mr. Bingen: I think the Chairman, when he put this question, spoke of "saving all just exceptions", and speaking for myself I thought we were discussing big block issues, and not some minor one to employees.

Chairman: I am much obliged. I did indicate that.

6478. *Professor Gower*: Do you think the possibility of giving directors stock options is an abuse which we ought to try and stop? I thought you were using this as an example of encouragement to abuse the present law. Did I misunderstand?—You misunderstood me; I do not myself personally subscribe very strongly to this idea of stock options.

6479. *Mr. Brown*: You do not subscribe?—I do not, as an individual, subscribe at all strongly to it. If the employer pays and provides for his employees properly it is not necessary to give them the incentive of the stock option; but that is a purely personal expression of opinion. The point raised by Mr. Bingen, of course, can only be met by the very first point I made, that shareholders have it in their power to prevent there being a large unissued block of capital.

6480. *Professor Gower*: How do they have this in their power? If you have a capital of £1 million and the directors offer for issue £500,000, leaving £500,000 unissued, what can the shareholders do?—Not subscribe for the shares.

6481. That will really only leave a still larger block of unissued shares.—If they can get someone to underwrite the issue, of course, there will be a block unissued.

6482. *Mr. Richardson*: In practice it does not work like that, because you do not start off with an original capital of that size unless you mean to issue it.—The Stock Exchange has something to say on this, has it not? They do not like large unissued blocks of capital, and if there is one I think I am right in saying that they ask that it shall not be issued to a single

buyer so as to alter the incidence of control—I am afraid I am not familiar with the absolute details. But to that extent this matter is being attended to today under the law as it is, and I should have thought that would have been adequate.

6483. *Chairman*: Perhaps we could pass from that subject. As with all the other subjects there are two views, and we shall find some not altogether easy to reconcile. Our next point is a different one—directors' and officers' dealings in their own companies' shares. On that topic I gather you would be in favour of having the register of directors' dealings under section 195 open at all times during the usual business hours like the register of members?—We would like any step taken, Sir, which will rapidly disclose dealings of directors in the shares of their own company.

6484. And the section 195 register, given that it is open long enough, should fill that need?—It is about the only way we could suggest for doing it. We can think of no other.

6485. Would you favour a summary of the contents of the directors' register being sent out to the shareholders with the directors' report?—When I gave my evidence in a personal capacity to the Cohen Committee in 1946, I made that suggestion myself.

6486. *Mr. Bingen*: Would this register of directors' shareholdings show dealings where a man bought and sold within an account?—No, it would not, nor would it show the dealings that you persuaded your cook to undertake.

6487. It would relate solely to dealings by the director himself? The fact that the director's name has never got on to the register does not let him out of the fact that he has bought and sold the shares.—I would agree with that: but how one is going to find out is another thing altogether.

6488. *Chairman*: Anyhow something could be done in that direction.—The Federation in its corporate capacity, I in my personal capacity, and all of us feel strongly on this: if something can be done to prevent directors dealing in shares of

their own company on the basis of privileged information, it should be done. We realise that this is a terribly difficult thing about which to legislate.

6489. You no doubt observed in *The Times* I think it was some days ago a rather impressive list of rises in the prices of shares concerned in take-over bids before any announcement of the offer.—That does not necessarily mean individuals were playing the market. If any company intending to bid for shares clears the market in its corporate capacity, as a company in advance of its bid, it is a very different thing from individual directors round the board table doing it for their own account.

6490. I agree. These figures would not prove the directors were doing anything improper, but it proves somebody is availing himself of information about the forthcoming bid.—Agreed. Of course, a director who buys for his own account, or who tells his friend to buy is in my opinion equally culpable, there is no difference between the two; but if the purchaser is the company itself, and it buys such shares as are available in the market, is it necessarily acting dishonestly or dishonourably?

6491. *Mr. Althaus*: It might also be the intended victim.—Yes.

6492. *Chairman*: On the same subject, what do you think of the law in the United States, or some parts of the United States, under which directors have to account to a company for profits on short-term dealings—say six months?—I think it is quite a good sanction. I do not object to it at all.

6493. You would not mind?—Personally I would not mind in the least, because I think if anybody does that kind of thing as an individual any punishment you can inflict upon him is well deserved.

6494. That will be taken down and used in evidence!—That is one of the reasons why I never myself buy or sell shares in any company with which I am connected.

Mr. Shenfield: They would have to be realised profits.

6495. *Professor Gower*: In the United States too they forbid short sales by

directors. You must not sell more shares in your company than you have got. Do you agree with that?—*Sir Nutcombe Hume*: I think it is even more criminal to sell on the knowledge of bad information than to buy on the knowledge of good information. I would subscribe to that very cordially.

6496. *Chairman*: You say that this register should be open to inspection by the public. Is there any particular reason for that? Is it not enough if members are given the right?—It should be normally open to the public.

Chairman: There is not very much in the point, but I should have thought if it was open to the inspection of shareholders that would suffice.

Professor Gower: With respect there is a point here, because one of the people who might well want to see it is the shareholder who has sold, and he will cease to be a member at this stage, and that is one advantage of saying the public.

6497. *Chairman*: I am obliged. That is an example of a case where it might be desirable for a member of the public and not a shareholder to inspect.—The register of members is surely available to a member of the public, who can go and pay his shilling, or whatever it is, and have a look; and that is what we meant by these recommendations. Admittedly it is rather a slow process, because the annual return is always in arrear, and is not therefore as quick in operation as is desirable.

6498. It would be available to the public in the end.—Precisely. I do not think we considered that the dealings of directors should be more quickly available to the public than the dealings by any other shareholder. But I think the information should be available, at the company's offices presumably, to a shareholder who comes along and says: "What have the directors been doing in the shares?". Our secretary says that we did mean the public so that the financial journalists can have access to the information fairly quickly. I would not object if that was what was done.

6499. It is not a point of major importance, but it would have to be

settled in one way or another.—To sum up our views, anything which you suggest should be included in the law to make it more difficult for directors who deal in their own shares on the basis of inside information, the more we should be in accord with that.

6500. That brings me to shares with restricted or no voting rights. You are not in favour of legislation to abolish such shares, but you say one should leave it to the Stock Exchange to exercise their discretion. As against that the line taken by the Stock Exchange is I think that they would not go so far as to deny a quotation to such shares, but would prefer to see the matter dealt with by legislation, so far as there is any question of abolition that is to say, so you get two opposed views on that.—Well, Sir, despite what the Stock Exchange say I think we stick to our view that it is better left in their hands than that an attempt is made to deal with this matter in any new Companies Act. If I may make a general statement, we feel that once a matter becomes an Act of Parliament you get to that stage where people are able to go 99.9 per cent. and remain within the law, whereas the flexibility associated with decisions by such bodies as the Council of the Stock Exchange or the Institute of Chartered Accountants, is much more appropriate in certain cases, and this is one in which we think the flexibility of the Stock Exchange control is more appropriate than attempting to deal with this matter by law.

6501. Then if the voteless share is really a bad thing, I suppose you say in the long run there will be no demand for it, and they will gradually fade out—that is a possibility?—They would not get a quotation. I believe I am reflecting the views of all the reputable issuing houses, when I say that they will not undertake the flotation of shares which have no voting or restricted voting rights. It would be no surprise to me to see the Stock Exchange refuse permission to deal in such shares but in such circumstances we must realise we are dealing only with those companies which seek a Stock Exchange quotation, or seek the assistance of an issuing house in the flotation; we

are not dealing with the company which is privately established and financed.

6502. *Mr. Bingen*: Is there not a case in today's paper of an issue with restricted voting rights which is properly sponsored?—There is, and frankly, I am surprised to see it happen.

6503. I presume they will get a quotation?—Yes. I expect so.

6504. *Mr. Lawson*: What is the real objection to this. You do get the situation, do you not, of a private company building itself up and wanting to develop further, and therefore wanting more capital. If they go ahead and give voting rights to all shareholders, within a week or two they will probably get a take-over bid from one of their competitors. How are they going to protect themselves from that sort of thing?—By issuing a different class of capital. It is a very, very difficult question to answer. This goes back to the old management shares of 30, 40, 50 years ago, and, of course, today's issue, to which Mr. Bingen referred, is in fact the old management share, the plural voting small equity, but in this particular instance otherwise enjoying precisely the same rights that the publicly held shares enjoy.

6505. *Chairman*: Of course, the old management share was I think generally directed to the question of death duties, was it not?—No, Sir. They were introduced long before death duties were a serious threat. It was with this idea of the family being able in the ultimate to control the company.

6506. They used to create a management share which father had during his lifetime, and during his life it carried all the votes but did not have a dividend; he had a large salary. When he died it was turned by provision in the articles into an ordinary share.—They had all kinds of rights attaching to them.

6507. Of course that was at one time a very successful method of avoiding duty.—I think it would be very wrong to say as a matter of downright opinion that the holding of a block of capital by a selected body of persons is necessarily against the public interest, or against the interests of

the company and the rest of the shareholders; this is Mr. Lawson's point. The risk of getting a take-over bid a short time after flotation I suppose may be regarded as one of the reasons that might justify the issue of voteless shares.

6508. Of course there are a number of arguments pro and con the merits of these shares.—On the whole I would be inclined to leave the law as it is, and leave it to the good sense of people to shun those issues of companies which seek to exercise rights of this kind unfairly.

6509. *Mr. Brown*: Carrying your recommendation a little further, you appear to visualise the Stock Exchange would exercise discretion; refusing quotations in some cases and not in others; refusing quotation for any share if they do not think the holder of such a share will be adequately protected. Can you suggest any lines on which the Stock Exchange or anyone else can select at the time of creation or issue, so that the shareholder in that case would be adequately protected.—It is awfully difficult, Mr. Brown, I do agree. I think there might be a kind of rough and ready rule, that the retention of a right of control without adequate financial stake in the consequences of exercising control is a kind of yardstick. I would be very sorry to see the Stock Exchange ever give permission to deal in a block of ordinary capital where there was but one share which had a million votes against £900,000 of capital that was issued publicly, carrying the equity benefit and burden. That might be an example of an extreme case. I would have thought that the Council of the Stock Exchange, or the Issuing Houses Association or a great institution like your own, which has a necessary part in most people's public issues, could be left to exercise judgment here. The case of today's issue is a very fair example; far be it from me to ask whether you are going to subscribe or not! It is just that kind of case where public opinion I think must be left to be the best judge.

6510. *Chairman*: The problem really is more important with quoted shares than with unquoted ones.—With unquoted shares the recommendation we make does not hold water; it does not arise.

6511. But do you think the objections to voteless shares are less cogent with respect to shares in an unquoted company than they are where its shares are quoted on the Stock Exchange?—Yes, I suppose so. Mr. Brown may be better able to answer that question; the Prudential has just got through a scheme dealing with changes in voting rights.

6512. *Chairman:* My next point arises on paragraph 9 of your memorandum, the protection of special classes of shares, and that links up, I think, with what you said about the issue of shares *pro rata*. It points out the serious consequences there may be to a class of share by issuing shares of the same class or carrying the same rights. You discuss that, and then you say:—

“A compromise, which would be considerably more satisfactory than the present position, would be for the voting powers of all future issues of shares to be based on their nominal value.”

I wanted to ask a general question. Are not the kind of matters dealt with in that paragraph more appropriate for the articles of any given company than they are for legislation which would appear in the body of any new Act?—Yes.

6513. It is impossible to legislate in advance for every kind of capitalisation that might be thought desirable.—I am sure we all agree with that.

6514. Your views there would involve the repeal of article 5 of Table A, I think, which is the one which says that the creation of shares carrying the same rights is not to be a modification of the rights of the class unless otherwise provided in the articles. You would do away with that, would you not?—I think the answer to that is yes.

6515. You deal later on with the Board of Trade's powers to appoint inspectors and you, like many other witnesses, would favour any feasible scheme for making the operations of the Board of Trade in the matter of appointing inspectors work rather more quickly and effectively than at present?—Yes, that is so.

6516. You make a suggestion that there should be two classes of inspection, one

carrying a big stigma and the other a little stigma, or relatively so. Do you think that would really reduce the overall stigma to any appreciable extent?—It is very difficult to answer your question.

6517. In the one case the Board of Trade would appear in the guise or uniform of a policeman, so to speak, and in the other of the plain clothes detective or private inquiry agent, or something like that.—I accept your view, Sir, but it does not alter the fact that there should be devised, in our opinion, some form of demanding disclosure in cases which are not so bad or so patently bad as to throw up the stigma of criminal action. I was warned by your Secretary that you were going to ask a question on this and I have been trying, in the last day or two, to think out how I would answer this question. I have not discussed this with my colleagues. It might be that an inspector from the Board of Trade could be a man who was a relatively ‘little stigma’ man, and if you wanted the ‘big stigma’ man it would not be the Board of Trade at all but someone like the Director of Public Prosecutions who would make the appointment. But to say the Board of Trade should have two classes, class A which is not a bad man and class B which is a bad man, is I agree a very difficult one. One can understand the Board of Trade would be very reluctant to take steps to put the cross against a company. It might best be dealt with if there were two different departments which had these two separate responsibilities, and people might in the course of time become accustomed to a Board of Trade inquiry being something through which it was not particularly reprehensible to have to go. Obviously it would be somewhat of a stigma, and perhaps rightly.

6518. Do you think there is anything in the possibility of having some form of Board of Trade inquiry, or appointment of an inspector, which would be done privately?—I gravely doubt whether in fact it ever would be able to be done privately; the Press or somebody would find out. The idea that these things can be done privately are all right in theory, but in practice it is difficult.

6519. The income tax people manage to do it, do they not—or do their best to?

—Yes, I think they do, but is it an analogy?—I do not know.

6520. Possibly not.—*Mr. Saunders*: I think it also imposes a very difficult burden on the directors themselves *vis-à-vis* their shareholders. They know that there is this sinister figure in the corridors, and if the shareholders knew it or the public knew it they would draw the inference about the stigma. That is why we felt it was not a bad thing to have some kind of inquiry which you would be able to make public, and you would be able to say—"We are having an investigation", and it would be known, as Sir Nutcombe says, as an investigation which did not deal with criminal matters. Quite obviously you do not want the police looking for somebody who "can assist them in their inquiries", as in the case of murder; that would be a stigma. If there were two departments it would help. If you had to hush it up it would be very difficult.

6521. I think there would probably be a rumpus in the Press, although secrecy would be wholly for the benefit of the suspected party and for the company as a whole.—"It is interesting to know Mr. X has visited the offices of Y company now four times; he is employed in such and such a department." Those are the things which I think are terribly difficult. Put it the other way round; this question of the director knowing there is this thing hanging over him. I think it is not a right position to be put into.

6522. It is certainly a very difficult question.—*Sir Nutcombe Hume*: It is a very difficult question, Chairman, and I think all we really want to say to you is that, as the law stands at the moment, it is unsatisfactory; something must be done about it. What we are not quite clear about is precisely what should be done.

Mr. Saunders: I do feel, going further, the Board of Trade have been given powers; they are not in fact recognised as a part of the criminal investigation. Somehow gradually these powers have tended to be exercised only in this particular sphere. One gets the impression the Board of Trade is very reluctant to take any steps unless there is a very strong *prima facie* case that there is something to

be investigated. If that could be swept aside, and it could be made plain the Board of Trade investigations would be more numerous and not only after there was a very strong *prima facie* case, a good deal of this difficulty would be got rid of. If it was again made plain that no investigation for criminal proceedings would take place except after reference to the Director of Public Prosecutions, I think that would help. I think people are not happy that they should be subject to prosecution originating from a Ministry which is not necessarily concerned with prosecutions.

6523. We will have to see what can be done about that. The next matter is disclosure of beneficial interest and financial control. I do not think we need go into that at any great length. Your view is that any system for securing the disclosure of beneficial interests would necessarily be too complicated to make it a practical proposition; that is really what it comes to I think?—*Sir Nutcombe Hume*: That is what it comes to. This was discussed in great detail in the Cohen Committee. Everyone would like to see some machinery established, but it seems impossible to do so.

6524. There again you come back to the inspectorate sections and say there is the machinery for ascertaining beneficial interests, if only it could be operated rather more speedily.—No Sir, we go so far as to say we cannot see the inspection machinery as it is today, or as anybody is likely to be able to devise it, will achieve this object. In the end you come up against a company registered in say, Bermuda, and there you are stuck because you cannot look behind that company.

6525. I am sorry, I got it wrong; I thought you said something might be done in the way of calling in the Board of Trade.—I agree we do say that; but it will not catch the man who is out to avoid it; that is our difficulty and it is a practical difficulty.

6526. *Professor Gower*: The Board of Trade have pretty effective sanctions; they can freeze the shares. If they do not get any information there can be an order: no dividends, no voting rights on the shares in question. This, I should have

thought might in the end get behind your Bermuda company.—It might. If they applied that once or twice and made it public that they had done so, it might have that effect. We do not want the law to lay it down that all nominee shareholders are necessarily uncovered, but that there is a right to uncover them.

6527. Would you see any objection to a provision that when shares are registered you have to say whether you are holding them as beneficial holder or as nominee or trustee, so that on the register there would be "B", meaning registered in the name of the beneficial owner, or "N" or "T", registered in the name of a nominee or trustee?—I would not object but do not know if the banks would give the same answer.

6528. This would not impose any great burden as I see it. It would meet some of the objections which have been raised to the present system, that you never know whether people are nominees or not.—*Mr. Saunders*: I think our point has been that you can lay down these systems which every helpful and honest person complies with carefully, but you do not in fact deal with the evil. I think that was the gist of the Cohen Committee's report. What we thought in our reference to the Board of Trade here was that you will not get rid of this abuse by laying down regulations. If the Board of Trade carry out an investigation it is much more likely that experienced inspectors will be able to form an opinion and as you suggest, Professor, take an attitude about a particular holding.

6529. I should have thought as long as there are some sanctions this is the kind of thing that is sooner or later going to be discovered—if there are sanctions.—We think this machinery can apply it, if the Board of Trade uses it, and do it better.

6530. It is perhaps a tremendous steam hammer to crack what may be a very small nut. You say yourself the Board of Trade inspectorate is a thing to which considerable stigma is attached.—I would disagree, with respect. This is a case where the Board of Trade can make quite plain what they are going to inquire into. For instance they can say, openly,

that it is alleged there are undisclosed or undesirable nominee holdings and they wish to find out what the position is.

6531. The argument in favour of disclosing whether there are nominee holdings is not only directed to the undesirable ones. The economists say—"We want to know who owns British industry, and we cannot find out."—*Sir Nutcombe Hume*: In any event, that sort of investigation does not cause a stigma on the company concerned. The company may say to the Board of Trade—"We are as anxious to know as you are"—and that is quite a different proposition from the investigation we were talking about earlier.

Mr. Saunders: If there is a *prima facie* case and the register is not a frank statement of who the shareholders are, I do not believe the Board of Trade would do very much better by saying to everybody—"You must speak the truth"—because there will still be people who will not speak the truth, and you will not be any further.

6532. *Chairman*: The suggestion has been made that directors of companies might be empowered, if they had reason to believe that any substantial quantity of their shares were being dealt in in the names of nominees, to refer the matter to the Board of Trade to put their machinery in operation. The difference from the existing law is that it would empower the board of directors to do it as well as the prescribed minority of shareholders. I do not know if that is any great improvement.—*Sir Nutcombe Hume*: I see no objection to that, Sir.

6533. It is a possibility anyhow.—I thought the purpose of your question was to find out whether we had some suggestion for putting teeth into the Board of Trade in this matter, but if they have already got the teeth but are not using them, the sooner they use them the better.

6534. If the Board of Trade came in on this suggested request from the directors then the Board would come in with all this machinery, including the power to freeze the shares.—Of course there have been cases—I have not infrequently been faced with them myself—where shares are registered in the name of a bank, and

there is a good deal of anxiety generated as a result of that. People are wondering whether somebody is building up a holding in order to acquire power and seek to exercise control, upset the management, and all the rest of it. There are cases in which a board of directors might properly go to some authority and say—"Will you please find out for us who is buying the shares." If that is at the back of your question, Chairman, I would agree with it.

6535. That is the general idea. I think we will have to leave that at a not very satisfactory position. I would like you to tell us something next about take-over bids. First of all, what is your view of the Board of Trade's recent regulations on that subject, the rules made under the Prevention of Fraud Act?—Without having them in my head line by line, I should have thought they were as good as could have been expected in the circumstances and in the time available; just like the issuing houses' advice on the same matter. I am very much afraid the words "take-over bid" have become distorted and misused. The take-over bid, if it is another way of describing an amalgamation or merger, has gone on ever since the first Companies Act came on to the statute book in the middle of the last century. It is the basis upon which our banks, insurance companies and many other institutions have been built up, and thus exercised is wholly desirable and to the advantage of all concerned. It is only in recent years that the aggressive kind of take-over bid has crept in, and has now been made the subject of a great deal of apprehension, alarm and so on. I think we have got to be quite clear; when you talk about take-over bid you mean this aggressive, offensive take-over bid over the heads of the directors?

6536. I do not think we mean only the kind of transaction where somebody comes in in the last act with their pockets simply bulging with scrip and says—"Here you are; now I own your company." We mean in fact offers to shareholders generally, in respect of any shares, with a view to obtaining those shares.—The negotiated amalgamation, whereby for convenience company A in fact buys the shares of company B. Is that what we are talking about, because in that event

I cannot see anything wrong with what is going on today and what has gone on for 100 years. It is a perfectly satisfactory arrangement.

6537. It means any kind of offer intended to result in the acquisition by the offeror of the shares in question or the majority of them.—If the offeror is offering his shares in exchange for the shares of the offeree we think the offeror should disclose such information about his company and therefore of the value of his shares as the law at present demands under the prospectus provisions. That is what we have said.

6538. *Mr. Lumsden*: It has been suggested it would be unduly onerous to provide a full prospectus in such cases and the position is adequately safeguarded by the fact that the circular making the offer either has to be approved by the Board of Trade or issued by an exempted dealer.—I do not agree with that representation that has been made to you. If you are offering bits of paper in your company in exchange for the cash of other people you have to tell them what the bits of paper are worth and all about them. If you are offering bits of paper in your company in exchange for bits of paper in somebody else's company I cannot see how the basis of the transaction is altered at all. The bit of paper instead of being a pound note is a share certificate; that is the only difference.

6539. *Chairman*: The Board of Trade rules define a take-over as follows:

"A take-over offer means an offer to acquire securities in a corporation made to more than one holder of those securities calculated to result in any person acquiring or becoming entitled to acquire control of that corporation, and for the purposes of this definition where two or more persons hold securities in a corporation jointly they shall be treated as a single holder."

—That is all right; that fits in very well with what we have been discussing.

6540. It is not altogether easy to follow at first reading, but I think it is reasonably plain that these rules, which cover the field which we intend in our reference to take-over bids, cover the whole of the old ground of amalgamations and mergers.
—Quite.

6541. *Mrs. Naylor*: I think it also includes the type you find offensive?—I think this discussion really should be divided into two parts, what you might call the negotiated transaction—after all I suppose there are many men sitting round this room today who have had much experience of amalgamations, where it nearly always happens that company A and company B by their directors, or chairman or managing director, meet and say it would be a good thing to get together and work together because there would be certain advantages in doing so. They say—"What is the best way of doing it; shall my company buy your company, or shall your company buy my company, or shall we form an apex company which offers for the shares of both?" As a result of consulting professional advisers it is decided, because of the capital structure, because of some taxation advantage or otherwise, that company A should buy company B, or alternatively company B might buy company A. If the sale to company A of company B for shares and not for cash is decided upon the shareholders of company B are, in my opinion, entitled to know the size and shape of company A whose securities they are asked to accept in exchange for theirs. But it is mere fortuity that that company A happens to be the buyer and not company B or company C which is at the apex.

6542. *Chairman*: Your suggestion is to make some special provision for the case of amalgamations and mergers negotiated between boards of the companies concerned?—Where shares are exchanged. The man who is receiving the shares of the buying company should have a proper description of the buying company and the prospectus provisions now seem to cover that very well.

6543. *Mr. Bingen*: He also requires some information from the directors of his own company as to their views.—Of course he does, but you do not have to put that into the law.

6544. *Chairman*: I should have thought you might well want to.—No, surely not. You cannot lay down by law that the directors of company B shall offer advice to their own shareholders.

6545. There is nothing in these Board of Trade rules to prohibit amalgamations and so forth of the kind you have in mind.—Exactly; it would be very wrong if they did.

6546. What they aim to regulate is the less formal transaction—I am not saying it is anything but a harmless, innocent one—which works the other way round and starts on the initiative of an outsider.—The outsider, you mean, who is, so to speak, shunned by the board whom he approaches and says—"We will not have anything to do with you"?

6547. The board know nothing of the man, I am prepared to assume.—If he is prepared to pay cash you do not need to know much about him, except that he has the cash.

6548. The board know nothing of the man until they receive from him the notification of the bid he is proposing to make for the shares of the company.—In that case what we say is, if he is offering cash he must give evidence of the fact that he has got the cash. If he is offering shares the point does not arise because he is not offering as himself, he is offering on behalf of some company that has got shares and that therefore comes under the first definition.

6549. *Professor Gower*: You are making the point, as I understand it, that wherever a person is going to end up with shares in another company, for which he is going to pay in cash or in shares in his existing company, he should be given the same information about the shares in the new company as he would have been given had a prospectus been published?—Precisely.

6550. The anomaly, as I understand it, at the moment is that whichever way the amalgamation takes place, he will not get precisely that information, and the information he gets will depend on the method of amalgamation adopted. If it is by a take-over bid, then he will get such information as is required under the Board of Trade Regulations. If it is done under sections 206 or 208 of the Companies Act, then he will get such information as the Court in its wisdom thinks he should be given. Your argument, I understand, is whatever the

method, since he is being asked to pay for shares in a new company, he should be given the same information about the shares in the new company as he would get had a prospectus been published. Is that a fair statement of your view?—I think perfectly fair. Mr. Saunders has suggested, Chairman, we ought to make some reference in this context to the protection of employees of the company. I am bound to confess, speaking personally, I find it a little difficult to suggest that the law should deal with this point. It is a matter of good practice. I do not see, out of hand, how the law can say the employees of any company which is taken over shall be protected in some way or other. After all, the object of many amalgamations is to streamline the management and to enable more work to be done by fewer people.

6551. It could be argued at the moment the law prevents good practice; the *News Chronicle* case. An injunction has been granted preventing the *News Chronicle* from distributing among its employees money which it thought they were morally entitled to as compensation for loss of pension rights, and so on.—Is that under the Companies Act?

Professor Gower: It is under company law.

6552. *Chairman*: If there were pension rights there would be no difficulty, because the pension rights would be taken over and dealt with. May we just look at a few points on take-over bids? Various suggestions have been made; one is that bids should be for all the shares outstanding, that is to say, the bidder should not be able to say—"I am only going for 75 per cent.", or whatever it might be.—I am not sure. There are two ways of dealing with that. The bidder can say—"I close off my bid when I have got 75 per cent., and the people at the top of the queue get the advantage and the people at the end of it do not get the advantage."; or he can avowedly say at the start—"I offer for 75 per cent. of everybody's holding." In the latter case it does not seem to me to be necessarily objectionable; he makes it perfectly plain from the start what his bargain is. If a man says—"I offer to

buy half your holding in the AB company"—you know what he is saying. If he says—"I met a man down the stairs; I am going to buy his shares and am not going to buy yours because I happened to meet the other man first" it is a different matter.

6553. I do not think I have made myself clear; the suggestion has been made to us that the bidder should not be allowed to limit his bid to a proportion of the shares, but must say—"I offer for the whole".—That is a matter of bargain, why should he not?

6554. You see no harm in that?—I see harm in laying down that every time the bid must necessarily be for the whole share capital.

6555. *Mr. Bingen*: I suppose the argument for saying you should not bid for less than the whole is that otherwise those left with minority shares are in an uncomfortable position. The man wishing to acquire control should acquire 100 per cent.—I am content to be a minority shareholder in about 90 companies; nobody bothers me. I would hate to find myself forced to sell my minority shares. I think there may be something in the point that the 10 per cent. dissenting minority, which has the right to be bought out under section 209, might conceivably be lifted to a bigger percentage, say 15 per cent. or 20 per cent., but I would not alter the law otherwise.

6556. That leads to the second point which has been made to us, that any non-assenting minority should be entitled to sell their shares to the bidder. That would mean if the bidder got 51 per cent. of the shares then the minority should be entitled to say—"You can take our 49 per cent. which is now a dubious security because we will have to defer to your management."—Yes, with this qualification. If the original bargain was—"I offer to buy 60 per cent. of each shareholding"—I cannot see then that the remaining 40 per cent. of each shareholding should necessarily have any right to demand from the bidder that he should extend his bid to that remaining 40 per cent., because he has said from the start that he was only wanting 60 per cent. If, however, he says—"I make a bid for

the whole of the share capital of this company, and I only am bound if 90 per cent. accept, or such less percentage as I, the bidder, may decide"—which I think is the formula for most take-over bids,—and he closes off at 51 per cent and says—"I want no more"—then I agree that there is something to be said for the balance being entitled to say to him—"You must not stop at less than the amount you were originally prepared to buy."

6557. *Mr. Scott*: You would impose some time limit presumably? Within a month, or something like that?—I agree.

6558. If a bidder offers to buy six million shares which represents say 60 per cent. of the company's capital, you would see no objection to his putting an offer forward on that basis, provided he did not do it on the basis—"I will accept those acceptances that come in first to the exclusion of those coming in later on." Putting it the other way, would you think it right that all acceptors should have an equal chance, so that if he keeps his offer open for three weeks he has then got to deal with all acceptors who come in within that three weeks and cannot say first come, first served?—I agree with that. I do not like first come, first served.

6559. You suggest it should be unlawful to make a bid on the first come, first served basis?—Yes, I think I would go so far as to say that.

6560. *Mr. Bingen*: Would you also agree with the view that if and when an offeror says—"My offer is unconditional"—he is bound to say—"I have x per cent."?—I see no objection to his being bound to say, when he says his offer is unconditional, how much he has got. I would go so far as to say if, as a result of that he says—"I will now stop and will not buy any more"—he must be obliged to go on and be prepared within a time limit, as Mr. Scott suggests, to fulfil his original bargain, which was to buy the lot. In fact, it has normally worked the other way round with take-over bids. A man advertises the fact that he has control and in the same breath says—"I am prepared to go on". That is the

common way of doing it, but I agree it could work the other way and it should not be allowed to do so.

6561. *Mr. Lumsden*: One further point; with the common form of offer to buy 90 per cent. or such lesser percentage as he may decide, there is the possibility that an offeror, having got 20 per cent., may declare it unconditional and take his 20 per cent., by which time somebody else has made a better bid, and he then re-sells that 20 per cent at a higher price to the next bidder; and the people who are caught are the unwary investors who have accepted his offer quickly through their ignorance; the professional investor has not been caught because he has waited until the last minute to see the best bid. It has been suggested that protection might be given by giving power to revoke an acceptance unless the bidder who was offering for the lot did in fact get sufficient shares to give him control; in other words, he could only take these acceptances and treat them as irrevocable provided he had at least 51 per cent., otherwise the acceptor would be entitled to withdraw. Have you any views on that?—I am not quite sure that I follow your question precisely. May I put it back to you in my own words?

6562. Please do.—The bidder makes a take-over bid and his is the only bid for, shall we say, a week. In the course of that week people who are in the habit of rapidly replying to such an approach say—"We will sell to you at, shall we say, 40s." On the eighth day somebody comes out of the clear and says—"I will offer 50s. for these shares". Your point is, should the people who have at that moment of time accepted the 40s. bid have the right to say—"We revoke our acceptance because we are now going to accept the 50s. bid"? Is that the question?

6563. That is the point; at that moment of time the first bidder has not committed himself as to whether he is going to make his bid unconditional, because his offer is conditional on receiving 90 per cent. or such lesser percentage as he may accept; but the person who has accepted his bid has given an irrevocable acceptance which may be treated as irrevocable even though

only 10 per cent. have accepted.—I have got the point exactly. The remedy might be to provide that offers of this kind must be open for a minimum period of x days during which either buyer or seller can revoke his bargain or his offer, either his offer to buy or his offer to sell. Is that what we are saying?

Mr. Lumsden: That sort of thought. The thought I was putting was that acceptances should only be irrevocable in the case of a take-over bid, a bid for control, if in fact control was obtained. In other words, if the bidder started with no shares in the company he would have to acquire a minimum of 51 per cent. before he could insist on the acceptances being irrevocable.

Professor Gower: There are two possibilities. One is that you should say that no acceptor is bound until the bidder has declared the offer unconditional. The less extreme measure is the one suggested by Mr. Lumsden, namely, that you should be bound once the bidder has 51 per cent. if he subsequently chooses to make the offer unconditional. That would have the advantage that he would know where he stood once he got 51 per cent., because thereafter there would be no withdrawals if he chose to make the offer unconditional.

6564. *Mr. Lumsden:* Nobody would be really harmed.—No, I think I am going all the way with you, Mr. Lumsden. I think your proposition is perfectly acceptable.

Mr. Scott: It would be very difficult for the offeror in that case; he would never know how many acceptances he had in fact got.

6565. *Professor Gower:* He would know once he had got 51 per cent.—It is not quite an analogy with withdrawing an application for a new issue. That is the question that is at the back of my mind.

6566. *Mr. Scott:* I rather thought it was the same.—I spoke very strongly about that in front of the Cohen Committee; I thought the withdrawing applicant for a new issue was a perfect curse, he made our trade impossible for us; but this is not quite the same thing.

Mr. Scott: If somebody gets 40 per cent. acceptances, why should he not be

allowed to say—"I have 40 per cent. acceptances and the deal goes through"? Why should the acceptors be allowed to revoke their acceptances? They have entered into an ordinary contract, and I cannot see why it should be said they can repudiate it.

Mr. Brown: Is it a contract when the offer is conditional? It is not a complete contract, only a one-sided contract.

Mr. Scott: Either the acceptor is bound or he is not bound, but if he is bound there is a contract.

6567. *Mr. Brown:* The question is, is it reasonable that such a one-sided contract should stand?—*Mr. Saunders:* I think the important thing that one wants to achieve is that the offer should be the fair price, and the thing that worries me is that you have a man who thinks he will be able to get away with offering less than he believes somebody else is going to offer and will gain an advantage which ought to be really to the benefit of the people holding the shares. There is merit in your proposal which puts the onus on the offeror to be sure the offer he is making is one which is unlikely to be capped by some out-bidder. I think the difficult thing and what one wants to avoid is an offer starting a sort of Dutch auction which creates a disruptive and demoralising situation and is bound to lead the people who are the first acceptors to feel they have been cheated. That is why I believe it would be possible to think out carefully a way of covering this particular problem.

Sir Nutcombe Hume: The case in which I am involved at this very moment conceivably has some lesson in it. We did, as a board of directors, say to our shareholders through the medium of the Press—"We have been offered 42s. 6d. for the shares of this company; the board is going to give you advice presently as to whether they think you should accept it or not." Is there anything to be thought of in the way of putting some kind of lag into the thing? I imagine not; I imagine it would be very difficult to do that because you will not get offerors prepared to be subject to the mere notification that they are prepared to buy the shares.

6568. *Mr. Richardson*: Of course in that particular case, Sir Nutcombe, the offer has not gone out yet, if I understand you rightly?—No, this is a notification that the offer is in the board room, so to speak. I do not know if there is anything conceivably to be learned from that; I rather doubt it.

6569. *Chairman*: In deference to a suggestion made in Parliament we have included in our questions on take-over bids the question whether it should be obligatory that some substantial proportion of the consideration should be in cash. I do not know if you see any merit in that suggestion?—No, Sir, I do not.

6570. *Mr. Lumsden*: You mentioned in your memorandum that you opposed any change in the exemption of banks from some of the accounting provisions of the Companies Act. I do not know if you would like to add any reasons why you have put forward that view?—I disclose my interest; I am chairman of a small bank. The banking methods and system in this country are such a tremendously strong part of the economy of the country that I think it would be a pity for them to have to vary their practices which have grown up over the years. I think it is enormously in favour of the stability of the economy of the country that its banking system should not have to show perhaps considerable fluctuations in its balance sheets and profit and loss accounts from year to year by reason of circumstances outside those banks' control. I am inclined to think it is in the public interest that they should enjoy the exemption that they now have. I am not speaking about the banks themselves, or even their shareholders, in that context. I feel the health of the economy of this country depends to some considerable extent upon the stability of its banking system.

6571. *Mr. Lawson*: What are your views about the disclosure of turnover in accounts? Do you think the Act should provide that all companies or all public companies should disclose their turnover?—No, I do not, because turnover is a very doubtful thing. To start with it is somewhat difficult of definition; in a service company I do not quite know

what turnover is. I am not in the least against the growing practice of disclosing turnover, where it gives some genuine information of help to shareholders, but to make it compulsory to disclose turnover might be very difficult and invidious for many companies.

6572. *Mr. Watson*: I wonder if Sir Nutcombe could tell us what his experience has been in the operation of section 54. You do not actually comment on this and it is perhaps not a very fair question. Have you come across its operation?—No, the only extent to which I think it is used at all is in schemes for helping employees to buy shares in companies. It is used to some extent in connection with pension funds I think. A pension funds holds shares in its own company from time to time. I am afraid I have got to ask you what is at the back of your question. Obviously in an amalgamation if company A has got a substantial cash balance, company B, having got control, also gets control of that bank balance, and to an extent necessarily uses the bank balance of company A to bolster up the overdraft Company B has incurred in buying the shares of company A. I do not know how you are going to avoid that, or even whether it is improper. I am dead against lending money to my own employees or myself to buy shares in my own company; that I think would be utterly wrong.

6573. I was thinking of just the case you have illustrated, two companies getting together.—They pool their cash balances. One company has an overdraft, the other has a cash balance; what do you do about it? The economic thing is to put the two together. If the overdraft has been incurred in the course of buying the shares of the company with the cash balance, what do you do—say you must not use the cash balance for the purpose of repaying the overdraft or the deal must come off? It is an impossible condition to make.

6574. You see nothing wrong in that transaction?—I do not think so. Is it a fraud on the creditors? They are the only people who might be aggrieved.

6575. *Mr. Lumsden*: There might be minority shareholders too.—There

might be minority shareholders. I should have thought today there was no great abuse from that point of view. It would be frightfully hard to legislate against it and not at the same time interfere with legitimate business. After all, one of the objects of amalgamating is to make the best use of cash resources all through the group.

6576. *Chairman*: Thank you.—Now, Sir, may Mr. Saunders make a point not in our memorandum but which has been raised by one of our members since we sent our memorandum in to you.

Mr. Saunders: I am afraid I have only got to know of this point recently. Had I known before I think the right thing would have been for us to submit a further short memorandum to you about it. It is a matter that I understand is causing some concern to members who are private companies, and it results from a decision *re Prenn's Settlement, Trurox Engineering Co. v. Board of Trade* [1960] 3. All E.R. 564. The effect of it could be in certain circumstances to deprive companies which were exempt private companies of their status by the interpretation which is placed upon something in the Seventh Schedule of the Act. I do not want to develop it now because I believe it is much more capable of being put to you, in a short memorandum which gives the reasons for our concern about it, if the Committee would allow us that indulgence.

6577. If you would let us have it in a short time, say the next two weeks?—
* Yes. There is one general thing I wanted

* See supplementary note to Appendix XLIX.

to say if I could, and that is we have felt in our discussions that we do value in the Federation the code of conduct and the standards of morality which I believe are tremendously important in governing company activities, and we see a danger of legislation being too exact in prescribing how people should order their lives. Indeed, I think many of us who have had experience of some of the legislation in America about companies find that they do not in fact cure abuses but tend to enable astute people to find their ways round.

6578. It puts ideas into their heads?—Exactly, so we do believe a great many of these problems can be solved merely by the maintenance of good practice, which is much better left to bodies like the Stock Exchange and the actual conduct of business people. That is why we welcome very much the suggestions you have made about the use of Table A, which can be very valuable in this particular sort of thing.

6579. *Mrs. Naylor*: You would not like to abolish the Companies Act altogether, would you?—No, indeed not, I do believe however that legislation is not the only way of raising and maintaining good standards of conduct.

6580. *Chairman*: It only remains for me to thank you all very much for coming here and giving up so much of your time. It has been a very interesting meeting and we are very much obliged to you.

Sir Nutcombe Hume: Thank you, Chairman, for putting up with us so kindly.

(The witnesses withdrew)

APPENDIX XLVIII

Memorandum by the Council of The Institute of Chartered Accountants
in England and Wales

Introductory Note

1. This memorandum is submitted in response to an invitation dated 15th January, 1960, from the Committee appointed by the President of the Board of Trade under the chairmanship of Lord Jenkins with the following terms of reference:

"To review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable."

2. The Council has decided to comment on most of the 28 heads listed by the Committee in its questionnaire but it would be incorrect to assume from the length of the Council's memorandum that the Companies Act, 1948, has proved substantially inadequate. The Act brought into operation many major reforms and it has worked well in practice. Most of the shortcomings to which attention is drawn in this memorandum relate either to relatively minor matters or to matter such as take-over bids which have assumed prominence since the 1948 Act was drawn up.

3. Except where otherwise indicated, the sub-headings under each head of this memorandum are those shown in the questionnaire issued by the Company Law Committee.

1. Incorporation of Companies: Memoranda of Association

(a) Requirements as to minimum number of members and other conditions of incorporation

4. By reason of sections 1, 2 and 31 of the Companies Act, 1948, a private company must have at least two members and any other company at least seven members. If a company carries on business for more than six months while the number is reduced below the minimum every person who is a member during that time may become liable for the whole of the debts of the company contracted during that time. These provisions appear to be based on the principle that a company is an association of persons, but in practice this is often not the real position. There are in fact many "one-man" companies. One person may be the beneficial owner of the whole of the shares, the other member or members having only a nominal interest. It does not appear to be practicable to attempt to prevent this position and therefore there is no merit in retaining the present requirements.

5. Where a company is a wholly-owned subsidiary the holding company cannot be the only shareholder, because the subsidiary would not have the minimum number of members. In practice therefore there will be one or more persons holding one share merely to comply with the Act. Each such shareholder will usually have signed a declaration of trust and a share transfer which is held by the holding company. There is no merit in continuing this position.

SUBMISSIONS

6. *The Companies Act should recognise what is often the real position and should therefore be amended so that a company need not have more than one member.*

7. If the foregoing submission is not acceptable, the Act should be amended so that the minimum number of members would be two for any company, except that a subsidiary need not have any member other than its holding company.

8. Section 9 of the Act requires the articles of association to be printed. This requirement prevents the use of modern methods of copying documents.

SUBMISSION

9. Section 9 should be amended so that the articles of association shall be in typescript, either printed or copied by other means.

10. Section 2 (1) (b) of the Act provides that the memorandum of a company must state "whether the registered office of the company is to be situate in England or in Scotland". The Council understands that until a few years ago the Registrar of Companies took the view that because of this provision it is not permissible for the memorandum of a company to state that the registered office is to be situate in Wales, but that provided the memorandum states that the registered office is to be situate in England there is no objection to giving an address in Wales as the company's registered office. The Council understands that the Registrar will now accept a memorandum stating either that the registered office is to be situate in Wales or that the registered office is to be situate in England or Wales.

SUBMISSION

11. Section 2 (1) (b) should be amended to allow for a registered office to be situate in Wales.

(b) Limitation of objects to those stated in the memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties and as between a company and its directors. The present method of altering objects

12. No comment is made under this item, but the question of disclosure of the company's main fields of activity and changes therein is dealt with in paragraph 33 under head number 5.

(c) The company as a legal entity distinct from its members—"one-man" companies

13. See the submissions in paragraphs 6 and 7 above.

(d) Shares of no par value (bearing in mind the Government's announced intention to implement the recommendations of the Committee on Shares of No Par Value. Cmd. 9112, 1954)

14. No comment is made as the recommendations of the Committee on Shares of No Par Value were in accord with the submissions made to it by the Council in March 1953.

2. Prohibition of Partnerships with More Than 20 Members

(Section 434, Companies Act, 1948)

15. Before the introduction of the prohibition in the Companies Act, 1862, there was at common law no limit on the number of partners in a partnership. Presumably the change introduced by that Act was designed to ensure that in the absence of a public register of the members of a firm the number of partners was sufficiently small for identification of those responsible for its debts. The position has however been changed by the enactment of the Registration of Business Names Act, 1916, which provides a means for those who have dealings with a partnership to know with whom they are dealing. With that safeguard the enlargement of partnerships should tend to give greater security to the public in its financial dealings with them. Whether members of a partnership may be too numerous to be bound together by ties of mutual trust is considered to be a domestic matter for the partners rather than a

general question affecting the public at large. The Council is not aware of any valid reason for retaining the present limit of 20 or for imposing any higher limit. On the contrary, practical difficulties are created by the limitation and it becomes necessary to form separate partnerships having some partners who are partners in all the partnerships and some who are not. Such associated firms would often prefer to have one partnership of all the partners. In some other countries large firms are permitted, without any known detriment to the public.

SUBMISSION

16. *Section 434 of the Companies Act, 1948, causes practical difficulties but serves no useful purpose and should therefore be repealed. (No view is expressed on Section 429 which prohibits banking partnerships with more than ten members.)*

3. Classification of Companies

- (a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*
- (b) *Nature and merits of distinction between exempt and non-exempt private companies (sections 127, 129, Companies Act, 1948)*

17. The main privileges previously enjoyed by private companies were restricted by the Companies Act, 1948, to companies qualifying as exempt private companies. The Council is not aware of any need to continue to have private companies which are not exempt private companies. It would be sufficient and would simplify the legislation if there were only public companies and private companies, the latter being what are now exempt private companies.

18. Differing views may be held on the question whether a company which has limited liability should be exempt from the requirement to file its annual accounts, but assuming that this well-established privilege is to be continued for exempt private companies the Council considers that the directors of such a company should be required to show that they are complying with the provisions of the Act relating to annual accounts and the audit thereof and that they have no reason to believe that the company is insolvent.

19. Recent experience has shown that the conditions to be satisfied for exempt status are seriously deficient in that they do not prevent an exempt private company from inviting the public to place funds on deposit with or make loans to the company (as distinct from inviting subscriptions for shares or debentures, this being prohibited by the definition of a private company).

SUBMISSIONS

20. *All companies other than exempt private companies should be public companies.*

Note. If this submission were adopted a private company would be what is now called an exempt private company and the latter description would be discontinued. It is however retained in this memorandum.

21. *An exempt private company should be required to file a copy of its annual accounts unless the directors state in the annual return:*

- (a) *that there has been full compliance with the requirements of the Act relating to the preparation and audit of annual accounts and their circulation to shareholders and debenture-holders; and*
- (b) *that they have no reason to believe that the company will not be able to pay its debts in full as they fall due in the ordinary course of business.*

22. *A company should not be an exempt private company unless its articles prohibit any invitation to the public to place funds on deposit with or make loans to the company.*

23. In certain respects the conditions to be satisfied by an exempt private company are unnecessarily and no doubt unintentionally restrictive and should therefore be amended as indicated in the submissions below.

SUBMISSIONS

24. *One of the basic conditions for an exempt private company is that no body corporate is the holder of any shares or debentures. Certain exceptions to this condition are not fully effective:*

- (a) *paragraph 6 of the Seventh Schedule should be extended by replacing the word "shares" by the words "shares and debentures" so that a company is not disqualified from being an exempt private company where debentures of the company are held by another exempt private company*
- (b) *it should be made clear that paragraph 7 of the Seventh Schedule (which provides an exception where a banking or finance company acquires shares or debentures by arrangement with the company or its promoters) embraces not only a subscription for shares or debentures but also a purchase of shares or debentures from a member under such an arrangement*
- (c) *to remove practical difficulties in achieving "exempt" status for a wholly-owned subsidiary of an exempt private company paragraph 6 (1) of the Seventh Schedule should be extended so as to apply to shares held as nominee of another exempt private company in addition to the existing exception for shares held by an exempt private company.*

25. *The other basic condition for an exempt private company is that no person other than the holder has any interest in any of its shares or debentures. This condition should be modified in the following respects:*

- (a) *there should be an exception so that where shares or debentures of an exempt private company are held by a partnership it is not necessary to register them in the names of all the partners*
- (b) *paragraph 3 (1) (a) of the Seventh Schedule should be amended so that the exception for shares or debentures forming part of the estate of a deceased holder is extended to cover also "capitalisation" (bonus) shares issued to the trustees or executors of a deceased shareholder.*

26. One part of the definition of a private company is that it is a company which by its articles restricts the right to transfer its shares. On the death of a shareholder there may be considerable delay in making an acceptable transfer of the shares held by the deceased. Meanwhile the directors, acting in accordance with the provisions of the articles of association, may refuse to register the personal representatives as the holders of the shares with the result that the estate of the deceased (who may have been a controlling shareholder) is prevented from exercising the voting rights which the deceased had by virtue of his shareholding.

SUBMISSION

27. *The personal representatives of a deceased shareholder of a private company should be entitled to exercise the voting rights attaching to the shares held by the deceased unless the articles of the company provide to the contrary.*

28. Section 109 provides that a company shall not be entitled to commence any business or exercise any borrowing powers until certain information and documents have been delivered to the Registrar of Companies and he has certified that the company is entitled to commence business or exercise borrowing powers. The requirements of the section do not however apply to a private company. It is therefore possible to circumvent the requirements by incorporating a company as a private company and then converting it into a public company.

SUBMISSION

29. *If the restrictions imposed by section 109 on the commencement of business and the exercise of borrowing powers are considered to serve a useful purpose they should be made applicable to all companies; but if they serve no useful purpose they should be removed.*

(c) *Unlimited companies and companies limited by guarantee*

30. The Council does not wish to comment.

4. Donations by Companies for Charitable and Political Purposes

31. Donations by companies for charitable and political purposes are permissible only where they are in the interests of the company's business or where specific power to make them is given in the memorandum of association. Where such donations are permissible the authority to make them would rest with the board, unless the articles of association place a restriction on the powers of the board in this respect. The Council therefore considers that legislation is not required on this matter.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders

(a) *Fundamental changes in company's activities*

32. As indicated in paragraph 12 of Head No. 1, the Council wishes to make no submission regarding the limitation of the objects to those stated in the memorandum or on the *ultra vires* rule or the present method of altering the objects. In view however of the almost universal scope of the objects clause in the memorandum of most companies the Council considers that in the interests of the shareholders and of intending investors there should be adequate disclosure of the main fields of activity of a company and its subsidiaries. For this purpose section 157 (2) is not adequate. The section requires the directors' annual report to deal, so far as is material for the appreciation of the state of the company's affairs by its members and will not in the directors' opinion be harmful to the business of the company or any of its subsidiaries, with any change during the financial year in the nature of the company's business or in the company's subsidiaries or in the classes of business in which the company has an interest whether as a member of another company or otherwise.

SUBMISSION

33. *The main fields of activity in which a company and its subsidiaries operate should be stated each year in the report by the directors to the shareholders or in a statement accompanying that report. The report should also state any changes in the main fields of activity since the last report. The Board of Trade should have power to exempt from this requirement if the directors satisfy the Board that it would be harmful to the company to give the information.*

(b) *Disposal of undertaking and assets*

34. The objects clause in the memorandum of association of a company is usually sufficiently wide to enable the company's undertaking and assets to be disposed of without seeking the approval of the shareholders. The Council does not regard this as satisfactory except where the company has a substantial majority interest in the acquiring company. In general the principle should be that the function of the directors is to manage the shareholders' business, not to dispose of it.

SUBMISSION

35. *Before a company disposes of the whole or substantially the whole of its undertaking or of its assets, other than to an organisation in which the company has directly or indirectly a 75 per cent. interest, the company in general meeting should approve such disposal.*

(c) Issue of shares

36. Where a company's authorised capital is in excess of its issued capital the directors may (subject to any restrictions imposed by the articles) issue further capital up to the amount of the excess without consulting the existing shareholders. Such an issue may be in any form permitted by the articles and at any price provided there is compliance with the provisions of the Act relating to the issue of shares at a discount. The terms of such an issue might be unduly advantageous to the new shareholders as compared with the existing shareholders and might also result in the existing shareholders becoming a minority. This unsatisfactory position has recently been recognised by the Council of The Stock Exchange, London, which has stated that the specific approval of the holders of the equity should be sought when it is proposed to issue, to anyone other than the present shareholders, equity capital or securities which are either convertible into equity capital or confer the right to subscribe for equity capital.

SUBMISSION

37. *The specific approval by the company in general meeting should be required for an issue, to anyone other than the present shareholders, of equity share capital carrying voting rights or of non-equity capital with voting rights (other than rights arising only in special circumstances) or of share or loan capital which is convertible into equity capital or confers the right to subscribe for equity capital, if in any of these circumstances the issue is of a significant amount, say more than 25 per cent. of the issued equity capital prior to the new issue.*

(d) Borrowing money and charging property

38. A company normally has power to borrow and to charge its property. It is customary to vest such powers in the board, although they have to be limited if the company seeks a quotation for its shares on The Stock Exchange, London, and they may be limited in the case of other companies. If the directors were to seek to extend the powers vested in them to borrow or charge property, they would have to seek the approval of the company in general meeting; this is considered to be satisfactory.

(e) Lending money otherwise than in the ordinary course of business

39. The directors normally have power to invest surplus funds of a company and this power may be misused to the extent of realising assets of the company and lending the proceeds to a company in which the directors have a substantial interest. In this way the directors may circumvent the prohibition against loans to directors.

SUBMISSION

40. *The prohibition against loans to directors should be extended to cover loans to a company in which the directors of the lending company hold collectively, whether directly or indirectly, a majority interest.*

6. Directors' Duties

(a) Should their duties be stricter and more clearly defined and, if so, in what respects?

41. The Council does not wish to comment.

(b) Are directors generally aware of the legal duties arising from their fiduciary position?

42. The Council does not wish to comment on the general question asked in (b) but it is desired to draw attention to a defect in section 191 as a result of which directors are able to avoid a duty arising from their fiduciary position. Section 191 provides that a company may not make any payment to a director of the company by way of compensation for loss of office without particulars of the proposed payment being disclosed to members of the company and the proposal being approved by the company. It appears that the requirements of this section do not extend to a payment made to a director of a holding company by way of compensation for loss of office as director of a subsidiary.

SUBMISSION

43. *Section 191 should be extended to apply to compensation paid to a director of a company for loss of office as director of a subsidiary of that company.*

(c) *Directors' and officers' dealings in their own companies' shares*

44. Section 195 requires a company to keep a register showing for each director any shares or debentures of the company (and of other companies in the same group) which he holds or of which he has any right to become the holder. The register does not extend to officers other than directors although such officers may have no less opportunity of dealing to their advantage. It is not clear whether the section embraces directors' dealings in options. The rights under subsection (5) to inspect the register appear to be unduly restricted.

SUBMISSION

45. *Section 195 should be amended in the following respects:*

(a) *the scope of the register should be extended to include officers other than directors, for which purpose "officer" would need to be clearly defined; it is assumed that the definition would for this purpose include an auditor*

(b) *it should be made clear that the section applies to dealings in options*

(c) *the register should be open to inspection by the public on the same conditions as is the register of members.*

(d) *Disclosure of directors' interests*

46. The Council does not wish to comment.

(e) *Should bodies corporate be allowed to be directors?*

47. The Council sees no reason why corporate bodies should be prohibited from being directors.

Matters concerning the appointment of directors

48. The Council wishes to comment on the following matters relevant to this head but not covered by items (a) to (e) of the questionnaire.

Appointment of a new director

49. Article 95 of Table A gives power to directors to fill a casual vacancy or add to the number of existing directors. It provides however that any director so appointed shall hold office only until the next following annual general meeting and shall then be eligible for re-election. These provisions could usefully be given statutory force.

SUBMISSION

50. *The provisions of Article 95 of Table A concerning the appointment of a director to fill a casual vacancy or as an addition to the existing directors should be given statutory force.*

Fraudulent persons managing the affairs of companies

51. Section 188 gives power to restrain a person from taking part in the management of a company if he has been fraudulent in relation to the affairs of a company. The effect of the section is to enable an application to be made to the Court to make an order whereby the person against whom the order is made shall not, without the leave of the Court, be a director of or in any way concerned in the management of a company for such period not exceeding five years as may be specified in the order. The Council considers that a person who has been fraudulent, whether in company matters or in similar matters, should be prevented from taking any part in the management of a company except by permission of the Court.

SUBMISSION

52. *Section 188 should be amended so that any person described in subsection (1) or any person who has been fraudulent in a similar manner (such as fraudulent bankruptcy)*

would be prohibited from being a director of or in any way concerned in the management of a company unless he has applied to and obtained permission of the Court; this provision should apply not only to new appointments but also to appointments already held.

7. Shares with Restricted or No Voting Rights

53. The view can be taken that shares with equal rights, other than voting rights, should also have equal voting rights. If legislation were to attempt to give effect to this proposition it seems that the requirements of the legislation could be avoided by the introduction of some slight variation into the rights, other than the voting rights, attaching to shares so that the voting rights need not be equal.

54. A view which is no less tenable is that persons who acquire shares with restricted or with no voting rights may be presumed to acquire them with full knowledge of what they are doing. It is however important that the limitation should be apparent.

SUBMISSION

55. *Shares with restricted or no voting rights should be described to show the limitation on the share certificates, in the annual accounts and in any invitation to subscribe for such shares.*

8. The Protection of Minorities

Adequacy of existing remedies. Winding-up under the "just and equitable" rule (section 225 (2), Companies Act, 1948); the remedy afforded by section 210)

56. There appears to be little experience of the use of section 210 and there are grounds for believing that this is due to the limited usefulness of the section rather than to the absence of the kind of oppression with which it is intended to deal. It is important particularly in a private company for adequate remedies to be available to an oppressed minority and no doubt the Committee will be receiving evidence from other quarters regarding the practical application of section 210. The Council has therefore decided to confine itself to an observation on one particular respect in which the section appears to be unduly restricted.

57. Under subsection (2) the Court has to be satisfied:

- (a) that the company's affairs are being conducted in a manner oppressive to some part of the members; and
- (b) that to wind up the company would unfairly prejudice that part of the members but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

The inclusion of the requirement under (b) is an unnecessary limitation on the scope of the section. The Council is informed that persons wishing to apply under section 210 have been deterred from doing so because although they had no doubt about their ability to show that the company's affairs were being conducted in an oppressive manner they could not also show that the facts would justify the making of a winding-up order.

SUBMISSION

58. *The conditions specified in section 210 should be reviewed with a view to ensuring that the section provides a readily available remedy to an oppressed minority; in particular the need to show that the facts would justify the making of a winding-up order should be removed.*

9. Protection of Special Classes of Shares

Modification of class rights (section 72, Companies Act, 1948)—getting rid of preference shares by winding-up or return of capital

59. When the rights attaching to a class of shares are varied an appeal to the Court may be made under section 72 by the non-assenting holders of not less than 15 per

cent. of the issued shares of that class. The percentage is rather high (compare section 209 relating to compulsory acquisition of shares of a 10 per cent. minority) and the cost of an appeal may be a material consideration. A successful appeal results in cancellation of the variation, whereas in some cases it might be convenient for the Court to have power to modify the variation.

SL. REVISION

60. *Section 72 should be amended so that:*

- (a) *a minority of 10 per cent. instead of 15 per cent. would have the right of appeal*
- (b) *the cost of an appeal would be borne by the company unless the Court is satisfied that the appeal was unreasonable*
- (c) *the Court would have power to modify the variation of rights as an alternative to cancellation.*

10. Board of Trade Powers to Appoint Inspectors

61. The Council does not wish to comment.

11. Disclosure of Ownership and Control

- (a) *Nominee shareholders and debenture-holders (including nominee holding companies)*
- (b) *Control through nominee directors*

62. The Council does not wish to comment.

12. Share Transfer and Registration Procedure

Note. The sub-headings below were not shown in the questionnaire.

Need for simplification

63. Share transfer and registration procedure is cumbersome and slow. There are various ways in which delays could be avoided if a revised procedure, satisfactory to all concerned, could be devised. For example:

- (a) at present the same transfer document has to be signed by both the transferor and the transferee. The delay which this causes could be avoided if it were possible for the transferor and the transferee to sign separate documents which could be brought together by a stockbroker and registered with the company. The requirements of the Stamp Act could be complied with by stamping the document signed by the transferee. Where shares are being transferred to more than one transferee the present procedure for certification of transfers by the registrar of the company could be followed
- (b) if a procedure on the lines of (a) above were introduced the document to be signed by the transferor could form part of the share certificate; where the holder is disposing of only part of the shares represented by the certificate a balance ticket could be issued by the registrar of the company and exchanged later for a new share certificate
- (c) delays arise in practice because the signatures of the transferor and the transferee are required to be witnessed; such delays could be avoided if a transferor and a transferee were merely required to sign, after which the signature could be confirmed by a stockbroker, bank official or other responsible person dealing with the transfer
- (d) where a transferor or a transferee is a corporate body delay is caused because of that body's internal procedure for affixing the seal to the transfer; this would be avoided if the transfer could be executed by the signatures of duly authorised officers instead of under seal.

SUBMISSION

64. *There should be an examination of share transfer and registration procedure with a view to simplification and the avoidance of delays.*

Stock and unnumbered shares

65. "Stock" and "share" both represent the same kind of interest in the capital of a company. It would remove some public confusion and would also simplify considerably a good many provisions of the Act if only one of these descriptions were in use. If all the issued shares, or all the issued shares of a particular class, are fully paid and rank *pari passu* for all purposes the shares do not have to be distinguished by numbers (section 74). Stock is virtually the same as unnumbered shares and the description "stock" is therefore unnecessary.

SUBMISSION

66. *References to stock in relation to share capital should be removed from company legislation.*

67. On a strict reading of section 74 it appears that when there is a new issue of fully-paid shares of a class already in existence the new shares are required to be numbered at the time of issue notwithstanding that the numbering may be dispensed with almost immediately afterwards.

SUBMISSION

68. *Section 74 should be amended to make it clear that when there is a new issue of fully-paid shares ranking *pari passu* with unnumbered shares already issued, the new shares need not be numbered.*

Notice of trust on registers

69. Section 117 provides that no notice of any trust shall be entered on the register of members or be receivable by the Registrar in the case of companies registered in England. There is no similar provision relating to the register of debenture-holders. The provisions of the section do not apply to Scotland where the practice is to note trusts for the purpose of marking stock as the property of a particular trust. In England many companies refuse to accept any special designation because they consider that to do so may be a breach of section 117. This causes considerable inconvenience to persons who are holders in more than one capacity of shares in the same company.

SUBMISSION

70. *Section 117 should be amended to make it clear that a company is not in breach of that section and is not incurring any obligation under any law relating to trusts if at the request of a shareholder a holding of shares is specially designated in some manner which does not in itself indicate that the holder is a trustee.*

13. Multiplicity of Directorships held by One Individual

71. Whether it is practicable or desirable for one individual to undertake the appointment of director to many companies is not a matter which can be dealt with by legislation. The work in connection with a directorship will differ as between one company and another and it would not be possible to decide upon the number of directorships which any particular individual might properly hold. The register of directors which has to be kept in order to comply with section 200 contains particulars of any other directorships held by each director, apart from those held by a director in companies of which the company is the wholly-owned subsidiary. This disclosure (together with the disclosure to the board of a director's interest in contracts, required by section 199) is in the opinion of the Council sufficient safeguard in relation to a director's association with other companies.

14. Practice of Carrying On Business through Associated and Subsidiary Companies

72. It is often convenient for a company to operate through subsidiaries. The usual circumstances are:

- (a) where a company acquires shares in a company carrying on another business and allows that company to continue to conduct the business
- (b) where a subsidiary is formed in order to conduct an activity which would otherwise be carried on by a branch or separate division.

73. The Council has no comment to make on the provisions regarding disclosure by a holding company of its interests in subsidiaries. In head No. 21 a submission is made to the effect that the accounts of a subsidiary should disclose shares held in a fellow subsidiary (that is to say another subsidiary of the same holding company).

74. A company sometimes has a material holding of shares in another company which is not a subsidiary but whose business has some bearing on the business of the company. Sometimes two or more companies each have a similar holding of shares in such a company; this position may be brought about by the acquisition of shares in an existing business or by a joint arrangement to form a company for the specific purpose of carrying on an activity which has a bearing on the business of each of the shareholding companies. Shares of this kind are dealt with in the accounts as trade investments and the Council has no comment to make.

15. Loan Capital

- (a) *Debentures and debenture stock*
- (b) *Trust deeds—duties of trustees and receivers*

75. The Council does not wish to comment on (a) and (b).

- (c) *Registration of charges*

76. A charge created by a company registered in England must be registered within 21 days of the creation of the charge. In the interest of creditors and possible creditors of the company, it is desirable that this period should be reduced; a reduction will not however be possible unless the Registrar of Companies is permitted to accept for registration an unstamped copy of the instrument by which the charge is created or evidenced.

SUBMISSION

77. *Section 95 should be amended by reducing from 21 days to seven days the time limit for the registration of a charge created by a company registered in England; and to make this possible it should be permissible for the Registrar of Companies to accept unstamped a copy of the instrument by which the charge is created or evidenced. Evidence of stamping should be submitted to him later.*

16. Take-Over Bids

78. For the purpose of this memorandum a "take-over bid" is defined as a general offer to acquire shares or other securities of a particular class or classes, usually with a view to obtaining a controlling interest in the equity capital of the company and involving both a time-limit for acceptance of the offer and a minimum volume of acceptances. It does not therefore include offers to acquire shares piecemeal from individual shareholders privately or through the normal market for the shares.

79. The change of control which results from a successful take-over bid is part of the process whereby two or more companies are amalgamated or one company is acquired by another. Such amalgamations or acquisitions may be economically desirable and are normal features of an economy based on free enterprise. To prohibit or discourage them would tend to create rigidities and therefore to hamper business development in a progressive economy. Nevertheless some safeguards are

needed to ensure that persons whose shares are the subject of a take-over bid are given sufficient information to enable them to obtain a balanced view of the merits of the bid and that the purchase price will be paid.

80. Such safeguards could be provided by means of a general code of conduct, not itself having statutory force. To create an effective code of conduct however it would be necessary to channel all take-over bids through a number of organisations whose eligibility for that purpose would need to be specified by statute or by an effective non-statutory authority. This would tend to restrict freedom of enterprise and as this would be undesirable the Council considers that the matter should be dealt with by legislation so that any company or other person would be free to make a take-over bid provided there is compliance with the provisions of the law. Accordingly the following submissions, made under the headings set out in the questionnaire, are on the basis that safeguards should be provided by legislation.

SUBMISSIONS

(a) Procedure

81. *It should not be permissible to make a general offer to shareholders to purchase their shares or part thereof unless the offer satisfies the conditions for a "valid bid" as set out below.*

82. *The conditions to be satisfied for a "valid bid" should be:*

- (a) *there shall be disclosure of the identity of the bidders and of the number of shares held by them, directly or indirectly, at the time when the bid is made; there shall also be disclosed the terms of any collateral agreement to transfer the shares to a third party in the event of the bid being successful*
- (b) *where the bid involves payment for the shares in cash there shall be deposited with the company a letter from an approved organisation stating that the full cash amount required to implement the bid is available; for this purpose an approved organisation means a member of the Bankers' Clearing House or a body approved for this purpose by the Board of Trade*
- (c) *where securities (either alone or together with cash) are offered in payment for the shares the bid shall be accompanied by such information about those securities as is considered necessary by The Stock Exchange, London, or by the relevant prescribed Stock Exchange where the securities are not dealt in on The Stock Exchange, London*
- (d) *where securities are offered with cash as an alternative the bid shall be accompanied by the information referred to in (c); and there shall be deposited with the company either a letter as in (b) or a letter from an exempt dealer under the Prevention of Fraud (Investments) Act, 1958, stating that adequate arrangements have been made to underwrite in full the cash alternative*
- (e) *if the bid is for part but not the whole of the shares of a particular class it shall be on the basis that if acceptances are received relating to a greater number of shares than that in respect of which the bid is made then the number of shares to be acquired by the bidders from each of the shareholders shall be reduced rateably, so far as practicable, according to the number of shares in respect of which the bid is accepted by each shareholder; a bid on a "first come first served" basis should not be permissible*
- (f) *where the bidders make it a condition of the bid that a minimum volume of acceptances must be received they shall undertake, as part of the offer, not to declare the offer to have become unconditional without at the same time disclosing the number of shares in respect of which the bid has been accepted.*

83. *Where a bid is communicated direct to the shareholders by the bidders it shall be the duty of the bidders to declare, as part of the offer, that the conditions for a valid bid have been satisfied; and they shall notify the full terms of the bid to the directors of the company.*

(b) Securing disclosure of information on which shareholders can form an opinion

84. The submissions made under (a) and (c) of this head are intended to ensure that shareholders are given information which will enable them to obtain a balanced view of the merits of a bid.

(c) Functions of directors

SUBMISSIONS

85. *It should be the duty of the directors of the company to decide within seven days of receiving a bid (or of receiving details of a bid made direct to the shareholders) whether the conditions for a valid bid have been satisfied; if so, the directors shall immediately give preliminary details of the bid to any Stock Exchange on which the shares are quoted.*

86. *As quickly as possible (within a period to be prescribed by the Act) after the directors have decided that there is a valid bid they should send to the shareholders concerned:*

- (a) details of the bid, including all the information referred to in (a) to (f) of paragraph 82 above (unless the bid has been made direct to the shareholders by the bidders) together with a statement whether there has been any material change in the financial and trading position of the company since the last balance sheet and, if so, particulars of such change*
- (b) the directors' recommendation to accept or not to accept the bid and their reasons therefor, or a statement that they offer no advice*
- (c) a statement of the directors' beneficial interest in the shares of the company and in shares of any company associated with the bidders and the basis on which compensation, if any, is to be paid to the directors for loss of office and any other inducement offered to the directors which is not available to shareholders generally.*

87. *Shareholders should be given at least 14 days from the issue of the information referred to in the preceding paragraph to decide whether to accept the bid.*

88. *Accounting information given in any statement relating to a bid should not be described as "audited" unless the auditors concerned have approved the information in the context in which it appears.*

89. *Penalties should be prescribed for failure by the directors or the bidders to comply with the requirements of the Act and for giving defective information or acting in a reckless manner; but no responsibility should rest on the directors for the accuracy of any information supplied to them by the bidders.*

(d) Disclosure of identity of bidder

90. See paragraph 82 (a) above.

(e) The financing of such transactions

91. See paragraph 82 (b), (c) and (d) above.

(f) Disclosure of directors' interests—compensation for loss of office (sections 191–194, Companies Act, 1948)

92. See paragraph 86 (c) above.

(g) Application of provisions regarding compulsory acquisition of shares of dissenting minority (section 209, Companies Act, 1948)

SUBMISSION

93. *Section 209 should be amended so that when approval has been given by the holders of not less than 90 per cent. of the shares it would be permissible to proceed under the section without waiting for the expiration of four months after the making of the offer.*

17. Prospectuses—Statements in Lieu of Prospectuses—Offers for Sale—Issues of Shares to Existing Shareholders*(a) Adequacy of protection afforded to investors by existing law*

94. In general the existing law is adequate for the protection of investors except for:

(a) the ability of a unit trust to invite the public to purchase units without issuing anything comparable with the prospectus requirements relating to a company (see head No. 19)

(b) the need for a review of the requirements to be satisfied by persons who invite the public to deposit money or to make loans.

SUBMISSIONS

95. *In addition to the prohibition relating to exempt private companies referred to in the submission in paragraph 22 of head No. 3, there should be an investigation to determine what conditions should be satisfied by persons who invite the public to deposit money or to make loans; in particular, consideration should be given to the disclosure to be made about the financial position and earnings in advertisements, the way in which funds are invested and the contents of accounts or returns to be issued or made available for inspection.*

96. *(The Council of the Institute subsequently requested the Company Law Committee to delete the paragraph which appeared here.)*

(b) Usefulness and necessity of the existing provisions

97. The existing provisions of the Companies Act, 1948, relating to prospectuses, statements in lieu of prospectus, and offers for sale are found in practice to work well. There are however a few changes which could usefully be made when the Act is being amended.

98. The Third, Fourth and Fifth Schedules require reports to be made on the profits and losses of the company, or any business to be acquired, for the five financial years immediately preceding the issue of a prospectus or the delivery of a statement in lieu. It is however the practice of The Stock Exchange, London, to require the report to cover a period of ten years and it would be appropriate to make this a statutory requirement.

99. Similarly it would be appropriate to extend to ten years the period of five years specified in paragraph 19 (1) (b) of the Fourth Schedule which requires reports on the rates of dividends paid.

SUBMISSION

100. *The Third, Fourth and Fifth Schedules to the Companies Act, 1948, should be amended so as to require reports on the profits and losses and rates of dividends to be in respect of ten years, instead of five years; but a prescribed Stock Exchange should have power to reduce this period in the same way that it is able to issue a certificate of exemption under section 39 (J).*

101. The Third, Fourth and Fifth Schedules require that the assets and liabilities of a business or company to be acquired shall be stated as at the last date to which the accounts of the business or company were made up. While it is difficult to fix an arbitrary period it is highly desirable that an unduly long period should not have elapsed between the date to which the accounts were made up and the date of the issue of the prospectus or offer for sale or the delivery of the statement in lieu.

SUBMISSION

102. *The Third, Fourth and Fifth Schedules to the Companies Act, 1948, should be amended so that the statements of assets and liabilities required thereby shall be based on accounts made up to a date not earlier than one year before the issue of the prospectus*

or offer for sale or the delivery of a statement in lieu; but a prescribed Stock Exchange should have power to extend this period.

(c) *Certificates of exemption (section 39, Companies Act, 1948)*

103. Section 39 (1) permits a prescribed Stock Exchange to give a certificate of exemption from compliance with the Fourth Schedule on the ground that compliance would be unduly burdensome in the circumstances to which the section relates. There is no power of exemption on the ground that to comply with the schedule would be misleading or irrelevant.

104. By reason of section 30 (1) the power of exemption under section 39 (1) applies also to a statement in lieu of prospectus where a private company alters its articles so as to cease to be a private company. The power of exemption does not however extend to the statement in lieu of prospectus required by section 48 and there appears to be no reason for this limitation of the power.

SUBMISSION

105. *Section 39 should be extended so that a prescribed Stock Exchange would be permitted to issue a certificate of exemption:*

- (a) *on the ground that compliance with the requirements would be misleading or irrelevant*
- (b) *in respect of the statement in lieu of prospectus required by section 48.*

18. Control over Business of Dealing in Securities

106. The Council does not wish to comment.

19. Unit Trusts and "Open End Mutual Funds"

Note.—The sub-headings below were not shown in the questionnaire.

Need for amendment of the basic legislation

107. A unit trust (sometimes called an "open end" trust or mutual fund) enables an investor to acquire, by a single purchase, an interest in a wide spread of investments in securities dealt in on a recognised Stock Exchange. The investor is relieved of the responsibility of selecting and managing a suitable portfolio of securities; his risk of loss through capital depreciation and falling off of dividend income is minimised because any one company represents only a small fraction of his total investment; and he can at any time realise the whole or part of his investment by selling back to the managers of the trust at their "bid" price of the day, which is computed by reference to the Stock Exchange prices of all the underlying securities held by the trust. The managers recoup their expenses and provide their remuneration for maintaining a market in the units out of the difference between the "offer" price at which they sell units and the "bid" price at which unit holders may sell back to the managers. Their management remuneration for other services usually takes the form of an annual or semi-annual charge based on the market value of the portfolio.

108. A unit trust thus provides investment facilities that are not otherwise available except to investors with ample means. This is no doubt why there has been a large expansion in unit trust activity during recent years, when the expanding economy of this country has resulted in many people of limited means wishing to invest with the minimum of risk and with the opportunity of participating in the growth in income and capital value of industrial and commercial investments.

109. The safeguards needed for the protection of the investors in a unit trust (in addition to skill and honesty on the part of the managers) are:

- (a) *that the investments held by the trust and the income therefrom should be in safe custody, for which purpose trustees are a party to the trust deed*

- (b) that the managers should account periodically to the unit holders with sufficient information to show whether their management of the affairs of the trust has been in the interests of the unit holders; on this aspect of the matter the present position needs to be improved.

110. The present position is governed primarily by the Prevention of Fraud (Investments) Act, 1958, under which the Board of Trade may declare a unit trust to be authorised. The conditions for authorisation are specified in section 17 (1) and one is that the trust deed must provide, to the satisfaction of the Board of Trade, for the matters specified in the First Schedule. This has been amplified by a statement of Board of Trade "requirements", a copy of which can be obtained only by special application to the Board of Trade. In later paragraphs of this head submissions are made for improvement of the substance of the present requirements laid down by statute and the Board of Trade, but in addition their form is in need of improvement to ensure that they are readily available in consolidated form for the benefit of those who invest in unit trusts as well as those who undertake the formation and operation of such trusts.

111. Basically a unit trust is similar to a company. The position of unit holders is analogous to that of shareholders and the position of the managers analogous to that of directors. In principle therefore it would be desirable to require unit trusts to be incorporated (there is at present no such requirement) and to comply with legislation similar in principle to company law, but with such differences in detail as are necessary to take account of features peculiar to unit trusts. These would include suitable power to reduce capital, otherwise a unit trust would not be able to reduce the number of units in issue; at present this can be done by cancelling units bought back from unit holders instead of holding them for reissue. Without this facility a unit trust would be in difficulty in a period when the number of units which it is required to buy back from unit holders is in excess of the number it can sell to new unit holders, with the result that investments have to be sold to provide the funds to pay for the units bought back.

SUBMISSION

112. *Unit trusts should be required to be incorporated under a new Act relating specifically to the formation, operation, management and winding-up of unit trusts; this Act, supplemented as necessary by statutory orders, should deal comprehensively with the whole of the law affecting unit trusts.*

113. In the following paragraphs submissions are made for improvement of the present requirements for an authorised unit trust as laid down by statute and the Board of Trade. The substance of these submissions is applicable whether or not the submission in the preceding paragraph is adopted.

Accounts issued to unit holders

114. Paragraph 6 of the First Schedule to the Prevention of Fraud (Investments) Act, 1958, requires the trust deed of an authorised unit trust to provide for the circulation to unit holders of accounts relating to the trust, including accounts of the managers in relation to the trust and statements of their remuneration in connection therewith. This general provision is amplified considerably by the "requirements" of the Board of Trade (see paragraph 110 above) which have the effect that certain information must be circulated to unit holders at least once a year and certain information must be circulated to them at the end of each distribution period (which in practice is usually half-yearly). There is no statutory or Board of Trade requirement specifically imposing a duty on the managers to see that books of account in respect of the trust are properly kept.

115. The information required to be circulated annually consists of the accounts of the managers in relation to the trust, giving specified information and including disclosure of:

- (u) the percentage gross profits (before any deductions), or losses, from the sale of new units, the resale of units and the sale of underlying securities of liquidated units; the methods to be used for computing these percentages are set out
- (b) losses by the managers on holding securities and on holding units.

116. The significance of the requirement to circulate accounts of the managers in relation to the trust is that the managers of some unit trusts deal not only as agents for the unit holders but also as principals for themselves and therefore make profits or losses in both capacities. Profits or losses can be determined from the records, but to analyse them in the manner indicated in the preceding paragraph involves the making of certain assumptions. To some extent therefore the circulated information is questionable and if this information is to be given there should be disclosure of the basis on which it has been computed.

117. The information required to be circulated at the end of each distribution period consists of:

- (a) a statement showing how the amounts distributed to unit holders are made up; this must show (in relation to some convenient number of units, which in practice is usually taken as one unit) the gross amount of the income distribution and the amount of income tax deducted therefrom, the amount of any capital distribution and its source, the amount of all deductions whether by way of annual or semi-annual charge with an indication of the provisions in the trust deed which authorise such deductions and information concerning amounts included in the distribution by reason of securities being acquired or disposed of cum dividend or ex dividend
- (b) a statement showing, as at the end of the distribution period, what percentage of the total value of the trust funds was invested in each investment and what percentage was represented by cash
- (c) the ex dividend "bid" price on the last day of the period.

118. It would seem desirable that the accounts circulated to unit holders should be in the form of a balance sheet and income and expenditure account rather than in the form of the statements now used. Provided the accounts are required to show a true and fair view this would be a more positive method of requiring the managers to provide the unit holders with all relevant information. The state of affairs and the transactions of the trust would be disclosed in full instead of only by the unsatisfactory means of giving percentages and amounts per unit.

SUBMISSIONS

119. *The managers and/or trustees of a unit trust should be under statutory obligation to ensure that books of account are properly kept in respect of the trust and the transactions relating thereto.*

120. *An income and expenditure account in respect of each distribution period and a balance sheet as on the last day of the period should be circulated to the unit holders.*

121. *The balance sheet should show a true and fair view of the state of affairs of the trust. Specifically the balance sheet should show:*

- (a) *the assets and liabilities of the trust; the investments and other assets should be stated at amounts arrived at on the same basis as that used for the purpose of determining the managers' prices for units computed ex dividend as on the balance sheet date, and the basis should be stated*
- (b) *the amount, if any, set aside for distribution to unit holders*
- (c) *undistributed income*
- (d) *the balance on capital account, supported by a statement summarising the transactions on capital account during the distribution period*

- (e) the value (computed to the nearest one-tenth of a penny) of one unit, arrived at by aggregating the balance on capital account with the undistributed income and dividing this amount by the number of units on the balance sheet date
- (f) the ex dividend "bid" price of a unit on the balance sheet date
- (g) what percentage of the total value of the trust funds was, as on the balance sheet date, invested in each investment and what percentage was represented by the excess of amounts receivable and cash over amounts which are to be distributed for the distribution period and any other amounts payable.

122. The income and expenditure account should show a true and fair view of the income and expenditure for the distribution period. Specifically this account should be required to show in summarised form and with appropriate description the dividend and interest receivable, the total management remuneration and other expenses and the amount available for distribution to unit holders. If any part of the management remuneration or other expenses is charged to capital the amount so charged should be included by transfer in the income statement to offset the expenses to which it relates.

123. The corresponding amounts for the immediately-preceding period should be given for all items shown in the balance sheet and the income and expenditure account.

124. The accounts should show an analysis of the managers' profits or losses distinguishing those arising on the sale of new units, those arising on the resale of units, those arising on the sale of underlying securities, those arising from the holding of securities and those arising from the holding of units; and the basis adopted for distinguishing these amounts should be indicated.

Audit

125. Paragraph 6 of the First Schedule to the Prevention of Fraud (Investments) Act, 1958, requires the trust deed of an authorised unit trust to provide for the audit of the accounts relating to the trust, including the accounts of the managers in relation to the trust and the statements of their remuneration. This general provision is amplified by Board of Trade "requirements" but these are inadequate in that:

- (a) the auditors must be "approved by the trustee", but no qualification for appointment is specified
- (b) the report to be made by the auditors is of limited scope, requiring them to express their opinion whether the accounts to be circulated are properly drawn up in accordance with the books and records to disclose the profits or losses accruing to the managers from the trust
- (c) they do not lay down the procedure for the appointment and removal of auditors.

SUBMISSIONS

126. The audit requirements for unit trusts should be strengthened by provisions similar to those under company law relating to qualification for appointment as auditors, the procedure for appointment and removal, the auditors' rights of access to records and information, and the report to be made by the auditors.

127. Assuming the adoption of the submissions in paragraphs 119 to 124, the auditors should be required to state in their report whether in their opinion the accounts to be circulated have been properly drawn up so as to give a true and fair view of the state of affairs of the trust as on the balance sheet date and of the transactions relating thereto for the period ended on that date and to disclose the profit or loss accruing to the managers for that period.

128. The auditors' report should also contain statements which in their opinion are necessary if:

- (a) they have not obtained all the information and explanation which to the best of their knowledge and belief were necessary for the progress of their audit; or

- (b) *so far as appears from their examination, books of account have not been properly kept in respect of the trust; or*
(c) *the accounts to be circulated are not in agreement with the books.*

Invitations to invest

129. Managers of unit trusts make widespread invitations to the public to purchase units. Such appeals may be by advertisements in the Press or on television, pamphlets, and arrangements to buy and sell units over the counter at branches of banks. Managers are not required to comply with anything comparable to the requirements under company law relating to a prospectus or offer for sale.

SUBMISSION

130. *The managers of a unit trust should be required to ensure that before any units are sold by them or their agents to a new investor he shall be supplied with a copy of the latest accounts of the trust with an indication of the permitted range of investments.*

20. Reduction of Capital and Purchase by a Company of its Own Shares

131. Section 27 provides that, subject to certain specified exceptions, a company cannot be a member of a company which is its holding company and any allotment or transfer of shares in a company to its subsidiary shall be void. The specified exceptions do not cover the position where, since 1st July, 1948, company A has acquired shares in company B and subsequently company B wishes to acquire a majority holding of shares in company A, thereby making A a subsidiary of B. It is understood that the Board of Trade has expressed the view that in such circumstances:

- (a) *there is nothing objectionable in company B acquiring shares in company A and thus becoming its holding company; but if this is done, section 27 will operate to make void the earlier allotment or transfer of shares to company A by company B*
(b) *to avoid this difficulty, company A would be well advised to dispose of its holding in company B before company B acquires a majority holding of shares in company A.*

132. To require company A to dispose of its shares in company B is consistent with the object of section 27, but it does not seem reasonable to require this to be done before company A becomes a subsidiary of B. Moreover, it is not clear how section 27 operates where company A acquired its shares in company B from a third party, as it is difficult to envisage that the transfer by the third party could be declared void.

SUBMISSION

133. *Section 27 should be amended so that in circumstances such as the foregoing there would be a specified period (not longer than one year) within which the subsidiary's holding of shares in the holding company shall either:*

- (a) *be disposed of by the subsidiary; or*
(b) *be cancelled by the holding company as an effective reduction of capital, provided the shares are fully paid.*

134. The Council understands that legal opinions are now being expressed which interpret section 54 in a manner which could not have been intended. The object of the section (apart from the special circumstances dealt with in the proviso) is to prohibit financial assistance by a company for the purchase of its own shares or those of its holding company. The section includes the words "directly or indirectly" and "financial assistance for the purpose of . . . a purchase . . . made by any person of . . . any shares in the company" and it appears that these are being interpreted to mean that if company A (using its own resources or a bank overdraft or money borrowed from a third party) purchases the shares of company B it is thereafter

unlawful for company B to transfer to company A either by way of loan or dividend any part of the cash or other assets held by B at the time when the shares were acquired by A.

SUBMISSION

135. *Section 54 should be amended to make it clear that provided the shares of a company are acquired and the transaction is completed without using in any way the resources of that company it shall not be unlawful thereafter to transfer funds of that company by way of loan or dividend to the purchaser of the shares.*

21. Accounts

*Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies?
Are all the existing provisions necessary and useful in present-day conditions?*

136. Many detailed requirements regarding the accounts of companies are set out in the Eighth Schedule to the Companies Act, 1948, and there are some sections of the Act which require disclosure of particular matters, for example section 196 regarding directors' emoluments, pensions and compensation. The overriding and fundamental requirement is however contained in section 149 which provides that the balance sheet shall give a true and fair view of the state of affairs of the company as at the end of its financial year and the profit and loss account shall give a true and fair view of the profit or loss for the financial year. In addition, section 150 requires group accounts where applicable.

137. These requirements were a notable advance on the meagre requirements of the 1929 Act. In general they have worked remarkably well and may be said to be both necessary and useful and to have achieved substantially the objective of adequate disclosure of information. It is not however surprising that experience has shown some relatively minor respects in which the requirements could be improved and also that there are a few controversial matters involving important principles. The Council wishes to emphasise that these should not be allowed to overshadow the satisfactory experience of the general operation of the present requirements.

(a) *Revaluation of fixed assets and use of any resulting surplus*

138. If the fixed assets of a company are written-up on the basis of a valuation it is important that the surplus arising from the writing-up should be dealt with on sound accounting principles, which do not permit an unrealised surplus to be treated as available for distribution in cash or specie. There are differing views as to what is at present the legal position and it is desirable that this should be clarified.

(b) *Share premium account*

Note.—The next two paragraphs relate to a point of detail arising on section 56. The Council hopes to submit a supplementary memorandum on the principle involved in section 56. (See page 1436.)

139. Section 56 (2) permits the share premium account to be used for writing off preliminary expenses and the expenses of any issue of shares or debentures. The section does not refer specifically to stamp duty on capital and it would appear therefore that such duty cannot be written off against the share premium account unless the duty can in law be regarded as an expense of an issue of shares or debentures. The stamp duty is payable when the authorised capital is increased or when a company creates loan capital of such a description as to be capable of being dealt with on a Stock Exchange. The increase in authorised capital or the creation of the loan capital is not necessarily followed immediately by an issue of shares or debentures and it is therefore not clear whether the stamp duty can be regarded as an expense of an issue of shares or debentures which can properly be written off against the share premium account.

SUBMISSION

140. *Section 56 (2) should be amended so as to make it clear that the share premium account may be applied to write off any stamp duty paid on the creation of share capital or loan capital.*

(c) Use of pre-acquisition profits of subsidiaries

Note.—The next two paragraphs relate to what appears to be a drafting error in the Eighth Schedule. The Council hopes to deal in a supplementary memorandum with the general question of pre-acquisition profits and the considerations arising on mergers and reorganisations of companies. (See page 1438.)

141. Paragraph 15 (4) of the Eighth Schedule contains detailed provisions regarding information to be disclosed where group accounts are not submitted. The intention appears to be to ensure that the shareholders in the holding company shall, in relation to their share of the annual and accumulated profits or losses of the group as a whole, be furnished with information equivalent to that which they would have been given if there had been consolidated accounts dealing with all the companies in the group. On a strict reading of items (b) and (c) of paragraph 15 (4) the intention does not appear to have been achieved. The Council is advised that the references to "the company's accounts" in (b) and (c) relate in law only to the accounts of the year and not also to those of prior years. Paragraph 15 (4) therefore has the presumably unintended effect of calling for the disclosure of useless figures of profits less losses of subsidiaries for the whole period from their acquisition less only amounts dealt with in the holding company's accounts of the year and not after deducting amounts dealt with in earlier accounts of the holding company. In 1948 the Board of Trade authorised the Council to state that no exception would be taken by the Board of Trade to the information required by paragraph 15 (4) being dealt with on the lines indicated in the submission below.

SUBMISSION

142. *Paragraph 15 (4) of the Eighth Schedule should be amended so as to make it clear that (a) and (b) thereof require the following information in respect of the aggregate profits less losses (or vice versa) of subsidiaries:*

- (a) the amount which has neither been dealt with in the holding company's accounts of the year nor in its accounts of any prior year; and*
- (b) the amount dealt with in the holding company's accounts of the year sub-divided to distinguish the amounts derived respectively from current and other results of the subsidiaries dealt with.*

(d) Description of reserves

143. The Council does not wish to comment, but submissions are made later in paragraphs 168 to 173 on certain aspects of the present requirements relating to reserves and provisions.

(e) Definition of profits

144. The general aim of a profit and loss account should be to show a true and fair view of the profit or loss of the year, before and after taxation, based on the consistent application of recognised accounting principles. The account should be presented in a form which affords as clearly and readily as circumstances permit a comparison with the results of previous years.

145. There are differing opinions as to what should be included in the amount shown as the profit or loss of a year. Some consider that it should take into account, subject to separate disclosure of material items in certain circumstances, all profits or losses arising or ascertained within the year, including those items which are the result of activities of the year, and others which are the consequence, ascertained within the year, of transactions of earlier years. Others hold that the amount shown

as the profit of the year should be restricted to the results of the operations of the year and that all other items should be excluded from the profit or loss of the year as being adjustments of earlier years and should be so shown in the profit and loss account.

146. Each of these opinions has arguments in its favour and it cannot be said that either of them is generally accepted to the exclusion of the other. Provided that the account is prepared in conformity with either of these opinions and is the result of the consistent application of recognised accounting principles it can properly be said to be true and fair. If a change is made in the accounting principles applied and the effect is material, that fact and its consequences would need to be disclosed.

147. From a business point of view, a trading profit or loss does not arise until all trading expenses such as depreciation, directors' emoluments and auditors' remuneration have been charged. An amount arrived at before charging such expenditure is not significant information and should not be described as "profit".

SUBMISSION

148. *As far as is practicable, the profit and loss account should show as a minimum:*

- (a) *the trading profit or loss of the year computed after charging depreciation, directors' emoluments and all other trading expenses; any necessary disclosure of depreciation or other items charged or brought to credit in arriving at the trading profit or loss should be made by way of note*
- (b) *Items of income and expenditure (for example, investment income and debenture interest) not covered by (a) above but which the Act requires to be stated separately*
- (c) *profit before taxation, the taxation chargeable and the profit after taxation*
- (d) *exceptional credits and charges which are neither taken into account in (a), (b) or (c) above nor, in appropriate circumstances, taken direct to reserve.*
- (f) *Exemption of banks, assurance, shipping companies from some of the accounting provisions of the Companies Act, 1948*

149. The Council does not wish to comment, except in relation to auditors (see paragraph 197 under head No. 22).

Other matters

150. The Council wishes to comment on the following matters relevant to this head but not specifically covered by items (a) to (f) of the questionnaire.

Turnover

151. In recent years a relatively small but increasing number of the larger companies has adopted the practice of disclosing turnover, that is to say the revenue for the accounting period from sales or from the performance of the operations or services which the business provides. This practice has not however been adopted by the large majority of companies. Disclosure of turnover is normally of considerable value in studying the trend of a company's business and its activity, its efficiency in using its resources and its profitability in relation to the amount of business done.

152. The arguments usually advanced against the disclosure of turnover are:

- (a) that it might damage the company's business by providing information for competitors; and
- (b) that a definition of turnover would present great difficulties in regard to some types of business and the amount shown might be misleading.

153. The risk of damage is primarily a matter for consideration by business concerns. Some guidance can however be obtained from experience in certain overseas countries where disclosure of turnover is required; the Council is not aware that this requirement has proved harmful. If it were decided to require disclosure under

United Kingdom company law it would be desirable to permit exemption where the directors consider that disclosure would be harmful to the company. The risk of damage might be greater for a medium-sized or small undertaking than for a large concern with many differing activities.

154. The definition of turnover might be particularly difficult for some classes of company, for example those carrying on business as contractors or in the field of hire purchase. Moreover care would be needed to ensure that the amount shown as turnover would not give a misleading view of the trend of the business; for example where purchase tax or excise duty forms a significant part of the turnover and there have been material changes in the rate of tax or duty. Care would also be needed in regard to inter-company transactions within a group.

SUBMISSIONS

155. *Turnover for the accounting period should be shown in the profit and loss account by note or otherwise, unless the directors consider that disclosure is likely to be misleading or harmful to the company. If this submission is not acceptable in relation to companies generally it should apply to all companies whose share or loan capital is dealt in on a prescribed Stock Exchange.*

156. *The turnover to be disclosed should be the full amount receivable in respect of sales, or from the operations or services conducted by the business, during the accounting period; provided that the amount shall be so described or amplified as to prevent it from being misleading in relation to the comparative amount for the preceding period or, where given, the amounts for a series of preceding periods.*

157. *In relation to a group of companies:*

- (a) *the group accounts should disclose the consolidated turnover of the group, excluding so far as practicable all amounts relating to transactions between companies in the group; and*
- (b) *a holding company or a wholly-owned subsidiary should not be obliged to disclose its own turnover.*

Directors' emoluments

158. Where an employee of a company retires on pension and is given a seat on the board of directors it is not clear from section 196 (1), (2) and (3) that such a pension need not be shown separately. Similarly it is not clearly provided that where a person has not been a director during the whole of the period qualifying for pension the pension should be apportioned.

SUBMISSION

159. *Section 196 should be amended so as to make it clear that a pension granted to an employee of a company who, on retirement, is given a seat on the board of directors does not fall within the section; and that where an employee became a director before retirement the section applies only to that part of his pension which is attributable to his service as a director.*

160. Section 196 (2) refers to benefits otherwise than in cash. Since such benefits have now been brought into the ambit of taxation (Part VI of the Income Tax Act, 1952) it would clarify the position under the Companies Act if, in relation to directors chargeable to United Kingdom income tax on the emoluments of their office, regard were had only to benefits charged to income tax.

SUBMISSION

161. *Section 196 should be amended so that, in relation to directors chargeable to United Kingdom income tax on the emoluments of their office, benefits "otherwise than in cash" relate only to benefits charged to United Kingdom income tax.*

162. If the requirements of section 196 are not complied with, subsection (8) places a special duty on the auditors to give the required particulars in their report "so far as they are reasonably able to do so". There seems however to be no statutory obligation for directors to give in writing to the company information regarding emoluments.

SUBMISSION

163. *Section 198 (1) should be amended so that a notice in writing shall be required from each director covering all pensions, compensation and emoluments, including all benefits received otherwise than in cash.*

Auditors' remuneration

164. Paragraph 17 of the Eighth Schedule requires a consolidated profit and loss account to combine the information contained in the separate profit and loss accounts of the company and of its subsidiaries. The separate accounts generally show the auditors' remuneration only in those cases where it is not fixed by the company in general meeting (paragraph 13, Eighth Schedule) and not necessarily then in the case of overseas subsidiaries. Consequently it is valueless to show in the consolidated profit and loss account an aggregate of the items of auditors' remuneration which happen to appear in the separate accounts. Normally, such an aggregate would not be the total auditors' remuneration within the group and its omission from the consolidated accounts would not be contrary to the object of paragraph 13 of the Eighth Schedule, which is to ensure that the members of a company shall be aware of the cost of auditing their company's accounts if the amount has not been fixed in general meeting. It may also be noted that in the case of some overseas subsidiaries there is doubt as to who should be regarded as auditors for the purpose of aggregating remuneration.

SUBMISSION

165. *The Eighth Schedule should be amended so as to make it unnecessary in consolidated accounts to show an aggregate of auditors' remuneration; the remuneration of the holding company's auditors (if not fixed by the company in general meeting) should continue to be shown in its own profit and loss account or in the consolidated profit and loss account if the holding company's account is so framed.*

Tax charge

166. Paragraph 12 (1) (c) of the Eighth Schedule requires the charge for United Kingdom taxation on profits to include "as United Kingdom income tax any taxation imposed elsewhere to the extent of the relief, if any, from United Kingdom income tax". The use of the word "as" has the effect of requiring overseas tax to be described wrongly as United Kingdom income tax. Moreover the reference to relief from "United Kingdom income tax" does not recognise that under present taxation regulations relief from overseas taxation is given first against profits tax.

SUBMISSION

167. *The provisions of the Eighth Schedule relating to the disclosure of tax on the profits of a year should be amended to require, in the case of companies subject to overseas tax, disclosure of:*

- (a) *the amount, before double-tax relief, of United Kingdom tax, distinguishing profits tax from income tax*
- (b) *the amount of double-tax relief*
- (c) *the amount of overseas tax.*

Reserves and provisions

168. Paragraphs 12 (1) (e) and (f) of the Eighth Schedule provide that amounts set aside to, or withdrawn from, reserves and certain provisions shall be shown in the profit and loss account. It is assumed from paragraph 7 (1) that the said items (e) and (f) apply only to amounts charged or credited to revenue, and do not necessarily require

the passage through the profit and loss account of additions to or withdrawals from reserves and provisions which would not normally be passed through that account.

SUBMISSION

169. *Paragraph 12 of the Eighth Schedule should be amended so as to make it clear that additions to, or withdrawals from, reserves and provisions which would not normally be passed through the profit and loss account need not be shown in that account.*

170. In view of the definition of "provision" in paragraph 27 to the Eighth Schedule, it is not clear that amounts set aside for expenditure to be met in the future fall within the definition of "provision". In certain businesses it is normal practice to set aside each year amounts to meet accruing expenditure, such as on repairs, in order that the profits of a year may be correctly computed.

SUBMISSION

171. *It should be made clear that an amount necessarily set aside in accordance with a regularly employed accounting practice in order to meet accruing expenditure, such as that on repairs and other maintenance charges, is a provision; but that amounts so set aside need not be stated separately in the profit and loss account.*

172. Some companies holding investments as fixed assets adopt the practice of deducting proceeds of realisations from the cost of the investments as a whole, with the result that the amount at which the investments are stated in the balance sheet represents the cost of the investments held reduced by profits (less losses) on the realisation of investments no longer held. There is therefore no disclosure of the actual cost of the investments held or of the amount of profits made on the realisation of investments.

SUBMISSION

173. *It should be made clear that for balance sheet purposes:*

- (a) *the cost of investment means the actual cost of the investments held on the balance sheet date*
- (b) *the profits from realisation of investments previously held should be treated as reserves except to the extent that they have been utilised to meet losses or otherwise used for some appropriate purpose; and the movements on such reserves should be shown.*

Distinction between fixed and current assets

174. Paragraph 4 (2) of the Eighth Schedule requires that fixed assets shall be distinguished from current assets. The division of assets into either "fixed" or "current" is not always practicable and could be misleading. (This is sometimes the case with interests in subsidiaries.)

SUBMISSIONS

175. *Where neither "fixed" nor "current" is a true and fair description of assets, there should be a requirement that the assets shall not be described as either but that the nature of the assets shall be stated clearly.*

176. *It should be made clear that where an asset is classified as neither "fixed" nor "current" the method of arriving at and stating the amount of a fixed asset, set out in paragraph 4 (3) and (except in the case of interests in subsidiaries) paragraph 5 of the Eighth Schedule, should be applied.*

Shares of a subsidiary held by a fellow subsidiary

177. Although there is a requirement in paragraph 15 (2) of the Eighth Schedule for a holding company in its balance sheet to set out separately from all other assets the aggregate amount of its interests in subsidiaries, there is no similar requirement for a subsidiary to show separately in its balance sheet shares which it holds in a fellow subsidiary (that is to say another subsidiary of the same holding company).

SUBMISSION

178. *Shares held by a subsidiary in a fellow subsidiary should be shown separately in its balance sheet.*

Redeemable preference shares

179. Paragraph 2 (a) of the Eighth Schedule requires any part of the issued capital that consists of redeemable preference shares and the earliest date on which the company has power to redeem those shares to be specified. There are other material facts relating to the redemption of such shares which should be indicated in the accounts; examples are the latest date on which redemption may take place and any premium payable on redemption.

SUBMISSION

180. *There should be disclosure in a company's accounts of all material facts relating to the redemption of any redeemable preference shares of the company.*

22. Audit

(a) Qualifications and appointment of auditors

181. The United Kingdom accountancy bodies which are recognised by the Board of Trade under section 161 (1) (a) should now be specified in the Act. This would be in conformity with the practice adopted in other legislation specifying qualification for appointment as auditor.

182. Section 161 enables the Board of Trade to authorise for appointment as auditor a person having a suitable accountancy qualification obtained outside the United Kingdom. It is appropriate, and highly desirable in connection with overseas relations, that this power should be grouped in the section with the United Kingdom bodies and not, as now, with the two classes of unqualified persons who may act as auditor.

SUBMISSION

183. *Section 161 (1) should be amended so as to provide that a person shall not be qualified for appointment as auditor of a company unless either:*

(a) he is a member of one of the following bodies:

The Institute of Chartered Accountants in England and Wales

The Institute of Chartered Accountants of Scotland

The Association of Certified and Corporate Accountants

The Institute of Chartered Accountants in Ireland

provided that any of the foregoing bodies may be removed from and any other body of accountants established in the United Kingdom may be added to this provision by regulation requiring an affirmative resolution of both Houses of Parliament and provided further that the Board of Trade may authorise a person to be appointed as auditor by virtue of suitable qualifications obtained outside the United Kingdom; or

(b) he is for the time being authorised by the Board of Trade to be so appointed as having obtained adequate knowledge and experience in the course of his employment by a member of a body of accountants specified in (a) above or as having practised in Great Britain as an accountant before 6th August, 1947.

184. It is usual for accountants to practise in partnership and to be appointed as auditors in their firm name. The Act does not however refer specifically to the appointment of a firm as auditors, except for the reference to Scottish firms in section 161 (4). (In Scotland a partnership firm is in law an entity separate from the individual partners and as this separate entity cannot possess any accountancy qualification a Scottish firm would be ineligible for appointment as auditors if the Act did not include section 161 (4).).

185. The absence of specific reference to the appointment of a partnership firm (other than a Scottish firm) does not in practice cause any general difficulty. It is assumed that the appointment of a firm is in law the appointment of all the partners of that firm and if all the partners are eligible for appointment then the firm itself is so eligible. Where however there is a change in the constitution of a partnership doubts may arise regarding the correct procedure under the Companies Act. These doubts do not normally give rise to practical difficulty but this is not always the case and it seems desirable that the legal position should be clarified.

186. In the few cases where difficulty does arise the position is complicated by the automatic reappointment provisions of section 159 (2) whereby at any annual general meeting a retiring auditor is reappointed without any resolution being passed, except in the circumstances specified in the section. There is no necessity for the automatic reappointment procedure and its removal would facilitate the clarification of the position of partnership firms.

SUBMISSIONS

187. *The practice which obtained under the 1929 Act whereby a substantive resolution was required for the appointment of auditors at each annual general meeting should be revived with the amendments mentioned below.*

188. *Subsection (2) of section 159 should be replaced by a provision whereby, subject to paragraphs 189 and 190 below, it shall not be competent to a company to make any change in the auditors at an annual general meeting unless notice has been given of an intention to submit at that meeting a proposal which would have the effect that any of the retiring auditors who are eligible and willing to act shall not be reappointed or that a named person other than any of the retiring auditors be appointed. Such notice would be subject to the provisions of section 160.*

189. *Section 161 should be extended so as to make it clear that, subject to paragraph 190 below:*

- (a) persons who are in partnership may be appointed as auditors in their firm name provided that all are eligible for appointment*
- (b) such an appointment will constitute the appointment jointly of all those who are partners in the firm at the time of appointment and will not be affected as regards the surviving or continuing partners by the subsequent death or retirement of a partner; the appointment of a retiring partner in such a firm will cease upon his retirement from the partnership*
- (c) the appointment of the continuing partners will not be affected by the subsequent introduction of a new partner or more than one new partner who jointly with those who were partners at the time when the firm was appointed or last reappointed will, therefore, be deemed to be auditors and eligible for reappointment; section 159 and section 160 (1) shall apply to such a person as if he were a retiring auditor and special notice shall not be required in relation to his appointment.*

190. *The proposals in paragraph 189 above should be subject to an overriding provision to the effect that a casual vacancy within the meaning of section 159 (6) shall be deemed to arise where:*

- (a) more than one-half of those who were partners in the firm at the time when the firm was appointed or last reappointed have ceased to be partners; or*
- (b) the number of new partners introduced into the firm exceeds the number remaining of those who were partners at the time when the firm was appointed or last reappointed*

and the auditors shall be under obligation to notify the company of the facts required to enable its directors to deal with such a casual vacancy.

191. *Subsection (6) of section 159 (which enables the directors to fill a casual vacancy) should be extended to require the directors to report the facts in their next report to the company in annual general meeting and to require an affirmative resolution at that meeting as a condition precedent to the reappointment of an auditor appointed to fill such a vacancy.*

192. It is not unknown for a person to be nominated as auditor of a company without his knowledge. Apart from the fact that he may not be prepared to act this causes difficulty in relation to professional conduct on a change of auditor.

SUBMISSION

193. *Section 160 should be amended so as to provide that notice of the intended nomination shall be sent to the person nominated as well as to the existing auditor.*

194. Section 148 requires the annual accounts to be laid before the company in general meeting but does not require that it shall be the annual general meeting. Auditors are appointed at an annual general meeting to hold office until the conclusion of the next annual general meeting. It is therefore possible for the auditors to be removed (strictly in compliance with section 160) by calling an annual general meeting at which the removal of the auditors is the only business. In this way auditors can be and have been removed before they have been able to carry out their duty of reporting to the shareholders on the annual accounts. The accounts, reported on by new auditors, are subsequently laid before the company in general meeting. While it may sometimes be useful this facility is open to abuse and the Council considers that the balance of advantage lies in removing it.

SUBMISSION

195. *In order to prevent the removal of auditors before they have carried out their duties (which at present can be achieved by calling an annual general meeting at which no business is transacted other than the passing of a resolution to remove the auditors) and also for the reason indicated later in paragraph 220 of head No. 26 the Act should be amended to provide that the annual accounts with the auditors' report thereon shall be laid before the company at its annual general meeting.*

(b) Duties and responsibilities of auditors

196. The essential duty resting upon auditors is to report whether in their opinion the accounts present a true and fair view. To arrive at an opinion they apply their professional skill and judgment in examining the accounts and the underlying records. Having done so they ought not to be required to do more than report their opinion, with such reservations as may be necessary. The Ninth Schedule however requires that their report shall contain statements on all the matters set out in the schedule, whereas on most of those matters it is unnecessary to comment unless the auditors are dissatisfied. The schedule should therefore be revised to enable the auditors to report their opinion without specifying matters of detail on which they have satisfied themselves in reaching that opinion. This would greatly shorten the auditors' report in normal cases and would result in any reservations being more readily apparent to the shareholders.

197. The Ninth Schedule is also unsatisfactory in that it does not recognise that the accounts of a company may not show a true and fair view if it is a banking, insurance or other company which under Part III of the Eighth Schedule is exempted from disclosing certain information essential to the presentation of a true and fair view.

SUBMISSION

198. *The Ninth Schedule should be amended to the form set out at the end of this head.*

199. Auditors of holding companies would be assisted considerably if they had a statutory right to obtain information from the auditors of its subsidiaries. The Council considers that such a right is a necessary counterpart to the statutory obligation resting on the auditors of a holding company to report on the group accounts.

SUBMISSION

200. *Section 162 (3) (which entitles the auditor to require from the officers of the company such information and explanation as he thinks necessary) should be extended to entitle the auditor to require such information and explanation as he thinks necessary from the auditors of subsidiaries of the company.*

(c) *Exemption of exempt private companies from the provisions of Section 161, Companies Act 1948*

201. The Act requires every company to prepare annual accounts and have them audited for the shareholders. A person is not eligible to be appointed auditor unless he is qualified or authorised as required by section 161 (1) but the proviso thereto enables any unqualified or unauthorised person to be appointed where the company is an exempt private company. This exception is unsound and creates dangers to which a company should not be permitted to expose itself. The exception was introduced in the mistaken belief that there were not sufficient qualified auditors to act for all exempt private companies. The information available to the Council indicates that relatively few exempt private companies have auditors who are not qualified or authorised as required by section 161 and therefore the Council is satisfied that the removal of the exception would not create difficulty for exempt private companies in obtaining qualified auditors.

202. The preceding paragraph is concerned with the professional competence of the auditor to undertake the onerous statutory duty with which he is charged. Section 161 (2) contains provisions directed towards ensuring that the auditor shall be independent but the proviso thereto gives an important exception; it enables an exempt private company to appoint as auditor a person who is a partner of or in the employment of an officer or servant of the company. The Council is unanimous in the view that a person who is in the employment of an officer or servant of the company should not be eligible for appointment as auditor. The Council is not unanimous about the exception in favour of a partner of an officer or servant of the company:

- (a) some members of the Council consider that the independence of the auditor is of paramount importance, that an important matter of principle is involved and that, regardless of the way in which the exception may have hitherto operated in practice, the whole of the exception should be withdrawn
- (b) a majority of members of the Council point out however that the Council has not seen any evidence that abuse has flowed from the exception, which in their opinion has been of the greatest benefit to small family companies for which it is an economical and convenient arrangement; they consider that the exception should continue to be available to private companies which wish to take advantage of it.

203. If, in conformity with the view expressed in (b), the exception is not withdrawn the Council considers that there should be disclosure where applicable of the fact that advantage has been taken of the exception.

SUBMISSIONS

204. *The proviso to section 161 (1) (under which a person who is neither qualified nor authorised may be appointed auditor of an exempt private company) should be deleted; if it were considered to be necessary to preserve existing rights the deletion could be without prejudice to the appointment or reappointment of a person as auditor of any company of which that person was auditor on an appointed date.*

205. *The proviso to section 161 (2) (which permits a person who is a partner of or in the employment of an officer or servant to be appointed auditor of an exempt private company) should be amended so that:*

- (a) *a person who is in the employment of an officer or servant of the company shall not be qualified for appointment as auditor*

- (b) *if the auditor is a partner of an officer or servant of the company there should be a statutory obligation to disclose this fact in the notice convening the annual general meeting (but if the submission made in paragraph 187, to the effect that a substantive resolution should be required for the appointment of auditors at each annual general meeting, is not accepted then the disclosure should be made either in the notice convening the annual general meeting or in the directors' report).**

Proposed revised Ninth Schedule. See paragraphs 196 to 198

Statements to be contained in the auditors' report

206. (1) In their report the auditors shall state:

- (a) whether in their opinion the balance sheet and profit and loss account of the company or, in the case of a holding company submitting group accounts, the said accounts of the company and the group accounts, are properly drawn up in accordance with the provisions of this Act so as to give a true and fair view of the state of the company's affairs at the date of its balance sheet and of its profit or loss for its financial year ended on that date; or
- (b) in the case of a company entitled to the benefit of Part III of the Eighth Schedule to this Act, whether in their opinion the balance sheet and profit and loss account of the company or, in the case of a holding company submitting group accounts, the said accounts of the company and the group accounts, are drawn up in accordance with the provisions of this Act so as to disclose, to the extent required by the Act for the class of company concerned, the state of the company's affairs at the date of its balance sheet and its profit or loss for its financial year ended on that date.

207. (2) The auditors' report shall contain statements which in their opinion are necessary if:

- (a) they have not obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit; or
- (b) so far as appears from their examination, books of account have not been properly kept by the company; or
- (c) proper returns adequate for the purposes of their audit have not been received from branches not visited by them; or
- (d) the company's balance sheet and profit and loss account are not in agreement with the books of account and returns from branches.

23. Provisions as to Returns

208. There appears to be no particular significance or merit in the requirement under the Sixth Schedule that the fourteenth day after the annual general meeting is the date to which the annual return must be made up.

SUBMISSION

209. *The annual return should be made up as on the date of the general meeting at which the annual accounts are laid before the company and the return should be submitted to the registrar of companies within twenty-eight days after the date on which that meeting is concluded.*

210. The main reason for the requirement to file an annual return is to make available to the public the information contained therein. The practical value of this facility is however reduced considerably because the file is available for inspection only in London, or in Edinburgh if the registered office is in Scotland.

* Amended as requested in Q. 6418, page 1378.

SUBMISSION

211. *A member of the public should be entitled on payment of a nominal fee to inspect at the company's registered office a copy of each annual return duly signed by a director and by the secretary.*

212. The detailed requirements regarding the contents of the annual return need to be examined with a view to improvement and the elimination of any details which are of no practical value. Examples of matters which need attention are:

- (a) a separate form of annual return should be prescribed for companies whose issued capital consists solely of stock (see however paragraph 66 of head No. 12)
- (b) having regard to the work involved and the doubtful utility of the information, there should be reconsideration of the requirement under item 5 of Part II of the Sixth Schedule to show in the annual return particulars of shares transferred since the last return (or since incorporation) by persons who are still members and by persons who have ceased to be members
- (c) the information to be given in respect of forfeited shares and shares issued at a discount appears to be unnecessarily detailed.

213. Similarly, an examination of the detailed requirements relating to other returns could usefully be made with the same object. For example:

- (a) the return of allotments under section 52(1)(a) is required to show the names, addresses and descriptions of the allottees; the inclusion of the descriptions appears to serve no useful purpose
- (b) when a company increases its capital it is required to file two statements which are almost identical, one under section 63 and one under the Stamp Act; with slight adaptation one form could serve both purposes.

214. Such an examination of detailed requirements could however best be undertaken after the Company Law Committee has completed its work. At that stage the Council would be pleased to assist with suggestions.

SUBMISSION

215. *In due course there should be an examination of the detailed requirements regarding the contents of the annual return and of other returns.*

24. Company and Business Names

Effectiveness of present provisions (see sections 17 to 19, Companies Act, 1948 and the Registration of Business Names Act, 1916); similarity of names; misleading names

216. The Council has no major points to raise regarding the nature and operation of the Registration of Business Names Act, 1916, and the provisions of the Companies Act, 1948, relating to company and business names. The Council's attention has however been drawn to two matters which appear to need consideration:

- (a) it seems undesirable that a company should be registered with a name which is the same as that of an unincorporated organisation already registered under the Registration of Business Names Act (and *vice versa*)
- (b) there appears to be an anomaly under the Registration of Business Names Act with the result that a Mr. Smith and a Mr. Brown may carry on business as Smith & Brown without being registered and complying with the requirements of the Act, but if they carry on business as J. Smith & T. Brown they are required to register and comply with the Act; it is illogical to exempt from registration where either the full names (including full Christian names) are used or the surnames only are used, but to require registration where surnames and initials are used.

25. Foreign Companies

217. Companies which trade in Great Britain but which are incorporated outside

Great Britain are required by the Companies Act, 1948, to give as much information about their companies as would be required of a company incorporated in Great Britain. The Council has no comment to make on this position.

26. Internal Management and Administration

(a) Annual and other general meetings

218. Section 131 (1) is construed as requiring an annual general meeting to be held in each calendar year and as prohibiting the holding of more than one annual general meeting in the same calendar year. If this construction is correct the section creates unnecessary practical difficulties for some companies. Thus:

- (a) a company which normally holds its annual general meeting late in the calendar year may on occasion find that it is not possible to issue its accounts and directors' report until later than usual with the result that in order to comply with the Act an annual general meeting is held in December and immediately adjourned, the effective meeting being held in January
- (b) a company which normally holds its annual general meeting in January is prevented from holding the next annual general meeting in December of the same year even though it may have good reasons for wishing to do so.

SUBMISSION

219. *Section 131 should be amended so as to remove the requirement to hold an annual general meeting in each calendar year (which is the construction now placed on the words "in each year") while retaining the requirement to hold an annual general meeting not later than fifteen months after the date of the previous annual general meeting but with power to the Board of Trade to extend this period on application by the company.*

220. It is normal practice to lay the annual accounts before the company at its annual general meeting, but section 148 does not require this to be done; it requires the annual accounts to be laid before the company "in general meeting". An annual general meeting has little significance unless the accounts and the directors' report are laid before the meeting and it is therefore desirable that this should be a requirement of the law. (This is also desirable for another reason explained in paragraphs 194 and 195 of head No. 22 in connection with the removal of auditors.)

221. Section 148 specifies the maximum period which may elapse between the date to which the annual accounts are made up and the date of the meeting at which they are laid before the members. This period could with advantage be reduced.

SUBMISSION

222. *Section 148 should be amended so that:*

- (a) *the annual accounts (at present required to be laid before the company "in general meeting") shall be laid before the company at the annual general meeting*
- (b) *the annual accounts shall be made up to a date not earlier than six months (instead of the present nine months) before the date of the meeting at which they are laid before the members, or nine months (instead of the present twelve months) in the case of a company carrying on business or having interests abroad; provided that the Board of Trade shall have power to extend the period of six or nine months on application by the company.*

223. The minimum period of notice required for the calling of an annual general meeting is considered to be too long and it reduces unnecessarily the time available for preparation of the documents to be issued for the meeting.

224. The twenty-one days' notice for an annual general meeting may be waived by agreement of all the members entitled to attend and vote; but the period for any other general meeting may be waived by agreement of a large majority of the members entitled to attend and vote. There appears to be no necessity for the more stringent requirement in relation to the annual general meeting. The Act does not require the agreement of the auditors, although they have an important right of attendance.

SUBMISSION

225. *Section 133 should be amended so that:*

- (a) *the minimum length of notice for an annual general meeting would be reduced from twenty-one to fourteen days*
- (b) *notice of an annual general meeting could be waived by the same majority as that now required for any other general meeting, instead of the present requirement that all the members must agree*
- (c) *having regard to section 162 (4), which entitles the auditors to attend any general meeting and to be heard on any part of the business of the meeting which concerns them as auditors, the agreement of the auditors shall be required for the waiving of the normal period of notice of a general meeting.*

(b) *Mode of passing extraordinary and special resolutions*

226. The only practical difference between an extraordinary resolution and a special resolution is that fourteen days' notice of the meeting is required for the former and twenty-one days for the latter. There appears to be no merit in this distinction and the period of twenty-one days is considered to be unduly long.

SUBMISSION

227. *References to extraordinary resolutions should be removed from the Act and replaced by references to special resolutions (or vice versa) and the minimum period of notice should be fourteen days.*

228. It is generally accepted that a special or an extraordinary resolution is passed if not less than 75 per cent. of those voting vote in favour. Arguments do however arise from time to time on the basis that the words "a majority of" which appear in section 141 require a majority (that is to say the difference between the number voting for and the number voting against) of not less than 75 per cent.; on this basis at least 87½ per cent. of those voting must vote in favour in order that the difference between 87½ per cent. for and 12½ per cent. against shall be 75 per cent. of those voting.

SUBMISSION

229. *Section 141 should be amended by deleting the words "a majority of" in subsection (1) and making consequential amendments to the remainder of the section.*

230. Section 143 (1) causes expense and inconvenience because it does not recognise that copies of resolutions or agreements in a form suitable for filing with the Registrar can be made by means other than printing.

SUBMISSION

231. *Section 143 (1) which at present requires printed copies of resolutions or agreements to be sent to the Registrar of Companies should be amended so that the copies shall be in typescript, either printed or copied by other means.*

(c) *Securing proper disclosure of information in circulars seeking proxy votes*

232. In recent years it has become common practice for directors to seek proxies from members entitled to attend and vote at a meeting of the company. To comply with the requirements of The Stock Exchange, London, the practice of companies whose shares are quoted thereon is to send proxy forms to shareholders and debenture-holders entitled to attend and vote in all cases where proposals other than those of a purely routine nature are to be considered. Good practice is to word the proxy forms so that a shareholder or debenture-holder may vote either for or against each separate resolution and this could with advantage be required by law.

SUBMISSION

233. *Proxy forms sent to members and debenture-holders should be in such form that a member or debenture-holder may appoint a proxy to vote either for or against each separate resolution.*

(d) *Exercise of voting rights in cases of interlocking shareholdings, unit trusts, and in other special cases, e.g., by trustees of pension and welfare funds for employees in relation to shares held by such funds in the employer or any associated company*

234. Amounts set aside for the benefit of employees of a company, either by way of pension funds or otherwise, are sometimes invested in shares of the company. If a substantial number of shares carrying voting rights is held in this way by trustees for employees and the directors are able to influence the way in which the trustees use their votes the result may be that the directors are able to ensure that their proposals and actions are invariably approved at a general meeting of the company. Conversely, the position may be such that the employees, through the trustees, are virtually in control of the company.

SUBMISSION

235. *The Council expresses no opinion on the desirability or otherwise of shares of a company being held by trustees of pension or other funds set aside for the benefit of employees of that company; but where such shares carrying voting rights are held the position should be disclosed and a convenient method of achieving this would be to require them to be recorded in the register of shares and debentures held by directors (see paragraph 44 of head No. 6).*

27. Winding-up

Note.—The sub-headings below were not shown in the questionnaire.

Insolvent companies

Calling of meetings

236. Fourteen days' notice is normally required for a meeting of members at which to propose a resolution for a creditors' voluntary winding-up. Section 293 requires a meeting of creditors to be held on the same day or the next day, the notice to be issued simultaneously with the notice calling the meeting of members. More than fourteen days will therefore normally elapse between the date when it is decided to propose winding-up and the date when a liquidator is appointed by the creditors. During this period the state of affairs may deteriorate with the result that creditors will receive less than would have been available if earlier action had been taken to protect the assets.

237. Conversely, a meeting of creditors may be held at such short notice that those able to attend are not a representative body. This arises because section 133 (3) enables notice of a meeting of members to be waived by agreement of a large majority of members and where this is done the effect of section 293, referred to in the preceding paragraph, may be to require the holding of a meeting of creditors without adequate notice.

238. These conflicting considerations need to be reconciled by amendment of the law but it is also necessary to provide for the position where, through lack of information or because of the complexity of the company's affairs, it is impractical to call winding-up meetings of members and creditors within the normal time. The consequent delay in appointing a liquidator may be detrimental to the state of the company. This position could be remedied by enabling the directors to appoint a provisional liquidator in a creditors' voluntary winding-up, as the Court may do under section 238 in a winding-up by the Court.

SUBMISSION

239. *The Companies Act should be amended so that:*

- (a) *subject to (c) below, seven days should be specified as the period of notice required for a meeting of members at which a resolution for a creditors' voluntary winding-up is to be proposed; seven days' notice should also be required for the meeting of creditors, which should be held within twenty-four hours after the meeting of members*

- (b) *Section 133 (3), which enables notice of a meeting of members to be waived, should be made inapplicable to a meeting at which a resolution for a creditors' voluntary winding-up is to be proposed*
- (c) *the directors should have power to file a declaration that the company cannot by reason of its liabilities continue its business and that meetings of the company and of its creditors will be summoned for a date not more than twenty-eight days after the date of the declaration. On filing such a declaration the directors should be required to appoint forthwith a provisional liquidator to remain in office for twenty-eight days or such extended period as the Board of Trade may allow, or until the earlier appointment of a liquidator. The date of the appointment of the provisional liquidator should be treated as the commencement of the winding-up. The provisional liquidator should be protected by statute in relation to all acts properly done by him and should be entitled to adequate remuneration for his services and to reimbursement of all expenses properly incurred.*

Responsibilities of directors

240. There is little in the Companies Act to discourage directors from continuing the business of a company even though they know the company is unable to pay its creditors as the amounts due to them fall due for payment. In a winding-up by the Court section 268 gives the Court power to summon directors and other officers or persons for an examination on oath if they are suspected of having property of a company, but this is for the purpose of discovering property of the company and not for the purpose of enquiring into the conduct of the director or other person before the winding-up of the company was commenced. Section 270 gives power to the Court in certain circumstances to order the public examination of the promoter and officers of a company which is being wound up by the Court. If there were a similar power in relation to any winding-up this would discourage directors from continuing the business of an insolvent company.

241. Section 332 makes provision for the Court to declare that any persons, who were knowingly parties to the carrying on of the business of a company with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, are to be personally liable, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct. The section requires fraudulent intent, which it may not be possible to establish even though the directors have incurred debts in a reckless manner. Personal liability beyond the scope of this section would be a deterrent.

SUBMISSION

242. *The Companies Act should be amended to give the Court power to order:*

- (a) *the public examination of the directors and other officers of a company which is found on winding-up to be unable to pay its creditors in full*
- (b) *that any director or other officer who has been responsible for incurring debts on behalf of a company in a reckless manner shall be liable without any limitation of liability for all or any of the debts or other liabilities so incurred.*

Preferential creditors

243. Section 319 (1) (a) (ii) provides that the Inland Revenue shall be a preferential creditor in respect of taxes assessed on the company up to the fifth day of April next before the date of the winding-up and not exceeding in the whole one year's assessment. The fifth day of April refers to income tax and is inappropriate in respect of profits tax which did not exist when the section was originally drafted. The effect can therefore be arbitrary, for example when the accounting period for profits tax ends on 30th April.

SUBMISSION

244. *The reference to the fifth day of April should be omitted from section 319 (1) (a) (ii) so that it relates to taxes assessed up to the date of winding-up.*

245. A right of subrogation is given by section 319 (4) to a lender whose advance is used for the payment of wages, salaries, or holiday remuneration, so that he may become a preferential creditor in a winding-up in respect of his loan. The lender thus gains a benefit in the nature of an unregistered charge on the assets of a company.

SUBMISSION

246. *A lender who exercises a right of subrogation by reason of section 319 (4) should be a preferential creditor in respect of his loan only to the extent of an amount equal to the wages, salaries or holiday remuneration paid for the period of one month before the date of the commencement of the winding-up.*

Arrangement between company and creditors

247. Section 306 (1) provides, *inter alia*, that any arrangement entered into between a company about to be, or in the course of being, wound up and its creditors shall, subject to a right of appeal, be binding on the creditors if the arrangement is acceded to by three-fourths in number and value of the creditors.

248. The circumstances of a company could be that, whereas a large proportion of the total amount owing to creditors is due to a few creditors, the majority of the creditors have small sums owing to them. In such circumstances the result of a request to the creditors to accede to an arrangement between the company and the creditors may not be answered by as many as three-fourths in number, although the arrangement may be approved by a majority greater than three-fourths in amount.

SUBMISSION

249. *Section 306 (1) should be amended so that where an arrangement between a company and its creditors has been assented to by three-fourths in value of the creditors it would, subject to appeal to the Court, be binding upon all the creditors.*

Accounts and audit

250. To comply with the requirements of section 148 the directors of every company have to submit once in every calendar year a profit and loss account and a balance sheet to the company in general meeting. If the company passes a resolution to wind up, these requirements apparently lapse. Such accounts, made up to the date of commencement of the winding-up, should be prepared by the directors, audited and submitted to the members. In a creditors' voluntary winding-up there is, however, the practical difficulty of lack of funds.

SUBMISSION

251. *A duty should be placed on the directors of a company to present to a meeting of members, at the company's expense, audited accounts covering the period from the last audited balance sheet to the date of the commencement of a members' voluntary winding-up. In a creditors' voluntary winding-up the creditors should have power to require such accounts to be presented to a meeting of creditors.*

252. In a winding-up by the Court the liquidator's accounts are audited by the Board of Trade. There is no provision for audit of the liquidator's accounts in a voluntary winding-up. It is desirable that the accounts should be audited, though lack of funds presents difficulty when the company is insolvent.

SUBMISSION

253. *Company law should provide that an auditor may be appointed to report on the liquidator's accounts, the appointment to be made and the remuneration to be fixed by the members in a members' voluntary winding-up and by the committee of inspection (or the creditors, if there is no committee of inspection) in a creditors' voluntary winding-up.*

Creditors paid in full

254. When, in a creditors' voluntary winding-up, the creditors have been paid in full the Companies Act does not make provision for the winding-up to be converted

into a members' voluntary winding-up. When creditors have been paid in full in a creditors' winding-up, no creditors are left to fix the remuneration of the liquidator; this should be fixed by the members of the company who will be interested in the disposal of the surplus funds of the company.

SUBMISSION

255. *Company legislation should make provision for a creditors' voluntary winding-up to be converted into a members' voluntary winding-up when all creditors have been paid in full.*

Gratuities to ex-employees

256. In a members' voluntary winding-up it may be thought desirable to provide gratuities for employees of the company who are losing employment by reason of the winding-up of the company. Once the decision to wind up has been made it will not be possible to pay such gratuities unless such payments are an "object" of the company under its memorandum of association or all the members of the company approve the payment of the gratuities. It may not be possible for members to give approval; for example, where the members are trustees, or where they are abroad.

SUBMISSION

257. *In a members' voluntary winding-up the liquidator should have power, with the approval of the company in general meeting, to pay gratuities to employees and ex-employees of the company or to classes of such employees and ex-employees.*

Contributories

258. Section 212 sets out the circumstances in which present and past members of a company may be liable in respect of the debts of the company as contributories. The liability of a contributory is limited to the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member. If therefore all the present and past members have held only fully-paid shares or stock of the company there can be no present or past members liable as contributories. Strictly, however, liquidators are bound under the section to prepare a list of all the present and certain past members of a company even though no one is liable as a contributory.

SUBMISSION

259. *A liquidator should not be required to prepare lists of present and past members where the capital held by those members was fully paid.*

Winding-up subject to supervision of the Court

260. Sections 311 to 315 provide a means of winding-up subject to supervision of the Court. This method of winding-up is not used at the present time and the sections have become a dead-letter.

SUBMISSION

261. *The Companies Act should be amended by deleting references to winding-up subject to supervision of the Court.*

Winding-up by the Court

262. Section 218 (3) provides that where the paid-up share capital of a company does not exceed £10,000, the county court is to have concurrent jurisdiction with the High Court to wind up the company. The amount of £10,000 has remained unchanged since 1890.

SUBMISSION

263. *The amount of £10,000 in section 218 (3) should be increased to £50,000.*

Winding-up Rules

264. Although the winding-up rules have been amended from time to time they are now in need of further amendment both in general concept and in detail. They need codifying, indexing and cross-referencing and should be fitted to present-day needs

when liquidators of companies are normally professional accountants subject to the discipline of their professional organisation. The Board of Trade has power to amend the rules.

SUBMISSION

265. *The Companies (Winding-up) Rules should be examined after the work of the Company Law Committee has been completed. The Council will be pleased to assist by submitting suggestions for amendment of the rules to bring them up to date.*

28. Problems of Administration and Enforcement of the Law

In particular, are any difficulties caused by provisions which appear obsolete or inappropriate in modern conditions?

266. The Council does not wish to comment.

1st June, 1960.

Supplementary Memorandum by the Council of The Institute of Chartered Accountants in England and Wales

21. Accounts

The first two sections of this supplementary memorandum relate respectively to the share premium account and the use of pre-acquisition profits of subsidiaries. In certain circumstances these two matters are closely related. The following paragraphs indicate that as a general principle the share premium account should be regarded as being in the nature of contributed capital and the pre-acquisition profits of subsidiaries should not normally be regarded as available for revenue purposes from the standpoint of the holding company. Experience shows however that there are circumstances in which it is appropriate to depart from this general principle and the difficult problem for consideration is to determine who should be responsible for authorising the departure. The conclusion reached by the Council is that this authority should rest with those who are responsible for the affairs of the company, that is to say the directors and shareholders, with the additional safeguard that the auditors of the company should also be satisfied with the nature and extent of the departure.

Share premium account

267. It is an accepted accounting principle that money contributed to a company in consideration of an issue of its shares is equally a capital contribution whether it represents the nominal amount of the share capital issued or partly that amount and partly a sum described as a premium. Were it not that under United Kingdom law every share has a nominal par value, accounting principles would require the whole contribution to be taken to share capital account. The use of a share premium account in conjunction with the share capital account recognises this principle and enables the whole capital contribution to be distinguished from reserves arising in the ordinary course of business, in particular from amounts which are available for dividend.

268. It is also an accepted accounting principle that moneys contributed as capital should not be returned to the shareholders by way of dividend, though prior to the enactment of the Companies Act, 1947, such a return was permitted by law except in companies whose own articles of association prohibited it. The present law on the subject is contained in section 56 of the Companies Act, 1948.

269. Section 56 provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums

on those shares must be transferred to a share premium account which (with certain limited exceptions referred to in paragraph 274 below) is subject to the provisions of the Act relating to the reduction of capital. No difficulty arises where shares are issued for cash. The amount to be taken to the share premium account is the amount of the cash premium.

270. Where however shares are issued for a consideration other than cash it is necessary to decide whether the consideration includes a premium. The view can be taken that as such a consideration has money's worth a proper value should be placed on the consideration and if the value exceeds the nominal amount of the shares issued then the excess should be taken to the share premium account. This would be in accordance with sound accounting and appears to be required by the terms of section 56.

271. While some lawyers take that view others have a different opinion. Some have expressed the view that shares acquired in exchange for an issue of shares can lawfully be brought into the accounts of the issuing company on the basis of the nominal amount of the shares issued and therefore no premium arises, notwithstanding that the shares acquired have a market value greatly in excess of the nominal amount of the shares issued or that the shares of the company are themselves quoted in the market at a price above their nominal amount.

272. In this connection it appears that different lawyers hold different opinions about the effect of the decision in *Head (Henry) & Co. Ltd. v. Ropner Holdings Ltd.* ([1952] 1 Ch. 124). One view is that the case established that where shares are issued for a consideration other than cash and the value of the assets acquired is greater than the nominal amount of the shares issued then the excess is a premium to which section 56 applies. Another view is that the case did no more than establish that if the assets acquired are brought into the accounts at a value in excess of the nominal amount of the shares issued then the excess must be treated as a share premium; but that the case did not establish that it is necessary in law to bring them into the accounts at such a value. It is highly desirable that the law should be clarified.

273. In view of the differences of opinion among lawyers as to whether a premium account should be established where there is an exchange of shares the Council has considered whether it is proper to apply to such transactions any accounting principle different from that applicable to an issue of shares for cash. It is difficult to put forward tenable proposals to that effect and this leads to the conclusion that the principle indicated in paragraph 270 above (placing a proper value on the consideration received) should always be applied and if the value of the consideration exceeds the nominal amount of the shares issued then the excess should be treated as share premium.

274. The restrictions on the use of the share premium account should however be reconsidered. In paragraph 139 of its first memorandum the Council referred to section 56 (2) which permits the share premium account to be used for writing off preliminary expenses and the expenses of any issue of shares or debentures; and in paragraph 140 the Council submitted that it should be made clear that this includes the writing off of any stamp duty paid on the creation of share capital or loan capital. This principle of permitting the premium to be applied in writing off certain "intangibles" could, with suitable safeguards, properly be extended so as to enable it to be applied to eliminate or reduce the "goodwill element" arising on the acquisition of a subsidiary, or of a business, by means of an issue of shares.

275. The use of the share premium account in the manner suggested in the preceding paragraph would have the advantage of enabling a company to eliminate from its balance sheet or its consolidated balance sheet an intangible item which may have no practical significance where it is balanced on the other side by an item of share premium. The proposal would not operate to relieve the profit and loss account of charges which ought properly to be borne by that account.

276. The directors of a company have a statutory duty to ensure that the annual accounts show a true and fair view of the state of the company's affairs; and the

auditors have a statutory duty to report whether in their opinion the accounts so comply with the Act. In discharging these statutory duties the directors and the auditors have to exercise their judgment on a great many matters and it is considered that the appropriate treatment of a share premium arising on an exchange of shares, or on an issue of shares to acquire a business, should be one of those matters. The submission made below is on the basis that the law should be amended to achieve that position.

SUBMISSION

277. *Section 56 should be amended in the following respects:*

- (a) *it should make clear that whatever the nature of the consideration received for an issue of shares, i.e., whether cash or other than cash, a proper value should be placed upon it by the issuing company. If this value exceeds the nominal amount of the shares issued the excess should be treated as a premium. The proper value should be determined for this purpose by reference to all relevant information*
- (b) *except as now specified in the section, the amount standing on share premium account should not be reduced except for the following purposes:*
 - (i) *as submitted in paragraph 140 of the Council's first memorandum, the section should make clear that the share premium account may be applied to write off any stamp duty paid on the creation of share capital or loan capital*
 - (ii) *subject to the conditions specified in (c) below, to reduce or eliminate the amount of the "goodwill" item which would otherwise be included in the accounts of the company and/or its group accounts as a result of the acquisition, in exchange for the issue of shares to which the premium relates, of a business or goodwill or of interests in a subsidiary; and to make a corresponding reduction, when and to the extent that it becomes necessary, in the amount at which the shares in the subsidiary are carried in the books of the company. For this purpose "goodwill" includes any intangible item arising in consequence of the treatment of pre-acquisition reserves of the subsidiary as revenue reserves for the purpose of the holding company's group accounts (see paragraph 286)*
- (c) *any reduction of the share premium account for the purpose referred to in (ii) above shall be subject to all the following conditions:*
 - (i) *the right to make such a reduction shall have been reserved in the terms of issue of the shares at a premium (except that there should be appropriate transitional exemption for the benefit of companies which have already issued shares at a premium without reserving such right); and*
 - (ii) *the reduction shall be authorised by specific resolution of the shareholders; and*
 - (iii) *the accounts shall disclose the manner in which the premium has been applied and shall contain statements by the directors and by the auditors that in their opinion, having regard to all relevant circumstances, the treatment adopted is consistent with the presentation of a true and fair view of the state of the company's affairs.*

Use of pre-acquisition profits of subsidiaries

Note.—In paragraphs 141 and 142 of its first memorandum the Council dealt with what appears to be a drafting error in paragraph 15 (4) of the Eighth Schedule. The paragraphs below relate to the general question of pre-acquisition profits.

278. Where a company purchases shares in another company to an extent sufficient to make that other company its subsidiary, the asset which the holding company acquires consists of shares in the subsidiary but those shares represent the whole of the net assets of the subsidiary (or the appropriate proportion thereof where there are

minority interests). The holding company's real investment is therefore in the underlying assets of the subsidiary. If the subsidiary declares a dividend out of profits earned prior to the acquisition of the subsidiary by the holding company the dividend received by the holding company is in effect a return of part of the capital investment and should be applied by the holding company in reduction of the cost of the investment.

279. As a matter of accounting principle therefore the reserves of a subsidiary on the date as from which the shares in the subsidiary were acquired should be treated by the holding company as being of a capital nature and not normally be brought into account in determining the profits which in the hands of the holding company may properly be regarded as available for distribution to its shareholders. The Committee on Company Law Amendment recommended in paragraph 123 of its Report (Cmd. 6659) that this principle should be specifically incorporated into company law. The section proposed by that Committee was not adopted and there is doubt as to how far paragraphs 15 (4) and 15 (5) of the Eighth Schedule to the Companies Act 1948 give effect to the principle.

280. Paragraphs 15 (4) and 15 (5) of the Eighth Schedule relate to the statement which is required to be annexed to the balance sheet where group accounts are not submitted. For that purpose paragraph 15 (5) prohibits (subject to a specified exception) the treatment of pre-acquisition profits or losses as being revenue profits or losses in the accounts of the holding company. The paragraph also includes in parentheses the words "for that or any other purpose". The meaning of these words is not clear. Some lawyers consider that they give effect to the principle recommended by the Committee on Company Law Amendment but other lawyers do not accept that view.

281. The Council considers that the principle referred to in paragraph 279 above should be embodied in company law and should not be subject to any exception where the shares in a subsidiary are purchased for cash or other assets of the holding company or in exchange for an issue of debentures or other securities which create a liability of the holding company. Where however the shares in a subsidiary are acquired in exchange for an issue of shares of the holding company (or such shares together with cash or other assets) additional considerations arise. The effect of such an exchange is that the shareholders in the subsidiary become instead shareholders in the holding company and it is appropriate, subject to certain safeguards, that if the parties to the exchange are agreeable the holding company should be permitted to treat the pre-acquisition reserves of the subsidiary as being of a revenue nature from the standpoint of the holding company.

282. This is a matter which concerns only the shareholders and not the creditors of either company. Any distribution by the subsidiary out of pre-acquisition reserves would not exceed the amount which it could have distributed before or at the time of the acquisition; and the creditors of the subsidiary are unaffected by whether the holding company treats the dividend received as being revenue or capital. Similarly, the creditors of the holding company have never had an interest in the reserves of the subsidiary and where the acquisition is made in exchange for an issue of shares by the holding company they are not prejudiced by the way in which the holding company deals with the dividend received.

283. Paragraphs (a) and (b) of paragraph 15 (5) of the Eighth Schedule already permit the pre-acquisition reserves of subsidiaries to remain (for the purpose of that paragraph) as revenue reserves when there is a transfer of ownership of a subsidiary within an existing group, that is to say where a subsidiary acquires shares in a fellow subsidiary either from the holding company or from another fellow subsidiary. There should be similar preservation of the revenue nature of reserves where a reorganisation is brought about by the formation of a new holding company which is superimposed on an existing company. Thus an existing company (whether a holding company or not) may find it advantageous to reorganise its affairs so that it becomes a subsidiary of a new holding company which issues its own shares to the shareholders in the

existing company in exchange for their shares therein. After such a transaction there would be no change in the identity of the shareholders or their interests in the group.

284. There is a great variety of other circumstances in which exchanges of shares occur with or without additional consideration in the form of cash or other assets. A new company may be formed which issues its shares to the shareholders of two or more other companies in exchange for their shares in those companies, so that after the transaction the shareholders in the holding company consist only of the persons who were the shareholders of the acquired companies. The parties to the scheme may consider that its acceptance requires the inclusion of a condition that to a specified extent the revenue reserves of the subsidiaries at acquisition should be available for revenue purposes of the holding company in order that they may continue after the exchange to enjoy what they regard as reasonable cover by way of revenue reserves for their future dividends. An existing company may take over shares in several other companies, or one company may acquire the shares of another, by means of a transaction involving exchanges of shares. The amount, if any, of the holding company's revenue reserves which were attributable to each of its shares before the acquisition under such a scheme will necessarily be reduced by the admission of new shareholders to participate in those reserves unless a corresponding amount of the subsidiary's revenue reserves at acquisition is available for treatment by the holding company as revenue after acquisition. There may be circumstances in which the treatment of a subsidiary's reserves at acquisition as being available for revenue purposes to the holding company after acquisition would be entirely appropriate; in others the appropriate course would be to treat the reserves as capital from the standpoint of the holding company. The appropriate treatment of the revenue reserves of the companies concerned can be determined only after consideration of the precise nature of the transaction, the value of the shares involved, the relative interests of the shareholders of the companies before and after the exchange and the conditions on which the exchange is accepted by them.

285. The Council considers that it is impracticable to attempt to legislate for all the different circumstances and that accordingly there should be suitable provisions under which appropriate treatment can be decided upon in relation to the facts of each case. The directors of a company have a statutory duty to ensure that the annual accounts show a true and fair view of the state of the company's affairs as on the balance sheet date and a true and fair view of the profit or loss for the financial year; and the auditors have a statutory duty to report whether in their opinion the accounts so comply with the Act. The Council considers that the appropriate treatment of pre-acquisition reserves should be decided in the light of these statutory requirements. The submissions below are made on this basis with the further safeguards that the treatment should accord with the conditions on which the shares are acquired and that a specific resolution of the shareholders should be required on each occasion when pre-acquisition reserves are actually applied by the holding company for purposes for which they would only be available if they were revenue reserves from the standpoint of the group.

SUBMISSION

286. *Responsibility should be placed upon the directors and shareholders to ensure (and upon the auditors to satisfy themselves) that the following rules are complied with by a holding company in relation to its treatment of the pre-acquisition reserves of its subsidiaries which are attributable to its holdings of shares in those companies. By "pre-acquisition reserves" are meant reserves of a subsidiary which were in existence in the subsidiary at the date or respective dates as from which the shares in the subsidiary were acquired by the holding company:*

- (a) *pre-acquisition reserves of a subsidiary should be treated by the holding company as being of a capital nature from its standpoint except to the extent that other treatment is permitted in the circumstances and to the extent mentioned in (c) to (f) below*

- (b) *treatment of a reserve as being of a capital nature means for this purpose that any dividend declared or paid out of such a reserve by the subsidiary to the holding company should be treated by the holding company as not being available for distribution in dividend to its own shareholders and that in any group accounts or equivalent statement the reserve should not be treated as a revenue reserve nor used to relieve a post-acquisition loss of a subsidiary*
- (c) *where shares are acquired by a holding company in a subsidiary by means of an exchange of shares (with or without additional consideration in the form of cash or other assets or the assumption of a liability by the holding company) the pre-acquisition reserves of the subsidiary which are available for distribution by the subsidiary need not be treated by the holding company as being of a capital nature from its standpoint to the extent that the right of the holding company to treat them as revenue after the acquisition is reserved in the conditions on which the shares are acquired and always provided that:*
- (i) *on each occasion when pre-acquisition reserves of a company are effectively used for revenue purposes by a holding company of which it is a subsidiary such use is authorised by a specific resolution of the shareholders of the holding company; and*
 - (ii) *where pre-acquisition reserves of a subsidiary are included in the group accounts as or among revenue reserves, the accounts contain a statement that any use of those reserves for revenue purposes requires authorisation by specific resolution of the shareholders of the holding company and the amount of such reserves which are so included should be stated; and*
 - (iii) *the accounts contain statements by the directors and by the auditors that in their opinion, having regard to the amalgamation of the interests of the companies concerned and all relevant considerations, the treatment of pre-acquisition reserves as being of a revenue nature from the standpoint of the holding company is fair and reasonable in the circumstances and is consistent with the presentation of the true and fair view required by the Act*
- (d) *there should be appropriate transitional exemption for the benefit of companies which have already acquired subsidiaries without reserving, as required by (c) above, the right to treat pre-acquisition profits as revenue*
- (e) *the rule in (a) above should not apply to rearrangements of shareholdings within a holding company group*
- (f) *as part of the terms of the transaction under which shares in a subsidiary are acquired it should be permissible to specify that any amount properly set aside by the subsidiary in respect of future tax shall, for the purpose of the transaction, be treated as a liability of the subsidiary irrespective of the description given to the amount in the balance sheet of the subsidiary.*

Movements on capital account

287. The Act does not require the annual accounts to show changes which have taken place in the capital structure of a company since the previous accounts and it is desirable that this information should be disclosed.

SUBMISSION

288. *Where there has been a change in the share capital of a company (for example an increase of authorised capital or an issue of further capital for cash or a capitalisation issue or an issue in exchange for shares in another company) the changes since the previous balance sheet date should be disclosed in the annual accounts.*

Stock-in-trade and work in progress

289. In most businesses the amount carried forward for stock-in-trade and work in progress as on the balance sheet date has a material bearing on the amount of profit or loss for the period ended on that date. The basis normally used to determine the amount is cost less any part thereof which properly needs to be written off at the balance sheet date. There are however various methods of computing cost and alternative methods of arriving at the amount, if any, to be written off and there are various special bases which are regarded as appropriate in some businesses. Circumstances vary so widely that no one basis is suitable for all types of business nor even for all undertakings within a particular trade or industry.

290. It would therefore be undesirable to attempt to lay down by statute any rules governing the computation of the amount to be carried forward for stock-in-trade and work in progress. Nevertheless the overriding consideration is that the accounts should give a true and fair view and it is therefore important that the basis adopted should be used consistently from period to period and should be appropriate to the nature and circumstances of the business and that the accounts should disclose adequate information. Accordingly the following submission is made and by way of amplification reference is made to the Council's Recommendation No. 22 on TREATMENT OF STOCK-IN-TRADE AND WORK IN PROGRESS IN FINANCIAL ACCOUNTS. (That Recommendation is one of the Council's series of Recommendations on Accounting Principles. The full series has already been submitted to the Company Law Committee.)

SUBMISSION

291. *The Companies Act, 1948, should be amended so as to provide that:*

- (a) *where the amount carried forward for stock is material in relation to either the trading results or the financial position the accounts should indicate concisely the manner in which the amount has been computed; if that is not practicable the accounts should contain a note which makes a declaration to that effect and states whether the amount has been determined for the whole of the stock at the balance sheet date on bases and by methods of computation which are considered appropriate in the circumstances of the business and have been used consistently*
- (b) *where there has been a change in the basis or method of computation the effect if material should be disclosed as an exceptional item in the profit and loss account or by way of note.*

1st February, 1961

APPENDIX XLIX

Memorandum by the Federation of British Industries

1. Incorporation of Companies—Memoranda of Association

(a) Requirements as to minimum number of members, and other conditions of incorporation

We recommend that a company should be allowed to have a wholly-owned subsidiary company in which all the shares are held by the company itself. The power to form subsidiary companies is very highly valued by our members, but they complain of the administrative inconveniences involved in the requirement of two or seven members. At the moment, if the holding company wishes to retain complete control of the subsidiary, it has to set up a troublesome and useless structure of nominee shareholdings to do so. We recommend that this be made unnecessary by permitting a company, which already possesses all the beneficial interest in a subsidiary, to become the sole shareholder in that subsidiary. We do not recommend that such a privilege should be extended to private persons. We realise that such a rule would involve a fundamental change in the theoretical basis of company law, but we consider that its only practical effect would be to simplify companies' administration.

(b) Limitation of objects to those stated in the Memorandum; obsolescence of ultra vires rule in view of universality of modern objects clauses; effect of that rule as between a company or its directors and third parties, and as between a company and its directors. The present method of altering objects.

We support the recommendations of the Cohen Committee (paragraph 12). As the Committee said, "a practice has grown up of drafting memoranda of association very widely and at great length so as to enable the company to engage in any form of activity in which it might conceivably at some later date wish to engage and so as to confer on it all ancillary powers which it might conceivably require in connection with such activities. In consequence the doctrine of *ultra vires* is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company. . . . We think that every company, whether incorporated before or after the passing of a new Companies Act, should, notwithstanding anything omitted from its memorandum of association, have as regards third parties the same powers as an individual. Existing provisions in memoranda as regards the powers of companies and any like provisions introduced into memoranda in future should operate solely as a contract between a company and its shareholders as to the powers exercisable by the directors. In our view it would then be a sufficient safeguard if such provisions were alterable by special resolution without the necessity of obtaining the sanction of the Court, subject in cases where debentures have been issued before the coming into force of a new Act, to the consent of the debenture-holders by extraordinary resolution passed at a meeting held under the provisions contained in the trust deed or (in the absence of such provisions) convened by the Court." If this should lead to there being one document instead of the Memorandum and Articles, we would see no objection to this.

(c) The company as a legal entity distinct from its members—"one man" companies

We do not recommend any alteration of the law on this point. Although the original purpose of a company as a method of association is still of great value, it is today even more valuable as a method of creating new legal entities. Any limitation on this power would be a serious hindrance to British industry.

(d) Shares of no par value

Our evidence to the Gedge Committee on Shares of No Par Value was very much in favour of permitting that form of capital, subject to certain safeguards to ensure that the capital was preserved and the shareholder was not confused. We support that Committee's recommendations.

3. Classification of Companies

- (a) *Nature and merits of distinction between public and private companies; adequacy of restrictions imposed on the latter*
- (b) *Nature and merits of distinction between exempt and non-exempt private companies (sections 127, 129 of Companies Act, 1948)*

We do not consider any change in the law here is necessary. The only way in which any of our members are harmed by the present situation is that some of them suffer from bad debts incurred by exempt private companies, but we do not feel that the abolition of the privileges of exempt private companies would really cure this. There are also very grave practical difficulties in the way of any measure which would require the prompt filing of another 250,000 sets of properly audited accounts each year.

4. Donations by Companies for Charitable and Political Purposes

We do not recommend any change in the law here. As the law stands at the moment, any company which feels doubtful about its powers to make charitable or other donations may seek to increase those powers by special resolution. This seems to us to be a satisfactory situation.

5. Exercise of Powers of Companies by Directors and Degree of Control Retained by Shareholders.

The practice of drafting very full objects clauses has meant that directors may have a very wide discretion in the exercise of their powers. Such a discretion is, of course, almost always exercised reasonably and to the satisfaction of all concerned. However, we consider that it could be limited in the ways set out below under paragraphs "a" to "e" with some benefit to shareholders and without hampering British industry.

- (a) *Fundamental changes in company's activities*
- (b) *Disposal of undertaking and assets*

It is already standard practice among well-conducted companies to obtain the consent of the shareholders to a sale of a substantial part of the company's undertaking. We consider that this should be required by statute. We recommend that any contract to sell a substantial part (say, more than half) of the company's undertaking should be made with the shareholders' subsequent approval as a condition of validity, and further that, if the proceeds of the sale are in cash or in anything easily convertible into cash, then the consent of the shareholders should be required if those proceeds are to be redeployed in some substantially different activity, even though that activity is permitted by the memorandum.

- (c) *Issue of shares*
- (d) *Borrowing money and charging property*
- (e) *Lending money otherwise than in the ordinary course of business*

We do not consider that any change in the law relating to these last three matters is necessary, except that the law of Scotland about the creation of a floating charge should be brought into line with that of England. As our Scottish Council pointed out to the Law Reform Committee for Scotland last year, the present rule is a serious handicap to Scottish companies wishing to raise loan capital.

As a natural development, we would favour arrangements for bringing Scots companies into line with English companies in the matter of registration of charges. In particular, where a Scots company has a charge over property in England, we suggest that charge should be registrable with the Registrar of Companies in Edinburgh alongside the existing Company File and not with the Registrar of Companies in England, who does not hold the file of a Scots company.

6. Directors' Duties.

(a) *Should their duties be stricter and more clearly defined, and if so, in what respects?*

We do not consider that there is any need to make directors' duties stricter or more clearly defined.

(c) *Directors' and officers' dealings in their own companies' shares*

As the law stands, it is possible for a director to use his inside knowledge of a company's affairs to engage in profitable dealings in the company's shares. We are very strongly opposed to such conduct, and would support any practicable measure to prevent it. One improvement would be for the Register of Director's Shareholdings to be normally open to the public, and copies of it available, during business hours. The register should also be extended to include those officers of the company who normally attend board meetings. If it is impracticable to have the register open all the year round, it would be some improvement to adopt the Cohen Committee's recommendation that the Board of Trade should have power to order that the register be opened.

By section 195, a wholly-owned subsidiary has to keep a register of its directors' shares in its holding company. Where the director of the subsidiary is also a director of the holding company, the same information thus has to be duplicated in the registers of the subsidiary and the holding company. This benefits nobody, since the information on the subsidiary's register is already available to all the persons concerned. We, therefore, recommend that a director should not be obliged to disclose his shareholdings twice, provided that the information is already available to all the persons concerned.

(d) *Disclosure of directors' interests*

The present requirement under section 199, that directors shall disclose any interest, direct or indirect, in any contract or proposed contract with the company, is very burdensome when a director holds shares in any substantial number of companies. In such cases, the only way in which the statutory requirement can be complied with in practice is for companies to have a full list of all of each director's shareholdings for every board meeting. We fully accept that a director should have to disclose any interest which might affect his decisions at a board meeting, but the present rule goes too far. As far as interests in other companies are concerned it should be enough for a director to disclose any other directorships or any substantial shareholding. A substantial shareholding would, *prima facie*, be one of, say, more than 10 per cent of the issued capital.

(e) *Should bodies corporate be allowed to be directors?*

We consider that bodies corporate should still be allowed to be directors. A number of our members find their power to appoint corporate directors valuable, and we are not aware that it has ever been abused.

7. Shares with Restricted or No Voting Rights

We do not wish to recommend any change in the law relating to these shares. We appreciate the problems which the issue of such shares may cause, but a rule that all shares with the same rights, other than votes, should have equal voting rights would be far too heavy a restriction on legitimate operations, and anything less than this would be only too easy to evade. It would seem better to leave the matter to the Stock Exchanges, which can exercise their own discretion in each case as it arises, and can refuse quotations to any share if they do not think that the holder of such a share will be adequately protected. We would be glad to see such action taken in future cases, though we would oppose the withdrawal of quotations from non-voting shares already on the market.

8. The Protection of Minorities

We do not wish to submit any evidence specifically on this point, though our evidence under questions 9 and 10 is relevant to it.

9. The Protection of Special Classes of Shares

A. The protection given to the holder of special classes of shares by section 72 of the 1948 Act has been greatly reduced by the series of decisions, starting with *Greenhalgh v. Arderne Cinemas*, in which it has been held that a shareholder's rights are not "varied" by the creation of further shares with the same rights as his. Such an action may nevertheless have very serious effects on the shareholder's powers in practice, and there should be some measure of protection for him. On the other hand, a rule that each class of shareholder should have the right to veto any measure which would affect that class's voting powers would lead to an unduly rigid capital structure, or to a situation where the rights of the holders of a special class of shares included the right to be bought off every time the company's capital was increased. A compromise, which would be considerably more satisfactory than the present position, would be for the voting powers of all future issues of shares to be based on their nominal value. This would at least prevent the most objectionable technique, that of "splitting" one share with one vote into say four shares, each of a quarter the value and carrying four votes. If shares of no par value are permitted, the regulations governing their voting will have to be carefully drawn.

A similar difficulty has arisen in cases where preference shares, not originally issued as convertible, are converted into ordinary shares, thus affecting in a very practical way, the rights of the other ordinary shareholders. Such a change should only be possible with the consent of the ordinary shareholders as a class.

B. We do not recommend that preference shareholders should be given any power of veto which would prevent the return of capital on those shares as a result of a winding-up or reduction of capital. To do this would be unfair to the ordinary shareholders. The matter is best dealt with by leaving it to the bargain made by the preference shareholders when they subscribe for their shares. If, as is becoming common practice, the Spens formula (see Annex) is adopted in determining the amount to be paid to the preference shareholders in the event of liquidation or reduction of capital, then the preference shareholders will not suffer any real loss. We do, however, suggest that other classes of shares, ranking in front of ordinary shareholders, might be given the right to cast a vote in general meeting on a resolution for winding-up or reduction of capital.

C. Consideration might also be given to the insertion in Table A of any new Companies Act of a provision that, if a company adopts Table A and creates preference shares carrying a specified rate of dividend, then, unless the Articles specifically provide otherwise, those preference shares should carry certain defined rights and obligations, e.g.,—

- (a) they should give no right to participate in profits or any surplus in a winding-up,
- (b) the preference dividend should be cumulative,
- (c) the preference shareholders should not be entitled to vote in general meetings unless the preference dividend is in arrear and unpaid for a period of not less than six months,
- (d) in a winding-up the preference shares should rank both as regards repayment of capital and arrears of dividend in priority to other shares of the company.

10. Board of Trade Powers to Appoint Inspectors

Board of Trade inspectors have a very valuable function to perform. As standards of commercial morality have risen it has become generally agreed that there are some sorts of conduct which ought to be restrained, if sometimes only by publicity, but which

do not, and should not, lead to action by the Fraud Squad. It is that sort of case which calls for a Board of Trade inspector. However, their usefulness is at the moment limited by the fact that almost every Board of Trade enquiry to date has disclosed misconduct. As a result, the very appointment of an inspector is a serious stigma on a company, which the Board, quite properly, does not wish to impose wrongly. Inspectors are thus only appointed when there is virtually a case for the Fraud Squad, so that they almost always have misconduct to report. It might be possible to break this "vicious circle" by having two classes of enquiry. One would be for those cases where there was the suspicion of some form of criminal activity. The other would be for cases where there was no real suspicion of crime, but only of incorrect conduct. The class of the enquiry would always be clearly stated at the outset. However, such alteration in the Board's powers would be of no value if it were not accompanied by an alteration in policy which produced a wider use of them.

There are two minor amendments which would also require legislation. The first is that sections 164 and 165 should be extended to allow inspectors to be appointed where there has been some suspicious movement of the company's shares. The second is that the inspectors should be provided with a secretariat, since they are often barristers whose own organisation is necessarily too limited for the extra work involved.

11. Disclosure of Ownership and Control

We can make no recommendation for a change in the law here. This is not because we are satisfied with the present situation, in which nobody may know who is controlling or attempting to gain control of a company, but because there does not seem to be any practicable method of avoiding it. Any system which attempted to compel disclosure would in our view be subject to the following disadvantages:

- (1) It would never be watertight. It would always be possible for somebody determined to conceal his activities to do so, e.g., through a foreign company.
- (2) It would tend to restrict dealings in shares, and in particular would make bearer shares nonsensical.
- (3) It would discourage foreign investment, particularly through the "share deposit" system. Under this, such organisations as the Guaranty Trust in the U.S.A. and Sicovam in France hold blocks of shares in British companies, and issue "deposit certificates" in respect of them. These certificates are usually freely transferable as bearer documents. The British company, however, cannot go behind the company in whose name the shares are registered, and the system would lose much of its virtue if it could.
- (4) It would be impossible to apply in those cases where the holder of shares is neither the beneficial owner nor the nominee of a particular person, e.g., the trustee of an ordinary settlement or of a unit trust.
- (5) It would embarrass those who have legitimate reasons for concealing their interest.
- (6) It would entail much more work for Company Registrars than it would be worth.

Furthermore, the Board of Trade already has power to find out who owns a company's shares, under sections 172 and 173 of the current Act. If there is any suspicion of improper conduct, this power can and should be exercised. A more liberal use of this power would be a better solution than any attempt to make it automatically compulsory to disclose an interest.

13. Multiplicity of Directorships held by One Individual

This is not in our view a subject on which the law should lay down any limit, such as that of 20 directorships for any person which is to be found in the Indian Law.

Any numerical limit would be illogical. The responsibility falling on a director of a very large company may be much greater than that falling on a director of a string of much smaller companies whose affairs give little trouble.

This matter is partly tied up with the next item—carrying on business through subsidiary companies. If the carrying on of business through subsidiary companies is a valuable facility (and we have no doubt that it is), then it is obviously desirable to allow individuals to be appointed to the boards of subsidiaries without limit. Quite apart from that, however, we feel that the subject is not a proper one for legislation.

Many boards as a matter of policy are constituted partly of working directors and partly of directors who have special knowledge which will be valuable to the company. They may have knowledge of general finance, of markets, of raw material sources, or of technology in allied industries or may be useful in other ways. It is for the board to judge whether the other directorships held by any individual reduce his usefulness as one of them.

14. Practice of Carrying on Business through Associated and Subsidiary Companies

This practice is a very valuable one, which is not enjoyed in many foreign countries and which the business community in such countries envies. In some, company law puts difficulties in the way of having parent and subsidiary companies. In others, the tax penalty is so prohibitive that the system is rarely adopted. For example, in France a profit made by a subsidiary is taxed and, when that subsidiary pays a dividend, that dividend is in substance again taxed in the hands of the parent without recognition of the fact that it represents taxed profits. These difficulties do not exist in this country.

There are many advantages in having separate subsidiaries. There may be questions of securing continuity of management after an amalgamation or of relations with employees. In overseas trade it is often particularly important to keep the business with one particular market in a separate entity. Our taxation code not only imposes no penalty but actually facilitates the system of parent and subsidiary by allowing "subvention payments" and gives positive advantages to British resident subsidiaries which can qualify for status as Overseas Trade Corporations.

If the objects clause in the memorandum is to be more narrowly drawn in future, it will be increasingly desirable to permit the present freedom to organise as parent and subsidiary to continue. Many companies find it wise to diversify their interests. It is a matter for the Board to judge whether this is best secured by having what are essentially different businesses carried on as departments of one company or as distinct companies within the group.

It is suggested that most of the objectionable practices involving the system of parent and subsidiary have been stopped by the requirement of consolidated balance sheets, and there is certainly no need to abolish the whole system.

16. Take-over Bids

(a) Procedure

We do not recommend any attempt to lay down a set legal procedure for bids. Whilst the procedure suggested in the booklet put out by the Issuing Houses Association could hardly be bettered, we consider that any attempt to impose it in all cases would sometimes make useful amalgamations very difficult to bring about. The one rule which we would suggest ought to have statutory backing is that there should be a minimum period for the acceptance of an offer.

On one point we consider the present law—and the new Board of Trade regulations—too onerous. By section 193 (3) any payment to a director for his loss of office in connection with the transfer of all or any of the company's shares requires approval by a meeting of shareholders summoned for that purpose. In a take-over bid details

of such payments have often been included as part of the terms of the offer and it seems pointless to call a meeting of shareholders who, if the bid is accepted, will no longer have any interest in the company's future. It is suggested that shareholders should be permitted to indicate in writing (e.g., on the Forms of Acceptance and Transfer issued with the offer) whether they approve the proposed payment and that, if it is so approved by a majority of the shareholders, no meeting should be necessary.

(b) Securing disclosure of information on which shareholders can form an opinion

Shareholders should be given reasonable particulars of the bidding company, particularly when the consideration is shares in the bidding company.

There are two particular defects in the law as it stands. The first is that, according to the decision of Wynn Parry J. in *Government Stock, etc., Investment Co. v. Christopher*, an offer to give unissued shares in the bidding company in exchange for those in the company bid for is not a prospectus, and so does not have to include the information required in a prospectus. We submit that such an offer should be bound by the same rules as a prospectus.

Secondly, the rule in the Prevention of Frauds Act, 1958, sections 13 and 14 that a circular offering to acquire shares in a company must have the approval of the Board of Trade, does not apply to licensed and exempt dealers. We do not suggest that this privilege should be withdrawn, but we do recommend a tighter check on it. The qualifications for a licensed or exempt dealer should be more exacting, and licences should not only be renewed annually, but reviewed as well.

(c) Functions of Directors

We consider that directors should always disclose to their shareholders the actual receipt of any genuine bid which is materially in excess of the market value, and should give in some detail their reasons for recommending or opposing it.

The question of timing for the disclosure of negotiations between two boards is a difficult one, upon which we do not wish to make any recommendation. In principle a press announcement, etc., should always be delayed until the last possible moment. In many cases, however, it is quite obvious that news of a bid has leaked out and that some people have thereby profited on the Stock Exchange. In such a case the news should be made public at once, though the ideal should always be to maintain secrecy, as in the case of Nestlé's and Crosse & Blackwell.

It does sometimes happen that directors of a company, who have short-term service contracts at reasonable salaries, hear of an impending bid for their company and proceed to give themselves long-term contracts at very high salaries, thus increasing the amount of compensation they will receive if the bid succeeds and they have to resign. The bidder has probably settled the total amount he is prepared to pay for the company, and any increase in the amount he pays the directors will have to be deducted from the amount he can pay to the shareholders. We would welcome any change which would prevent such activities, provided that it did not also affect other, perfectly proper, long-term service contracts granted to directors.

(d) Disclosure of identity of bidder

It is desirable that the identity of the bidder should be disclosed from the start, but it should, in any event, be announced in the formal offer, together with a statement of the amount of its shareholding in the "bid for" company and the date(s) it acquired it. This requirement should apply equally to directors of the bidding company. It will have to be a statutory requirement, since it will otherwise be ignored by the very people who require controlling. We realise that such a provision could not be made watertight, but if it is made similar to the obligation on directors to disclose their dealings in their company's shares, the risk of being found out might be an adequate deterrent to evasion.

(c) The financing of such transactions

If the consideration is to be cash, we recommend that it should be irrevocably deposited with the company's bankers, or guaranteed by a bank, before the formal offer goes out.

(Note). It will be apparent that this answer was substantially settled before the publication of the draft Board of Trade Rules for Licensed Dealers, which satisfy many of our recommendations.

21. Accounts

*Do the accounts require the disclosure of sufficient information about the financial position of the company, including its subsidiaries and associated companies?
Are all the existing provisions necessary and useful in present-day conditions?*

We do not consider that the statutory rules about accounts need substantial alteration. Whilst we do not suggest that the accounts of every company in the United Kingdom are presented according to the best accounting practice, a more onerous version of Schedule VIII is not, in our opinion, the right way to improve their presentation. It is better left to the accounting profession, who may be relied on to continue to raise the standards of company accounts.

However, there are two matters which we would suggest might be considered by the accountants and the Committee:—

(d) Description of reserves

We consider that sums set aside to meet future tax liabilities should be described as such, and not included under "reserves" or "provisions". The Board of Trade should be able to grant exemption from this requirement in appropriate cases, e.g., tax set aside against a disputed claim in a foreign country.

(e) Definition of profits

The variety of methods of calculating profits in use today may make a comparison of company accounts misleading to the uninformed eye, but we do not recommend any attempt to impose a standard method of calculation, since no method is universally applicable. We oppose any change in the exemption of banks, etc., from some of the accounting provisions of the Companies Act.

22. Audit

(c) Exemption of "exempt" private companies from the provisions of section 161 of the Companies Act, 1948.

The great majority of our members do not benefit from this exemption, since they have to use qualified accountants for commercial and fiscal reasons. However, we do not recommend any alteration in the rule, since we do not consider that the exemption does any harm. If the company's affairs are so simple that unprofessionally prepared accounts are acceptable to the management, the shareholders, and the Inland Revenue, there can be no need for professional audit.

24. Company and Business Names

The present wide powers of the Board of Trade and of the Registrar of Business Names to refuse names appear to be satisfactory. However, their powers over names after they have been registered are too narrow. The Board of Trade can only order a company to change its name if it is too much like one already registered; the Registrar can only remove a name where it misleadingly gives the impression that the firm is under British ownership or control. It would be more satisfactory if their powers extended to all names which they considered "calculated to mislead". In such a case, the company might have power to appeal to the Court if it considered that this power was being improperly used.

A further defect is that a company incorporated outside Great Britain is not affected either by sections 17 and 18 of the Companies Act or by the Registration of Business Names Act. It is submitted that the Registration of Business Names Act should be extended to such companies.

There is also a difficulty where a company wishes to change its name. At the present time a company may, under section 18 of the Companies Act, 1948, change its name by special resolution and with the approval of the Board of Trade signified in writing. The practice of the Board of Trade is to sanction change of name only after a printed copy of the special resolution has been filed with the Registrar of Companies. The change of name is not complete until the Registrar has issued his certificate and provided that the new name has not been used meanwhile. If asked before the special resolution has been passed whether approval is likely to be forthcoming, the Board of Trade will say "yes" or "no" but will add that the Registrar has no power to reserve a name. Thus, even with the informal approval of the Board of Trade, the name may still be lost.

It would be possible to overcome this difficulty by providing that the Registrar on written application may reserve a name for a definite period, pending registration of a company or a change of name by an existing company.

Finally, we recommend that section 201 of the Companies Act, which requires that directors' names, former names, and nationalities, if not British, shall be printed on all trade catalogues, trade circulars, and showcards, should be repealed. It is of little or no value, and is frequently disregarded. In the case of business note-paper, however, we feel the present law should be retained.

25. Foreign Companies

Subject to the suggestion under question 24, we consider the law relating to foreign companies to be satisfactory.

26. Internal Management and Administration

(a) *Annual and other General Meetings*

(b) *Mode of passing extraordinary and special resolutions*

We consider that the present rules about resolutions are unnecessarily complicated. The extraordinary resolution is now of so little importance that it could well be abolished, and only ordinary and special resolutions left. As is already customary, fourteen days' notice of ordinary resolutions should be given. We do not recommend any change in the rules about special resolutions to prevent the anomaly of extraordinary meetings and special resolutions, we suggest that extraordinary meetings should be called "Special General Meetings".

The rules about meetings impose some very burdensome formalities on wholly-owned subsidiary companies. Article 5 of Table A, Part II, does ordain that a resolution in writing signed by all the members of the company entitled to vote shall be as valid and effective as if it had been passed at a general meeting, but this does not apply to all operations. Section 61 of the present Act, permitting a company to alter its share capital, requires that "the powers conferred by this section must be exercised by the company in general meeting". Similarly, section 131 requires that every company shall hold an annual general meeting. We recommend that a document executed by all the shareholders should have the same effect in law as a general meeting of shareholders. This will be particularly necessary if our recommendation of a single corporate shareholder is adopted.

*(d) Exercise of voting rights in special cases**(i) Interlocking Shareholdings and Unit Trusts*

We can make no recommendation about the general case of companies owning each others' shares or about unit trusts.

(ii) Pension Funds

We would not recommend any change in the general law about the powers and duties of the trustees of pension funds. The present law is, however, defective in its rules about the purchase by a company of its own shares for its employees. The present section 54 (1) (b) allows a subsidiary to buy shares for its employees in itself or its holding company, but does not allow for the case where the purchasing scheme is run by the holding company for the whole group, including the subsidiaries. The subsection should be altered to allow a company to purchase shares in the company or its holding company or its subsidiaries, to be held by or for the benefit of employees of the company or its subsidiaries.

28. Problems of Administration and Enforcement of the Law

A. By section 200, a company must inform the Registrar of every change in its directors' directorships. When a man who is a director of, say, 19 companies is appointed to the Board of a twentieth this involves 20 separate copies of Form 9A., to be filed with the Registrar; similarly, if he resigns from one of his 19 directorships all the 19 companies are required to file Form 9A. It would be preferable for the appointment (or resignation) to be reported only by the company directly concerned, giving the full list of companies affected as at present. The revised list of "other directorships" will in any event be shown in the next Annual Return filed by each of the other companies.

B. By section 113 (2) a company is required to provide copies of its register at the price of 6d. per hundred words. This figure completely fails to cover the cost of preparing such a list, and we see no reason why a commercial price should not be charged. We suggest that 1s. 6d. per hundred words would be a more reasonable figure.

We also recommend that the time for the production of such a list be extended from 10 days to, say, 21. The production of such a list can be a very laborious task for a large company, and the need to divert staff to it may be seriously inconvenient.

C. There is no authority in the Companies Act, 1948, for the issue of stock direct, but only for its conversion from shares. There seems to be no reason for this restriction and an unnecessary complication could be got rid of if the issue of stock direct was permitted, provided it was fully paid.

D. A considerable amount of work is caused to large companies under section 52 (1) (a) in supplying to the Registrar of Companies a full list of allottees when a capital issue has already caused a heavy volume of work. It would be of benefit to such companies if the obligation under section 52 (1) (a) could be waived and the company be given the alternative of filing a full Annual Return for that year.

E. We suggest that power should be given to extend sections 119 to 121 (which enable a U.K. company to keep a separate "Dominion register" in any part of H.M. Dominions in which it carries on business) to suitable countries outside H.M. Dominions. The power might be exercisable by order of the Board of Trade or by Order in Council, and it should be possible to extend the sections subject to special conditions and limitations. At present there is the anomalous position that a U.K. company may keep a Dominion register in Ottawa (transfer of shares registered in it being free under section 121 of U.K. stamp duty), but may not keep any register in New York which can be recognised for purposes of U.K. Company Law.

June, 1960.

ANNEX

Spens Formula.

The greater of:—

A. A specified sum; or

B. The nominal amount paid up on each preference share together with a sum equal to the amount by which the average of the respective means of the daily nominal quotation of such preference shares on the London Stock Exchange during the six months preceding the date of the notice of the meeting at which the resolution for liquidation or return of capital is passed exceeds the nominal amount paid up on such shares.

Supplementary Memorandum by Federation of British Industries

When the Federation's representatives gave oral evidence to the Company Law Committee on Friday, March 17th, the Committee was kind enough to give us permission to submit further evidence on the effect of paragraph 3 (1) of the 7th Schedule of the Companies Act, 1948, particularly in the light of the decision in *re Prew's Settlement, Truxox Engineering Co. v. Board of Trade*, [1960], 3 All E.R. 564.

We do not think that we need expound the legal position as we understand that the Law Society has already done so. We merely wish to express our concern that the now prevailing construction of the law should be contrary to what we believe the intention of the legislature was; for we do not think it possible that Parliament could have intended a company to lose its exempt status simply because some of the shares in it were acquired by the trustees of a family settlement. The privilege of exemption is valued very highly by those of our members who possess it; it is not acquired by accident and they often go to considerable trouble to keep it. Until this recent decision was handed down, many of them have conducted their affairs on the assumption that the trustees of a family settlement could take further shares in them without causing them to lose their exempt status. We think it inequitable that they should be penalised for sharing what we submit was a general, reasonable, and well-established view on the construction of the law. We would also suggest that this may well be a case where your Committee may think it appropriate to make an interim report. Even one year's loss of exemption would often cause its advantages to be permanently lost.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
NINETEENTH DAY

Thursday, 23rd March, 1961

Present:

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D. (*Questions 6664 to 6792 only*)

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

MR. M. F. COHEN AND PROFESSOR L. LOSS *called and examined*

6581. *Chairman:* Well, gentlemen, we are very much obliged to you both for coming here to help us this morning. Mr. Manuel F. Cohen, you are Director of the Division of Corporation Finance, Securities and Exchange Commission, Washington?—*Mr. Cohen:* Yes, Sir. May I explain that the memorandum submitted by the Commission has been reviewed by the Commission. So far as my answering questions is concerned, there is a Commission rule which I am required to announce whenever I appear outside the Commission, and that is that the remarks I make here today are mine, not necessarily those of the Commission, nor do they necessarily reflect the views of the Commission nor of my colleagues on the staff of the Commission.

6582. You, Professor Loss, are Professor Louis Loss, now of the Law School of Harvard University and formerly Associate General Counsel of the Securities and Exchange Commission; and I understand you played a leading part in the drafting of uniform securities laws which are gradually being brought into force in the United States?—*Professor Loss:* Yes, Sir.

Chairman: I will now ask Professor Gower if he will be so good as to lead the discussion.

6583. *Professor Gower:* Mr. Cohen, I know you spent some months in this country some five years ago on a Rockefeller Public Service Award, studying our methods of security regulation over here, and I know, Professor Loss, you, too, have studied our methods over here with considerable care. I think I speak for all my colleagues when I say we do hope you will not feel inhibited from being critical, because it will be helpful to us if you will express your views as freely as you feel able to do. As you are both experts on securities regulation, may I start with that? May we take the position of new issues under the Federal Securities Act, and, Mr. Cohen, may I start by asking you generally whether the survey you made of our practices led you to think they were capable of improvement and, if so, in what respects?—*Mr. Cohen:* I should hesitate to suggest that the law or practice in the United Kingdom requires improvement. I am not sure I am competent to speak on that subject, particularly since I do not feel that I am presently aware of the

circumstances which may suggest one or another possible change in your practice. There are some differences between the United States and United Kingdom practices. At the outset, of course, I must express on behalf of the United States and our Federal Government the great debt we owe to the United Kingdom. Our new issue regulation is, of course, borrowed from the British Companies Act, 1929. But there are some notable differences, and I would be glad to speak of those.

6584. I do not know whether you have anything to add to that, Professor Loss, or shall we get down to more detailed questions?—*Professor Loss*: It might be easier if I tried to answer detailed questions.

6585. Mr. Cohen, you have said there are various differences. Shall I ask a few questions, and then, if there are any more differences, perhaps you would draw our attention to them?—*Mr. Cohen*: Yes.

6586. How exactly does the S.E.C. go about scrutinising a proposed new issue?—If I may give a rather large answer to that question, one of the essential differences between our procedures and the procedures, as I understand them, in the United Kingdom, lies in the fact that the Government has certain responsibilities and, therefore, corresponding duties in connection with new issues. We borrowed the basic disclosure scheme that is found in your Companies Act. It was felt, however, the Federal Government should play a somewhat more active role in connection with new issues. To this end, the Securities Act of 1933 provides authority and responsibility in the Commission to examine documents filed at the Commission to determine whether or not it should take administrative action to the end of preventing their use in connection with new issues. In addition, our scheme of securities distribution is different to the United Kingdom scheme. It is based more on speed, and it is more a distribution technique than an underwriting technique. This presents special problems. To meet these special problems, the Commission has certain additional authority, and that is to expedite or accelerate the effectiveness of those

documents in order to permit the going forward of a new issue. In order to carry out both of these statutory responsibilities, the Commission from its earliest days determined that its staff would be required to review the documents and report to the Commission so that it might determine whether or not any one of these responsibilities required action on the part of the Commission. To this end, the Commission assembled and now have a staff of experts: these include lawyers, accountants, security analysts, engineers, geologists and other persons who have special competence in relation to the various types of companies and offerings which come before the Commission each year. In addition, we take advantage of the fact that in the Federal Government there are other agencies which have particular competence or skills, and we rely on them to assist us. All of these things are brought to bear on the documents. The documents, when they are received at the Commission, are reviewed very carefully by this group. Through the years, we believe we have obtained some experience in this area, and some competence; and although, because of the great influx of new issues in recent years, the time involved in particular cases seems inordinately long, nevertheless the actual work on a particular filing now goes forward with fairly good despatch. The entire process is more detailed and perhaps more comprehensive than, but similar in principle to, the vetting of the prospectus which I understand the London Stock Exchange effects in connection with new issues. The London Stock Exchange procedure, which I was privileged to witness, is a more informal arrangement. We think we do a more detailed job and a more comprehensive job, but in principle it is designed to achieve the same result.

6587. I suppose one contrast would be that the London Stock Exchange would rely on outside experts, whereas you rely upon your own staff to carry out these sorts of investigations. The London Stock Exchange do not have geologists or mining engineers or anyone of that sort. If they thought it necessary to investigate, they might go to someone outside—although I do not think they have gone that far?—My understanding

is that they have. I do want to make one thing clear. At the time the Act was passed, there was a debate about the extent to which the Federal Government should immerse itself in this process. One particular area was accounting, and a decision was made that reliance should be placed upon the work of independent accountants—*independent of the issuer*—who would certify the accounts. At that time, it was suggested that perhaps the Government should have a group of auditors and that those auditors should visit the premises of issuers. It was determined that this would be impossible, and it was also determined, I think wisely, that reliance should be placed upon the independent auditors. Coupled with this, however, authority was given to the Commission to prescribe rules and regulations in this area, to the end not of establishing standard accounting but, perhaps, of securing something by way of uniform accounts—uniform in the sense that the accounts of one company might be comparable with the accounts of another company in the same industry. One result of the Securities Act and of the Commission, we believe (and I think this view is shared by the accounting profession in the United States), is that this partnership, if I may so describe it, between the Commission and the accounting profession has done a great deal to build up the accounting profession in the United States. It has also resulted in the establishment of accounting principles which we think probably go further than those of any other place in the world, and, with due respect, even the United Kingdom. We have, however, insisted upon this concept of independence. I do not mean to suggest that auditors in the United Kingdom are not independent. Our concepts of independence may be slightly more fussy than yours. In sum, the Commission has been content to rely on the accounting profession to develop the principles. There are some exceptions, of course, and where a disagreement occurs the Commission insists on its own way of doing things; however, in most areas, we are content to rely on the accounting principles as established by the profession.

6588. Does that mean that, so far as the prospectus registration statement is concerned, so long as there is a report by

independent accountants, your staff do not bother about the accounting information at all?—No, Sir; I did not mean to leave that impression. We require a balance sheet normally and at least three years of detailed profit and loss statement. The summary of earnings, which is required to be included in the prospectus, usually covers a period of five years and frequently a longer period. In addition, we require supplementary schedules. To answer your question, I will have to enlarge on it somewhat to explain how we go about examining a registration statement, and deal with the accounting aspects of it as well. When a registration statement is filed, if it relates to a company that has filed accounts with the Commission before, it is immediately assigned to a group that has considered that company's filings before. These people are familiar to some extent with that particular company and with the industry within which that company operates. This obviates the necessity of fresh people examining documents that are new and strange to them. In connection with the financial statements, we require a fair number of supplementary schedules, on the basis of which our accountants can examine the financial statements and determine their internal consistency. These may raise a question on the face of the financial statements themselves. Frequently the auditor's certificate may point to a particular problem. These are considered. Our other people who are concerned with the registration statement—and, as I indicated, these include engineers, attorneys and accountants—all bring their skills to bear on the documents. Our people are constantly reviewing the situation in the industry, and comparing one company with another in the industry. Since most large companies in the United States live more or less in fishbowls, this information is readily available. It is readily available now because of the S.E.C., which is perhaps the greatest financial library in the world at the moment. We can examine one company's accounts by way of comparison. We have industry studies available to us. We are constantly in touch with what is going on in a particular industry and in the economy as a whole. In consequence, I think it is fair to say that these documents receive a fairly close

scrutiny. However, as I say, unless upon this scrutiny there appear to be serious questions—in which case we adopt some other procedures and I will deal with those in a moment—we are content to rely on the financial statements furnished to us and the auditor's certificate. Occasionally we are not satisfied and we find deficiencies, as we call them. These may be more or less material. Since our staff must review the documents in order to report to the Commission, we feel, in fairness to the people involved and in order to achieve the best possible prospectus, it is right to bring these comments to the attention of the issuer and its representatives with the idea that they should make such corrections as they deem appropriate. In most cases, there is complete agreement. Occasionally, there is disagreement, and we have a discussion about these matters. I should have said that frequently a particular issue may present problems, or at least there are problems which are recognised, before the documents are filed. Our staff is available for discussion, and many problems are resolved long before the documents are submitted to the Commission. If, however, the documents that are filed with the Commission present serious difficulties—apparently no real attempt has been made to comply with the statute, or the documents contain materially false, misleading statements or omit information of a material character—then the Commission has authority, as I indicated before, to initiate administrative proceedings. These procedures are designed to prevent the effectiveness of the registration statement, without which a sale of the securities may not be effected. Once that happens, there is a formal machinery. A hearing is set up before a Hearing Officer and, at that point, the proceeding takes on the coloration of a normal proceeding before a tribunal. The Commission has the authority in the end to determine the issue, but the Commission's determination is subject to review in the Courts. However, in the case of initial issues, it has been urged that this is a theoretical right and that it is not a very practical procedure, because most bankers and most issuers, are anxious to get on with their business and are not anxious to engage in argument with the Commission; so that there have been very

few cases in which the Commission's authority or action in this area has ever been questioned.

6589. You were dealing primarily with accounts there. May I now turn to one or two other aspects of the prospectus. It seems to me you are rather more insistent on ensuring that the prospectus brings out information on the competitive position of the company in the industry. Will you expand on that a little for us? —You did use a word which prompts me to make one further observation, if I may. A basic decision made when this statute was adopted—and it was adopted at a time when our various States already had their own securities statutes and regulations—was that the Federal Government should not be placed in the position of approving or disapproving issues; and, despite everything I have said, it should not be understood that because the documents have gone through a Commission review, it necessarily means the Commission feels the documents are true and accurate. We do have a rule set out on the front cover of the prospectus, and this is a repetition of a statutory requirement. It is to the effect that it is a criminal offence to suggest that the Commission has approved or disapproved the documents. I believe that these things we do contribute to the reliability of the documents that go to the public, although every now and then we stub our toes and learn later that the documents were not quite as good as we thought. So far as the competitive position is concerned, our concept of the prospectus is that it should be a document which will permit the investor or his adviser to arrive at an informed and independent appraisal of the merits of the security. It should be his and not someone else's appraisal. To this end, we feel all the facts relevant to such an appraisal should be included in the prospectus. At this point, we sometimes face competing forces. There is a tendency on the part of some issuers or their counsel to include in the prospectus great gobs of information, on the theory that in this way they avoid omissions. The Commission feels this is not the design of the statute, and that the prospectus should be as simple as possible consistent with providing the information. Through the years, we have adopted procedures and pressures of one kind or another to

achieve this result, and we have had some success. I think prospectuses are now reduced in size; even with the largest companies, prospectuses are fairly narrow in scope. Spread out, I think they would probably take up two pages of the *Financial Times* at most. We think the competitive position is extremely important. We do require that a company indicate its position in the industry and in the economy, and, with the growth of the multi-business company, this has become something of a problem. I think this is an area in which, as I recall them—and I have not read prospectuses from the United Kingdom for some time—prospectuses here do not go into detail to any extent. In your note, Professor Gower, I believe you refer to the situation of a company having stores in central locations in various cities. I think your remarks in your illustration were very apt. We would require a great deal more: some indication of the nature of the stores and the nature of the competition in the various localities in which the stores were held. We do not have any hard and fast rules about the competition; it depends upon the particular situation. I might say that this is something with which the issuers, their bankers and their counsel deal, and in most cases there are very few difficulties we encounter in the area of competition. We do have a difference now and then, but it is a rare case which is not settled most amicably.

6590. You sometimes do require considerable information about this for your own satisfaction, but not necessarily for publication?—So far as the prospectus is concerned, we try to limit its information to that necessary for the making of an informed investment decision, and no more. Of course, we do not feel that we can restrict the management if it wishes to expand the information beyond that, provided that the expansion does not create an overall misleading result. This has sometimes occurred, and the Commission has taken action in such cases. But you are quite right. To assist us in considering the material submitted to the Commission, and really to assist us in dealing with the problem as expeditiously as possible, we may require supplemental information for the Commission itself and not as public information. For example, the bankers quite frequently, as I am sure

they do here in the United Kingdom, may require a special report of some kind, depending upon the nature of the company. We may ask if such a report is available and whether or not we may review it so that we can consider the accuracy of the statements made and the comprehensiveness of them. We do this as a regular thing. In the United States it is a regular procedure, in many cases, for the bankers or others to require independent reports of one kind or another and, where available, we seek an opportunity of reviewing them.

6591. In conversation the other night, you mentioned an example of this in connection with a cement company, Professor Loss. Do you feel yourself at liberty to tell us about that?—*Professor Loss*: I have the impression that the Commission actually encourage, sometimes, that some of what we lawyers might call the basic evidentiary facts be given to them with a view to shortening the prospectus; that is to say, if the Commission are satisfied that the basic evidentiary facts support the more generalised factual statement in the prospectus, they will not insist that all those basic evidentiary facts go in the prospectus. But if a prospectus is submitted without supporting evidentiary facts, of course, the Commission cannot know whether the prospectus is sound or not.

Mr. Cohen: What Professor Loss has said is entirely correct. I want to emphasise another point. I may say in this connection—and it is a matter of some pride to us at the S.E.C.—that the people who would be strongest against the abolition of this procedure in the S.E.C. are the investment bankers. This is because it provides additional assurance to bankers that we do have our people review the documents. To add one further thing to what Professor Loss has said, we have had situations regarding this supplemental information where perhaps unwittingly there has been a misconstruction of a report of a geologist or an engineer or an independent auditor: we have brought this to the attention of the issuer and the bankers, not because we felt there was any deliberate intention to distort but because it was entirely inadvertent, and thereby we have secured correction. I think probably the greatest

good that has come from this is our ability to keep prospectuses within a reasonable compass.

Professor Loss: If I may add to that, I did not mean to give Professor Gower only half an answer; I have no objection to expanding on the reference to this cement company, because a specific illustration may do more to give you an idea of what we are talking about than a generalisation. This was a company created to build a plant for the manufacture of cement, and it was an initial public offering of stock. It was a company in one of the southern States. A local geologist had satisfied himself by making four, five or six borings on various parts of the property that there was enough limestone to support an estimate of 600,000 barrels of cement (or whatever it was) per year for x years, in terms of raw materials. This was stated in the registration statement, as to which I had been consulted by local counsel. However, when this was examined by the Commission's engineer, he said he thought there ought to be a substantial number of additional borings before the company was permitted to state it had the reserves for x years. At that point, the company either could have deleted from the prospectus the estimates of reserves for x years, which would have made it harder to sell shares, or it could have made additional borings; and it made additional borings. That is a good example of how the disclosure theory operates in practice. The Commission, in short, satisfied itself that what it regarded as proper geological techniques had been followed before it would permit a conclusion to be drawn as to reserves of limestone.

6592. You told me the company grumbled a good deal about this at the time, but told you afterwards that it was the best thing that could have happened?—Yes; and I think that is typical. I have heard lots of people say after they have been through this baptism that it is good for their souls.

6593. How far do you investigate the antecedents of the management of a company? Have you a rogues' gallery in which you can look up these people?—

Mr. Cohen: We do. The London Stock Exchange has something of a rogues'

gallery, though not quite as extensive as our own.

Professor Loss: We have more rogues in the States

Mr. Cohen: We are a larger country, and some of the rogues that you were successful in persuading to leave the United Kingdom came to the United States. But, seriously, we do have something that can be described as a rogues' gallery. We maintain in the Commission on a very current basis dossiers on individuals who in one way or another, whether under the Federal law or under State law, have gotten into difficulties in relation to securities matters or matters relating to securities. We now have files on approximately 70,000 individuals. We gather this information from various sources. We are also the central source for this type of information for agencies of one kind or another on State and Federal levels. When a document comes in, we have an automatic arrangement whereby all the names of the directors, officers and persons who may be in a control relationship with the company are noted, and an immediate search is made to determine whether or not we have information in respect of those individuals. If the company is engaged in a particular type of business over which another agency of the Government may have jurisdiction, such as a company having a television station or a company in the power business, we automatically send a copy of the prospectus to that particular agency with the idea of getting such assistance as they may provide with respect to the disclosures made concerning the business and officials of that company, particularly in relation to matters which may be well known in that agency and which may materially affect the business or prospects of the company. As I say, we have a fair financial library. Our own files contain a considerable amount of information about most of the larger companies in the United States and a great many companies outside the United States, as well as about many individuals who in one way or another have been connected with these companies. We do make a fairly adequate search, I think.

6594. Exactly how do you operate this, because, as I understand it, you cannot

refuse to register a statement merely because you do not think much of the quality of the investment? Presumably you cannot refuse to register a statement merely because the managing director or president of the corporation, in your view, is a rogue?—That is right, but if he is a rogue—and I use your expression—one may require that the prospectus shall indicate the manner in which he has been determined to be a rogue, so that the investor can determine for himself whether he wishes to entrust his funds to the company.

6595. *Mr. Brown*: Is your file of rogues limited to offences in connection with securities, or would it cover, for example, embezzling?—It is largely limited to securities offences; but we find these rogues get into all types of other difficulties. Lately we have found that because of the great interest in securities by so many people, many of the people who up till now have been engaged in the crasser types of roguery have now in one way or another found themselves in the securities markets. We are acquiring a great deal of information about a great many other rogues. I should add that we do have the facilities available to us of our Federal Bureau of Investigation and other agencies of the Federal and State Governments, and if we have occasion to believe there is something of importance to be discovered about a particular individual, we set about gathering that information. That is not to say, however, that we require a prospectus to indicate the fact that twenty-five or thirty years earlier someone was arrested for parking his car overnight in a restricted zone.

6596. *Sir George Erskine*: I am not certain whether this is the right stage at which to raise this, but may I ask you this question, Mr. Cohen? You have explained to us that under your system an underwriter is really a distributor endeavouring to sell a security; whereas under our system the company which publishes the prospectus is itself dealing direct with the public and the underwriter is simply someone who stands ready to take up the slack between what the public apply for and the total amount issued. Am I right in thinking that under your system, because of the method as I have stated it, the underwriter so-called has

the same responsibilities for the statements in the prospectus as the company itself?—First, I should say that we have both systems. It is true that in the United States in many cases underwriters are mainly distributors of securities. However, there are many cases of the character you have described where the offering is made directly or indirectly by the company itself, and the investment banker stands by in the nature of an underwriter in the traditional sense. So far as responsibility is concerned, under our statute the issuer is in fact an insurer of three things, essentially: one, that the prospectus, the registration statement, contains the information required to be included therein by the statute; two, that it does not include any false or misleading statements; and, three, that it does not include any half-truths, i.e., that there are no statements omitted which, if included, would have made the statements false and misleading. That is the issuer's responsibility. The underwriter has a very important responsibility under the statute. It is not quite the same as that of the issuer. The underwriter does have a defence that he has made proper investigations and has relied upon the proper information. But the scheme of things is essentially the same, I believe, whether the investment banker acts solely as underwriter or as distributor as well. The scheme of the statute in either case is that the underwriter is closely connected with the issue, and it is intended that he shall make investigations to the end of assuring that the statute is complied with. This responsibility is very keenly felt in the United States—at least by most underwriters. Unfortunately, in recent years, our investment banking fraternity has grown larger, and its ranks have been augmented by people with less experience and less scruples, too; but, generally speaking, I think this responsibility is felt and is carried out.

Professor Loss: Might I supplement that, briefly? First of all, it must be remembered that our section is basically modelled on what is now section 43 of the English Companies Act and is basically the same, except that you do not impose liability on the issuer or the underwriter, and we make the underwriter liable with substantially the same defences that you apply to your directors.

That may present not altogether a clear picture unless we add this: in the entire history of the Securities Act, there are in the reported decisions only 11 cases in which actions were brought under section 11, and I have been able to find only three cases where the plaintiffs have recovered. One does not know about settlements, of course. But the most recent case goes back 15 or 20 years. No one sues under this section—not, I suspect, because plaintiffs would not if they thought they could recover—and I believe this proves that the baptism of fire is a rather cheap insurance policy; and it is the reason why, if the investment bankers and the practising lawyers before the S.E.C. were given a free choice today, they would vote not to go over to the British system, but would prefer to continue with our own even though they do complain while they are going through the process.

6597. *Professor Gower*: It is sometimes suggested that the reason why there have not been any civil suits is because for the last 25 years the market has been rising; but that if there were a serious recession, investors would look round to see who they could sue?—That is a consideration, but I think there are two answers to that. First of all, there have been some periods, during those 25 or 26 years, of substantial drops. Secondly, and perhaps more convincingly, there have been, in recent years especially, increasing numbers of suits filed with regard to non-registered securities—securities offered without registration, either in violation of the statute or, more likely, because some exemption was available. There has been no similar scarcity of suits of that kind, so I think the inference is that the greatest explanation for the paucity of actions has been the Commission's examining process.

Mr. Cohen: As I indicated earlier, there have been some cases in which, despite our review, the documents which went to the public did not meet the statutory standards. I mention that only in relation to what Professor Loss has said. Our bankers, generally speaking, try to be as careful as British bankers are in connection with a prospectus. Perhaps their responsibility is a little bit more formalised in the United States than in

the United Kingdom, and their counsel are particularly careful about this. There is one other aspect that should be mentioned. When it does come to our attention, whether during the offering or even after the offering has been completed and even if perchance the company has come to rather a bad way, that the documents were false and misleading, the Commission undertakes to make investigations into these matters and, in one way or another, brings the facts to the attention of the public—the investing public particularly. In a context of that sort, it is almost foolhardy to resist a lawsuit. There have been cases where either an offer of rescission has been made or where, informally, the matter has been adequately adjusted. In many cases the investment bankers, even in situations where they do not personally feel any responsibility for what was wrong, have nevertheless undertaken to remedy the situation out of their own resources because they are bankers of some reputation. All of this contributes to the fact that there have been few cases in this area. It is not because in the United States there is any unwillingness on the part of stockholders to bring actions against companies and directors.

Professor Loss: And it is not considered unprofessional for lawyers to take actions on a contingent fee basis.

6598. And even if you lose, you do not necessarily have to pay the other side's costs?—That is true. Under the Securities Act the Court does have power to require an advance undertaking for costs if it thinks either the action or the defence is not in good faith.

Mr. Cohen: If I may, there is one point I should mention generally which I think is of significance, and that is, in the area of new issues—when an issue is made by someone in a control relationship to the company, registration must be effected. I do not believe this is true in the United Kingdom. For example, if I am chairman of a board and if I can reasonably be considered to be in a control relationship to the company and I decide to make a public offering of shares which I have held for many years, that may not be done except by way of registration, which must be effected by

the company as if the company itself were making the new issue.

Professor Gower: I do not think in practice there is any difference. A prospectus would in fact be published in those circumstances in this country.

6599. *Mr. Althaus:* Going back to the rogues, would you adopt the procedure that in rare cases is followed in London of declining to allow a prospectus to go forward unless changes were made in the board?—No, Sir. We would insist on disclosure of the facts, if the facts were material to an understanding of the issue. There have been cases in which people had previously become involved in one way or another, and we have not in all cases required disclosure of those involvements. But we do require disclosure if we feel the matter is of material importance in considering the issue. Where we ask for disclosure and disclosure is made, we have no authority to preclude the issue.

6600. *Professor Gower:* But the New York Stock Exchange might decline to list it?—The New York Stock Exchange is a semi-private body and can refuse a listing if it wishes.

6601. May I turn to another point? One of the great contrasts between English and American prospectuses is that ours contain forecasts about future dividends whereas yours do not. Would you care to comment on that?—We have a sort of old-fashioned notion about these things. We believe that under a disclosure statute, statements should be limited to facts and not contain someone's opinion of what the facts may be in the future. For this reason, we believe that forecasts are not appropriate and, although a particular investor may not be affected one way or the other by an opinion, we believe strongly that a forecast of that kind does not fit into our notions of what the standards under a disclosure statute statement should be.

6602. *The Chairman:* If I may go back to the cement case, I gather an estimate was made that over so many years so much cement would be produced, and I understand that the Commission quarrelled with that statement not because it was an estimate but because it was based

on an insufficient number of borings. When they had had additional borings made did you allow the estimate to go forward as part of the prospectus?—I am not familiar with all the details of the case, but I suspect the area of difficulty did not relate to the amount of cement which might be produced, but rather to the raw material in ground, that is the ore. In this regard the engineers have worked out procedures whereby, by blocking out ore and making certain borings, it is accepted as a fact that there is so much ore in ground. This is the area in which there probably was that difference of opinion. We felt that enough borings had not been made or enough steps taken to establish the claim as to the ore in ground as a fact. Once the borings were made then a decision could be made.

6603. The borings would be accurate enough to enable it to be said as a fact "There is x tons of ore in the ground"?—As I understand it, the scientists take the view that if you have enough borings and if they are close enough together and furnish certain information, then as a fact this is proven ore, as they term it. But we would not permit the company to say that over the next several years they hope to produce x tons of cement, because obviously this would depend upon whether or not they could produce cement at a cost which would enable it to be sold at a profit. This gets into the area of managerial ability and involves conditions about which assumptions have to be made. We are really dealing there with assumptions with respect to future economic conditions, and this we do not permit.

6604. It is very difficult to separate statements of fact and statements of opinion—you have a line of demarcation?—We do permit some statements of opinion; I do not want to leave with you the impression that we do not. There are certain areas where, of course, opinions are necessary. For example, a particular company may say it was able to establish as a certainty—and we use such factors as are available to us to indicate whether or not the claim is substantially true—that it is the tenth largest producer of widgets in the country. We may have information available to us which establishes to our satisfaction that it is in fact the tenth, or ninth, or eleventh largest producer, in

which case it may not be terribly material but if in fact our information establishes that it is the smallest producer of widgets, probably fiftieth of some fifty widget-producing companies, in other words that it did not have the suggested importance in the market, then we would be concerned about such an expression of opinion.

Professor Loss: If I may interject here, I am afraid I must take some slight exception with reference to the cement case, if Mr. Cohen will permit me. I agree with him entirely in what he said in answer to the Chairman's question with respect to the amount of limestone in the ground, but when it comes to the capacity of the plant the Commission did require us to state what the capacity would be by way of explaining the competitive position of the company in the industry. What it would not permit us to state, although like any sound management we had figures worked out to our own satisfaction, was the number of barrels we thought we could produce and what our earnings would be per barrel. But we did state that the capacity would be x barrels per year, though the Commission would not have permitted that if it had not been satisfied that we would have the kind of plant to produce that and the raw material to make it possible.

Mr. Cohen: I would say I do not accept this as an exception to what I have said; it is only further proof of what I have said. May I illustrate it in this way? If a company indicated that it had a million tons in ground but it had plant which could only produce a thousand tons per year, it would be significant to point out that fact because obviously such a company even if it were to obtain the ore might require additional finances to erect further plant or to enlarge its plant. We do ask for, and do require, information with respect to capacity of the plant. We have had situations where companies have made claims to having ore in ground, but where they have had no means of milling the ore. We have also had situations where the ore in ground was 500 miles away from the nearest railhead, but when they came in to us they did not mention that there was a complete wilderness between the ore and the railhead. We would require some statement to that effect.

6605. *Professor Gower:* What you will not allow under any circumstances is any estimate by the directors of what their future earnings are going to be?—That is right.

6606. On the other hand, you do insist that past earnings over the last few years are shown. Surely, these will reveal a trend of earnings? Do you investigate at all to see whether that trend is likely to continue and, if you decide it is not, do you insist on something being said about it?—Perhaps the last six or seven months is a very good period to use by way of illustration of your problem. In the United States we have had something that has been referred to as a recession or by some milder term. This has resulted, in some cases, in declining earnings, even in the face of increased sales. This may be as a result of the competitive situation, and this is one of the reasons why we insist on some disclosures of the competitive situation.

6607. *Mr. Althaus:* Going back to the cement company case, in such cases where there is involved a technical content would it be the practice of the issuing banker to have an independent report prepared, or would he rely on your investigations?—*Professor Loss:* This company—and I think this is typical—would have been very pleased to be able to get an investment banker. This kind of promotional venture cannot get an investment banker and therefore the issue has to be peddled. Many companies do not survive that process.

Mr. Cohen: I think the answer to your question is that in many cases the banker does obtain an independent report, and frequently makes that report available to us for review.

6608. *Mr. Watson:* Still on this cement company, I think Professor Loss said that the original report on the testing of the ore reserves was adjudged to be inadequate in its extent by the S.E.C. and that the company was given the opportunity then to instruct that a further investigation should be undertaken. I think at the same time, Professor Loss, you said it had the option to exclude it altogether?—*Professor Loss:* It could, of course, have said "We do not know what we have in

the ground". It could theoretically have said that.

6609. But would the S.E.C. expect to have some statement as to the natural resources with which the company expects to achieve its object of manufacturing its finished product?—I think it is fair to say that the Commission expects it if you make any statement that is based on the hypothesis that you have it.

6610. But you could omit it altogether and it would still be acceptable to the S.E.C.?—We could say "We are offering you an opportunity to buy shares in an unexplored hole in the ground". In theory that could be said.

Mr. Cohen: May I supplement that? I think you used the expression that the Commission adjudged the resources to be inadequate?

6611. Yes.—This is not quite the position. We do not do that. What we say is "Upon a review of the documents we are not in possession of facts, and you have not supplied us with facts, which support the claim made by you. If you are prepared to support the claim made we would be very happy to consider it"; but, in the absence of such support, we raise the question whether it is appropriate to include such a claim. The other aspect of your question is this. If a company is to engage in some aspect of development or exploitation of natural resources, as Professor Loss has said, the company has the opportunity to indicate it has nothing but a prospect in Hudson Bay and hopes perhaps it will find it profitable, and if that is made perfectly clear it is all right.

Professor Loss: You would not permit the expression "hope" under those circumstances?

Mr. Cohen: That may be, but if there is some indication the company intends to go in for a product in the way of ore we would require some indication as to the situation with respect to the source of ore.

6612. *Sir George Erskine:* Would it be true to say that your rule as regards estimates as to forecasts might make it very difficult—perhaps impossible—for the issue of a prospectus in a completely new venture?—No, Sir, absolutely not. I preside over a division which is con-

cerned, among other things, with new issues. When the Securities Act was first enacted arguments against it were (1) that it would stop the processes of the capital market, and (2) that it would make the seeking of venture capital impossible. In the last few years I have seen more companies come to the S.E.C. and have their securities registered, companies that were among the most venturesome, that I would ever have imagined—companies that had nothing really more than a prayer and a hope, companies which may be referred to as offering the widest type of speculation possible. Nevertheless, if all the appropriate disclosures are made (and in those cases we may be more insistent than in regard to an established company) registration may go forward. In fact during the last two years more than 50 per cent. of the companies registering securities with the Commission are companies that have gone to the public for funds for the first time. Many of them have been in existence only for a few months or a year; many are engaged in some of the more esoteric new developments in technology, making fuel for missiles and things of that sort.

6613. *Mr. Richardson:* The profit record might disclose a situation in which the profits had risen, let us say, every year for which they were shown from \$2 million to \$5 million over a five-year period. If the directors thought that the profit record trend was unlikely to continue in an upward direction, how would you deal with that?—If the directors had that view in my opinion they would be required to indicate it in the prospectus. We recognise the problems of a businessman in including in the prospectus information as of the most recent possible date, and the situation at present makes it all the more important that the financial information provided is of the most recent date practicable. In addition to the required information we require formal statements with respect to the trends of sales and the trends of earnings, and we do make supplemental enquiries as to whether or not there has been any change in the business which might reflect on the financial statements and other information included in the prospectus; where there is any indication of this sort we require affirmative statements in the prospectus.

6614. Assuming that the directors at the time of making the statement thought that trends were all still upwards, but that they were of opinion that within a measurable period of time the trends were not going to be upwards, that seems to me to involve some forecast. I do not know whether you would agree with that?—We would not let them say the trend was upward, but if they wanted to say the trend was downward we would not object to that.

6615. What would happen if they felt the trend in the future was going to be a downward one?—If they knew the trend was downwards we would expect them to say that. If we had any reason to believe the trend was such, we could require them to say that even if they had not thought of it themselves.

6616. *Professor Gower*: Could I put another case to you? Supposing the company has in fact been making very large profits because it has developed some new process which is not patented, it only needs another large firm to produce the same process for that company to go right down in profitability. Would you insist on something being said about this?—Yes. In recent years a great number of companies have become engaged in the new technologies—electronics perhaps is a good example. It may be a case of a scientist organising a company to produce a new type of transistor which is most successful. We require that the prospectus should disclose the competitive situation; that the science is in a state of flux, that there are new things coming along, that there is no patent and that there are giants in the industry who may at any moment produce something that would compete and who are in a position perhaps to affect materially the prospects of the business. We do require disclosure of these facts. The patent situation is important and we look at it very carefully.

6617. Is the S.E.C. objection to estimates of future profits just based on a kind of doctrinaire belief that there is a difference between fact and opinion, or is it based on experience?—It is based on hard experience, and perhaps it is slightly doctrinaire too. Throughout the years the Commission has had considerable experience with forecasts, and it has

also had considerable experience with appraisals of one kind or another. Much of this experience has been unfortunate. The Commission believes that its approach, whether characterised as doctrinaire or otherwise, has now been supported by its experience with many, many companies and many types of business. We have had experience of large companies, with the large bankers associated with them, undertaking to engage in substantial new developments. I have in mind a company that is engaged in a very large undertaking in Canada—and I think some of the London bankers have some association with this—dealing with a very important project in the area of uranium ore, and I think everyone felt there were great prospects for the company. I think that when they got down to drilling and extracting the ore they ran into an underground lake and that underground lake caused immense difficulties and tremendous losses. This is just one aspect of the dangers of prognostication.

6618. You mentioned appraisal. To what extent would you permit an up-to-date valuation of the assets of a property company, for example?—We do not permit it in the financial statements—that is, not yet. I should say that, as in the United Kingdom, there is considerable controversy in the United States in regard to this matter. It is not an accepted accounting principle in the United States to provide for a revaluation of assets in the financial statements. The Commission is content to accept that, at least for the moment. However, there are situations, particularly with respect to a company engaged in one or other aspect of real estate, where the problem of valuation is significant. We deal with this on an *ad hoc* basis in an attempt to provide the investor with some reasonable information, but we do not permit appraisals as such in the prospectus, nor do we permit revaluations in the financial statements.

6619. *Mr. Lumsden*: Going back to the earnings' forecast and the question about the prospectus of the completely new company. If it has no past record at all to give, how do you get over the difficulty of giving some estimate or basis on which the shares can be marketed? If you cannot get an estimate of future earnings, I am not quite clear how you handle the

prospectus at all?—The prospectus is required to indicate quite clearly the nature of the business, the nature of the product it is hoped will be manufactured or marketed, and the competitive factors are clearly disclosed. We require, I believe, that the prospectus should provide all information short of an actual forecast; in a forecast you are substituting the judgment of the director for the facts, and my insistence on the distinction between a fact and a judgment perhaps becomes more doctrinaire, in the words of Professor Gower, but this is basic to our view of the statute and of the information that should be provided to the investor. Once we depart from that principle—perhaps because we have more scallywags than you have here in the United Kingdom—we have no way of drawing a line. Further, I might mention that I, as an investor, would accept a forecast prepared by Morgan Grenfell, but that there may be another firm in London whose forecast I might not accept; and I, as an official, do not want to be in a position of saying one firm's forecast is all right and that another's is not. We deal with this problem as a matter of principle.

6620. *Mr. Lawson*: If a company made \$1 million profit last year and the budget shows they are likely to make only \$½ million next year, do you not permit the director to say that?—Yes, we insist on it, Sir.

6621. If it is downwards you insist on the figure of future profits being given?—I think you have me there; I do not think the matter would ever arise in that way in the context of American practice; I do not think a director would undertake to give a figure which in itself may give him trouble. This in a sense is a forecast. I think he would know that in the view of the public the earnings would be very, very substantially reduced in the coming year, and it may be a matter of draftsmanship or a matter of expression, but because of the liabilities placed upon the director and because of the liabilities placed upon the underwriters I do not think the parties would ever come to the Commission with a figure and we would not permit the indication of a figure.

6622. *Mr. Lawson*: What happens here quite frequently is this; you have a trend

of profits over the years and perhaps last year has been an exceptionally good year and then the directors in their prospectus will say "We cannot expect to maintain that figure of last year, but we think we will maintain the average figure of the last five years", which is perhaps half the figure of last year and they give a figure. I find it hard to see how your prospectus will read if you do not allow a figure when the figure is lower than the previous year.

Mr. Richardson: The figure they give is almost certainly one which would be exceeded because they would be conservative about the figure they chose.

6623. *Mr. Scott*: Is not your point that they might not be conservative in their estimates if they had freedom to make such forecasts?—Yes. We have the unfortunate experience of living on the seamy side as well as on the other side of the street in the S.E.C. I have no doubt that reputable bankers would be most conservative, and I for one might be interested in information of this sort, but the prospectus is designed to provide the facts upon the basis of which the investor himself or his adviser can reach some determination. The provision of a figure may serve to obviate the necessity for close analysis, I will grant you that, but our scheme is based on the view that the investor or his adviser should make the analysis and that the Commission should not be in a position of reviewing this analysis and testing the figure, so to speak.

6624. *Professor Gower*: Do you insist on accounts being made up to any particular date before registration?—Yes, our statutes require financial information as of a date within 90 days of the filing of the registration statement. This rule is varied in the case of certain listed companies, but in point of fact, particularly in recent times because of the great changes that are taking place, we insist on the information being as close as 90 days, although that 90 days figure need not be the latest audited figure; in addition we require information in respect to the trend of sales as recently as we can possibly get them.

6625. *Mr. Brown*: Referring back to Mr. Lawson's question with regard to the company with exceptional profits, where you would not allow a statement in the prospectus as to the figure in the coming

year, is there anything to stop the directors making a public statement to the shareholders of the company about what the profit is going to be next year?—We take the following positions with respect to the Securities Act and new issues. First, before the registration statement is filed the statute is clear that no offer or solicitation of an offer to buy may be made, and we treat those words in the broadest possible sense. This would include any attempt to condition the public by way of putting out information to the public generally with regard to the view of the directors concerning the prospects of the company over the ensuing period. We have had occasion to test this matter in Court, and, while we have not got it to a really high Court, generally speaking we have been upheld, and because of the Commission's control over the activities of bankers usually the Commission's view prevails in this area. On the other hand, the Commission feels that it should not adopt rules and procedures which would impede management from bringing to the attention of its shareholders information pertinent to their consideration of the affairs of the company, particularly in relation to trading in securities. Therefore, there has to be some blending of these two competing forces, and we manage to do it fairly well, perhaps with some difference of view occasionally. For example, the New York Stock Exchange requires that there should be prompt publication of information of importance to investors. Sometimes these events of importance occur just before the filing of a registration statement, before the offering or in the course of it, and it raises a question. If it is a normal announcement, usually published in the manner and at the time proposed, in nearly all cases there would be no problem. Finally, I should point out that while the statute requires a prospectus, the statute also permits additional information to be furnished to the investor with the prospectus which is not subject to the prospectus requirements but subject to the general anti-fraud provisions of the statute. In other words, if the directors provided the investor with a prospectus and in addition to the prospectus they provided him with another document in which they undertook to make a forecast, under the statute—theoretically at least—they may do so

subject to the general anti-fraud provisions. The Commission's views generally with respect to forecasts and appraisals, things of that sort, have rather wormed themselves into the law, and a Court in a particular case may take a dim view of this procedure, but, as I understand the statute, I think this would not, *per se*, be prohibited. This is also true of an appraisal. We do not like to advertise this procedure because it has certain dangers, but I believe it too would be permitted. Do you want to add to that?

Professor Loss: It is a big question. I do not think any Court would be likely to hold that a forecast in supplemental literature or given orally is *per se* fraudulent. I think it would depend on all the circumstances. A forecast might be fraudulent, and although the Commission takes one view as to the fact/opinion dichotomy for purposes of registration, it takes another view for purposes of fraud. For purposes of fraud the Courts have been saying that an opinion not honestly held is a mis-statement of fact, so that a forecast could be the subject of a fraud action, but I do not think it would be so *per se*.

Mr. Cohen: I think the provisions of your Prevention of Fraud Act, particularly sections 13 and 14, are far wider than ours; I think they are more comprehensive. I think those sections deal with the particular problem of forecasts and expressions of opinion in a much more express way than our statutes.

6626. *Professor Gower:* Yes, but it only imposes criminal sanction, and I think the view is that it would not give an investor any civil remedy.—This is a very essential and important difference.

6627. *Mr. Althaus:* Where the directors issue a supplementary statement of that kind, would it in appropriate circumstances be subject to the scrutiny and approval of the New York Stock Exchange?—If it were subject to the New York Stock Exchange, by their rules the company would be required to provide a copy to the New York Stock Exchange, who would then review it. I am not sure I can detail the exact procedure, but they do have a large staff and they do review these documents. However, not all the

exchanges in the United States have standards quite the same as those of the New York Stock Exchange. I do want to add that this supplemental statement need not be provided to the Commission; in fact it is usually not provided to the Commission. We have no way of reviewing it. These documents come to our attention sometimes on a complaint by an investor or in connection with an investigation, but there is no provision requiring them to be furnished to the Commission, and, frankly, I am quite content with that.

6628. *Professor Gower*: You require registration statements notwithstanding the issue is of shares uniform with those already listed on the Stock Exchange?—Oh, yes, Sir. I should add that for some time past there has been a suggestion, one of the most vocal exponents being the New York Stock Exchange, that such issues should be exempted from registration. I might add—and here I am being just a little funny, I expect—that recently we have had a number of criminal cases some of which related to companies whose securities were listed on the New York Stock Exchange, so that that standard alone raises some serious questions. I should make clear, as I indicated a little earlier, that the standards of the New York Stock Exchange are not adopted by all the other 13 registered Stock Exchanges.

Professor Loss: I think it might be added that the two largest exchanges, the New York Stock Exchange and the American Stock Exchange, do more than 90 per cent. of all the business in the country. The remainder is handled by the other dozen or so exchanges.

6629. You would require these registration statements even in the case of a rights issue to existing shareholders?—*Mr. Cohen*: Yes.

6630. And also if there is an issue of shares in exchange for shares in another company?—Yes. An offer made by way of exchange requires information not only with respect to the company offering the exchange, but information with respect to the company of which the recipient is a member. I have a prospectus that has recently been published by the McGraw Hill Publishing Company in which it made an offer of exchange to the

holders of certain securities of E. W. Dodge Corporation. That contains information both financial and non-financial with respect to the two companies.

6631. You will appreciate that on such an occasion the only regulation which would apply in England would be the new Board of Trade regulations for licensed dealers?—Yes.

6632. It would not, of course, give as much information as your requirements?—Quite so.

6633. *Mr. Scott*: I think that is not quite right. If the shares are to be quoted, the Stock Exchange regulations would apply as to what is disclosed about them.—The New York Stock Exchange in certain cases has adopted requirements that are much more penetrating than the requirements of the Commission.

6634. *Chairman*: In the case of an exchange of shares in this country, I would expect to find somewhere a statement by the directors that they were satisfied the exchange was a fair and reasonable proposition, and if the directors were not allowed to say that would not the applicant for the shares be completely in the dark?—Well, I am sure there is some language in the document which bears on this. Quite obviously, the offer would not be made under these circumstances unless the boards of both companies were quite satisfied. I think that would be implicit in the offer.

6635. *Mr. Lumsden*: On the question of valuation of assets which I think you discourage, in the case of a take-over offer it is said here that only too infrequently is such a valuation given and there ought always to be some valuation of the fixed assets where they are material. Do you not even allow it for perhaps valuable freehold properties?—In the case of a company which is engaged in any enterprise, we think the value of the investments to those interested in determining the value of the shares being offered to them, depends on an evaluation of the enterprise rather than of the underlying properties. Therefore, we think the emphasis should be placed on the business facts, the history of earnings, the issuer's standing in the industry, its prospects to the extent that they are

disclosed by the prospectus, rather than the inherent values of the underlying physical properties. For example, in the case of the United States Steel Corporation it undoubtedly has many valuable properties but I do not think that any analyst reaches a conclusion as to the value of United States Steel shares by trying to assess the value of those properties. He is trying to assess the value of shares in a continuing enterprise, particularly since it is not planned to liquidate the enterprise. Where you do have a situation in which the enterprise is to be liquidated, then obviously the physical assets of the company are of real significance. When that problem arises we deal with it so as to bring to the investor the facts which are relevant and pertinent.

6636. I was thinking particularly of the case of, say, shop properties which might in certain cases have an open market value much greater than their value in the business as a going concern.—Whether or not it has an open market value which is greater we think perhaps is relatively less important because the company does not plan to liquidate its business and sell its property. It plans to continue in business. When and if this company should determine to liquidate, many years hence, that value may be something else again, and its present value does not seem to be of much significance. Perhaps we misunderstand the position but we do not think people buy a merchandising company based upon an assessment of the physical property. We think they buy an interest in the enterprise as a merchandising business.

6637. I was thinking more from the point of view of the seller of the shares of the company which was being taken over.—As between the parties, the management of the selling company and the management of the purchasing company, we would think that reasonably they would take into account property valuation and any number of factors which are necessarily relevant to a determination of either an exchange of shares or purchase prices or other factors of a similar nature. These are necessary business decisions and made by business people in the context of their understanding of the enterprise and the purposes

of the enterprise. Those are considerations which I think are somewhat different than are involved in making an exchange of shares, shares of one company for the shares of another company, and where the companies continue in business as an enterprise.

6638. *Mrs. Naylor*: You are assuming there is always agreement between the boards of the two companies. What about the case when a company makes an offer for shares and has not succeeded in reaching agreement with the board of directors of the company to be acquired, and goes over the heads of the board to the shareholders?—This occasionally happens. Nevertheless, the company making the offer is required to provide essentially the same information as is provided in the case of the company where there is agreement.

6639. *Professor Gower*: How does it do that? I see it can provide information about its own company, but how can it get the requisite information about the company whose shares are being bought?—Normally it occurs in situations with respect to companies that have published information; the information is obtainable and can be provided. Obviously in those cases there may be some additional caveats required because of the lack of co-operation of the management. We have just had a case recently in which a take-over bid was made by one company at a time when another company was interested in making a take-over bid. The management was interested in one and had some private dealings in connection with it. This got to be a little sticky. The Commission had to intervene to seek an injunction against one for failure to provide suitable information. This was not an exchange offer but an offer to buy shares for cash. The question arose under our Rule 10 b-5, one of our general anti-fraud rules, and I have with me, again in anticipation of a possible question, a brief which we submitted to the United States District Court for the Southern District of New York in this matter. I might say the matter has been settled by consent, that is the defendants agreed that an injunction might issue against them. But the brief discusses the law and some of the

problems in this area and if the Committee wishes I will be glad to leave it here.

6640. *Mr. Brown:* Where a take-over bid occurs without consent of the management of the company concerned, whether it be for shares or cash, is there any obligation on the directors of the company being bid for to provide the shareholders with information?—We have certain anti-fraud provisions and theoretically under those provisions a case can be made that directors have an obligation to take certain steps in connection with such a purchase or sale of shares. I do not think that view has as yet been accepted under our Federal Statutes. You are now in an area of what I would consider conventional Company Law which is really outside the jurisdiction of the S.E.C. as such.

6641. There are no special S.E.C. provisions to deal with that case?—No.

6642. *Mr. Lawson:* Can I come back again to this very difficult problem of valuation of properties, shall we say, in the centre of a city. You can get a situation where you might have a factory, for instance, which was operating in the centre and where the property was much more valuable if the factory were closed down and the land used for some building programme. The present board may have carried on as they have in the past and done nothing about that. But a take-over bidder can come along and buy the company, completely move the industrial side of the business elsewhere, and probably make a large profit on development. Is it not something which the shareholders of the company should have been told, that there is that prospect of development of that particular property?—I would think so. How that would occur would depend on the circumstances of the take-over bid. If it were by way of exchange of shares, for example, I think that the documents would have to indicate this possibility, without necessarily getting to an actual property valuation. But I think the general facts that you have outlined would necessarily have to be included in the documents. Apart from that, I think that there might well be the duty on the part of the person who is making the take-over bid to disclose under certain

circumstances what plans he had. Now I have in mind a fairly simple case where the person making the take-over bid has a relationship with the company which might be considered in the nature of a controlling relationship or something close to that, where it can be argued he has a duty to the shareholders in the company—and we have had such cases. Under those circumstances, if he is out to acquire the shares of the minority shareholders and he has in mind a change in the nature of the business or selling its physical assets or perhaps he has already received an undisclosed offer from a third person to purchase the shares from him at a substantially higher price, the failure to disclose any of these facts would be considered violation of our anti-fraud provisions. Once you move away from the situation I have disclosed, to an offer by another person who is at arm's length, who is a stranger to the shareholders and to the corporation, this problem becomes a much more difficult one to treat with, because it then may get down to the question of the duty under the law of such a person to the shareholders to whom he has no trustee relationship.

6643. Could I follow up with one further question? Does it not really come back to the duty of the directors of the company being acquired to give some indication of that potential for development in their annual account?—I should point out that the Commission administers a number of statutes. We have been talking largely about the first of these statutes which is concerned with new issues. In the case of a new issue of a certain size the company is required to file with the Commission certain annual and other reports. These reports are required to include financial statements certified by independent auditors and they are designed essentially to bring up to date in a rough sort of way the information provided in the initial prospectus. Apart from that, it is customary for companies in the United States to send reports to the shareholders. Now, we do not have any direct or indirect supervision over the content of reports to shareholders, and in a situation such as you have mentioned, it would be normal, I think, for directors to bring matters of

this character to the attention of shareholders on a continuing basis so that they would be informed, and in this way the market generally is informed. I do want to add one further thing. Our requirements with respect to financial statements and disclosures with respect to changes in business I think go a little deeper than the present requirements under the Companies Act. We believe that by virtue of all of these requirements there is built up over a period of time, and on a continuing basis, information with regard to the company so that the situation you pose would not, except in certain exceptional circumstances, really arise. But should it arise, I think I would agree with you that the management of the company whose shareholders are being solicited might well have the duty to bring to the attention of their shareholders the situation with respect to the properties of the company, particularly in the case where they feel the take-over bidder is unfair or something of that sort. But again we are getting into an area which is mixed in the sense it is more Company Law in the conventional sense, which is not an S.E.C. function anymore than it is S.E.C. law, although there may be many cases in which our statutes would require such a result. There is one further thing that I have not mentioned which is also a marked difference between our way of doing things and yours; perhaps Professor Gower intended to reach this in the end. All companies the securities of which are registered for trading on a National Securities Exchange, are required to send to their shareholders in connection with solicitation of proxies—and this is a conventional procedure which has some notable exceptions in the United States—a fairly broad spectrum of information concerning the company and the officers and directors. The Commission also requires an annual report, which in the opinion of the manager is adequate to describe the operations and conditions of the company, to be furnished to the shareholders. Again, this is another aspect of the procedure whereby the shareholders themselves and the market as a whole are informed on a continuing basis with respect to developments in a company. I think we have carried this to a point that is perhaps further than it

is carried anywhere else in the world. It has led to perhaps the greater development, although I know you have them here, of a professional corps of security analysts who are continually probing and asking for information and developing information, all of which contributes to free, open and informed markets.

6644. You have the power, do you not, to refuse to register an annual balance sheet if it does not conform to standards which you think it should?—In the case of a company which has securities listed on the Stock Exchange, we have no power to refuse the filing of the annual report with the Commission which is the statutory report. If that report, however, does not comply with the requirements or is false and misleading in a material respect, the Commission has power to initiate administrative proceedings to remove from trading on the Stock Exchange that security or suspend trading for a period of time. This is really a formal way of securing appropriate correction. We also have power to go to Court and by way of an order of *mandamus* compel the company to file proper and correct annual reports and financial statements. Now, in the case of companies that do not have securities listed on the Stock Exchange but are required to file reports with the Commission—there are a number of those; they include companies which have made large offerings to the public or have a substantial public interest and outstanding securities, certain investment companies and certain other public utility companies—the Commission has a range of power which it can utilise to the end of securing appropriate correction.

6645. *Professor Gower*: While we are on this question of annual reports and financial statements and so on, could I just clear up one point about what we call turnover figures and you call gross sales. As I understand it, you require the global turnover to be shown in all accounts?—That is right, although there recently has developed a good deal of discussion with respect to this matter of a global figure. So many companies have become multi-product or multi-business companies.

6646. Could I leave that for a moment? At the moment we do not require this,

although some companies give it voluntarily. One of the objections that is raised to requiring companies to give it is that it would be very unfair to the little company manufacturing one line and in competition with a large multiple concern. The turnover figures of the large multiple concern would reveal nothing, whereas the turnover figures of the small one-line company would reveal a great deal and would in fact enable the big competitors to see exactly how much they needed to reduce their charges in order to drive the little man out of business.—Of course, this is the most attractive case against turnover figures. However, we are not persuaded. We have had considerable experience with this situation in relation to the smaller companies as against larger companies, and as against companies in multi-businesses, where the figures are more or less submerged, although not truly submerged because we do require some breakdown between important elements of the business in the prospectus and in the reports. However, while this is an appealing argument, I do not think it has been demonstrated to the satisfaction of the Commission that in fact damage has occurred to any company as a result of the required publication of these figures. This problem came up at an early point in the Commission's history and the matter went to the Court of Appeals for consideration. While there is some language in the Court of Appeals decision which suggests that perhaps one or another of the Judges might have decided the matter otherwise, the net result of the opinion was that the Court upheld the Commission's view of the matter. Since that time I think that business men have become much more sophisticated about the problems involved. I also have some difficulty in believing that a large company engaged in the particular line of business does not know pretty much what the little company is doing anyway, and *vice versa*.

6647. Yes. You would say he probably would not want to put him out of business because of the Anti-Trust Laws?—That is a very important element in the United States, of course, and it is one to which many business men are very sensitive.

6648. Could I then come to the question of break-down of the global turnover. As I understand it, you do not require this in the annual reports but you do ask for it in your initial registration statement when there is an original public issue?—We do require it in the initial prospectus, we also require it in the annual report, but not in the financial statements. The rules in respect of the financial statements require only the global figures. However, we do require in the narrative portion of the annual report, required to be filed with the Commission, some indication with respect to this matter to which you have referred, particularly if there has been a change since the initial registration statement, so that there is information on a continuing basis with respect to these matters. I want to say one further thing. I think I mentioned before that the Commission has no direct jurisdiction over the annual report which the management sends to its shareholders. This was a deliberate decision made in drafting the statutes and I think a very wise one. When management feels that it is subject to statutory restrictions, inhibitions of one kind and another, it may feel that it is not in a position to provide as much information or as candidly as it otherwise might. I think this was the basis for the decision that the Commission should not have any control or supervision over annual reports sent to shareholders. Now, the annual reports in the United States for the shareholders by and large do provide a considerable amount of information beyond statutory requirements. For example, the annual report of the United States Steel Corporation contains, I believe, more information than we require in the prospectus for the initial issue. But apart from that, the management does comment fairly liberally and with considerable freedom regarding the nature of the business of the company and its prospects.

6649. Finally, on this problem of new issues: Professor Loss, you, I know, have always been rather critical of our practice of a waiting period of three days. It seemed to us from the evidence we had from your American colleagues that perhaps there was not really much difference. That is accounted for by the different way in which issues are made in the two countries. Over here we do at

least ensure that the lay investor can read the prospectus for three days before he has to put in an application. Would I not be right in thinking that under your system of a red herring prospectus and a final registration statement, it is really only the people in the selling group or perhaps a few brokers and dealers who will ever have seen the red herring prospectus, and the lay investor has really got to buy as soon as the registration statement is registered, unless he has reason to suppose the shares will remain on tap for a considerable time? Would that be fair or not?—*Professor Loss*: Generally speaking, I have the impression that the typical lay investor probably does not see the actual prospectus until he gets it with the certificate that he has bought.

6650. And he would not see the red herring prospectus at all?—No. I am also of the conviction that the purpose behind the Act works primarily not through the prospectus but indirectly, because the information in the prospectus does become available to the brokers and the bankers who advise the little investor. In that sense, I do not know if it is of very great consequence that the little investor does not get the preliminary prospectus.

6651. *Mrs. Naylor*: Does the red herring prospectus go to the financial Press?—Yes, indeed. I do not know whether the Committee are familiar with the cards issued by Standard & Poors, which is one of our statistical services. Standard & Poors get a copy of every registration statement when it is filed. They manage to condense it on a card about 4 in. by 6 in. folded over. Standard and Poors sell those cards in great quantity to the underwriters and dealers and they are distributed rather widely, I think, among the dealers.

Mr. Cohen: I do not entirely share the view that the lay investor does not have an opportunity to view and consider the prospectus. In fact, it is because of our conviction that many more each year are in fact viewing the prospectus that we have geared our requirements to provide in the prospectus information that a lay investor can more readily digest as well as the more detailed information which requires more skilled analysis. To this end, in certain more speculative type issues

we require to be set out in the prospectus some itemisation of the hazards of the issue or the particular aspects of the issue which should receive attention. We require a simple capitalisation table and a summary of earnings as well as the full financial statements. My own experience is that investors do in fact read the prospectuses and some of them read them very carefully. Occasionally a registration statement is filed with respect to a particular issue and the "red herring" prospectuses are distributed fairly widely and in consequence of that fact sometimes the issue is withdrawn. Sometimes the price is substantially reduced. The Commission does not require the preliminary prospectus to be furnished to prospective investors. It requires only that the prospectus go to prospective dealer purchasers. However, in practice I know that great quantities of the preliminary prospectuses are in fact distributed and do go to investors. Moreover, in the case of a registration statement by way of exchange, the person to whom it is addressed is the investor. He is the one who receives it, there may be no dealers involved at all. In the case of an offering by way of rights, it goes directly to the investor, there may be no dealers involved. We make no distinction in our requirements with respect to prospectuses as between these cases. I receive a great deal of correspondence each year from people with respect to prospectuses or proposed prospectuses; some of it is misguided, it is true, but nevertheless it does reflect the fact that the prospectus has been viewed. I do not share the view that they do not read it, although I will agree that perhaps in the overall picture, the skilled analysis of a prospectus by the dealer, by the security analyst and by the financial publicist, is important and contributes most valuably to the informed markets that we think we have in the United States.

6652. *Professor Gower*: In other words, you would be critical of our three-day waiting period; you think longer should be provided?—We like our system. I would not want to be critical of the system in the United Kingdom.

6653. Could we turn now to deal with the Exchange Act?—We think it is a very important aspect of our work.

6654. *Chairman*: Before you do that, I have one small point on prospectuses. You told us that the Commission takes no responsibility for the accuracy or adequacy of their content.—Yes.

6655. What happens to a company which goes to the Commission and does everything they tell it to do and as far as the company knows it is treated as being all in order: would the company then be exposed to prosecution if it had issued a prospectus which contained an omission, or would they come under the normal scrutiny of the Commission?—Yes, such a company might find itself subject to such action.

6656. Would that not be a considerable hardship?—No, I do not think so. First, it does not happen very often. It happens only in cases where there has obviously been a deliberate effort to conceal information in a prospectus or from the Commission, as a result of which the Commission was not alert enough or its staff was not alert enough to detect the inaccuracies or inadequacies of the prospectus. It becomes effective perhaps and the offering is made and the securities are sold. Information later comes to our attention which raises serious questions with respect to the prospectus. The Commission takes the view that it may at that point, if it wishes, undertake administrative proceedings to test the accuracy of the prospectus. This is done for a variety of reasons: one, to correct the documents on file; two, to bring out the relevant facts so that the private persons involved may take such remedies as they feel appropriate and necessary; and three, to provide the Commission with the information which may be necessary so that it can undertake, if appropriate, necessary prosecution where that would seem to be indicated.

6657. Although the Commission may have told the company in the first place "You need not put that in"—Oh, it would not arise in that way. Normally, the prospectus comes to us, we review it and we raise certain questions with respect to the prospectus which indicate that in our view there are certain areas of unexplained details, that it is inadequate, that certain information has been omitted. We merely bring it to the attention of the

issuer and the banker. We make no ruling in the matter. They consider our suggestions. They may agree or not agree; they may come down and talk to us about it or call us on the telephone.

6658. *Professor Gower*: Would you in most cases, in fact make some suggestions about deficiency; the deficiency letter would be normal in all cases?—This is a normal procedure, although because of the recent influx of business we have had to undertake some measures with respect to some of the very well-established companies in order to minimise the time involved in reviewing the documents and permitting the companies to go to market. But in all cases they are reviewed and in nearly all cases we do submit to the issuer and to the bankers and to their counsel a letter in which we comment on the registration statement.

Professor Loss: May I add something which perhaps it is not quite so easy for Mr. Cohen to say in his present capacity? I have no hesitation, since I have no official capacity, in saying that, unless the issuer intentionally tries to conceal something, I do not think there is the slightest chance that anybody will be held civilly or criminally responsible for any omissions.

6659. *Chairman*: That is probably the practical answer.—It is never done, so far as I know. Unless there is actual concealment, no Court is likely to "out-Herod Herod" and require something more than the S.E.C. requires.

6660. *Professor Gower*: Is there any limit to the time you are allowed to go on selling on a prospectus? Under our rules there is no statutory limit to the time the prospectus remains available.—After nine months the prospectus may not contain information more than 16 months old; that is to say, if you use the prospectus more than nine months after the effective date, you must be certain that all the information is not more than 16 months old. That means that in the case of a continuous offering you must every so often bring the prospectus up to date.

Mr. Cohen: I think I would like to supplement that answer. Under our statutes the registration statement is filed and 20 days later it becomes effective

automatically unless the Commission accelerates that or an amendment is filed. When an amendment is filed the 20 days begin to run anew. It is contemplated that during that 20-day period two things will happen. The Commission will have the opportunity to review the documents and decide whether it should take some action; theoretically during that 20-day period the investor will have the opportunity to review that document, to determine whether or not he is interested in the issue. During that 20-day period, as it may be extended by amendments, an offering may be made but no sale or commitment to sell may be effected. This must await the actual effectiveness of the registration statement. And, as Professor Loss indicated, once a statement is effective it may be used for nine months subject to the general anti-fraud provisions of the Act. For example, if all the plant of the company should burn down, it would be considered appropriate at least to place a sticker on the prospectus to indicate that has happened during the course of the offering. After nine months the information in the prospectus may not be older than 16 months. This means that in the case of a continuous offering—and there are some companies that are making a continuous offering, notably our investment companies—in effect the prospectus is renewed each year. This happens in other types of offerings; for example, offerings under option or certain types of pension schemes in which securities are involved. In those cases the prospectus is renewed usually once a year.

. 6661. *Sir George Erskine*: Is the prospectus simply an abbreviation of the registration statement or have the two documents certain statutory differences? —The way the statute is written, technically there are two documents. In practice they have been merged in an attempt to simplify procedures without derogating from the statutory requirements. The prospectus contains the information which would go to the investor and it is the bulk of the registration statement. There is usually a part II of the registration statement itself which contains certain exhibits, the governing instruments of the company and certain contracts, and certain other information that the Commission must

have in order to test whether the filing has been made properly and appropriate fees have been paid and also certain information to determine whether or not certain events have occurred which should be reflected in the prospectus. But that portion of the registration statement is rather small except to the extent that it may contain in some cases voluminous exhibits. Usually it does not. We permit references to earlier registration statements, earlier filings. In the case of a company that has gone through the baptism the documents are fairly simple and almost standardised.

6662. *Mr. Lumsden*: I think it is often felt over here that although the information which you require has been put into your prospectus and is all very desirable, the result is a document that is so bulky that it defeats its own purpose and even for the expert it appears necessary for a statistical service to summarise it which would rather lend credence to that thought. Have you any comments on that?—Yes, I have some very strong comments on that point. There are some very substantial companies that prepare prospectuses that have gone to the public where the whole document including all the detailed financial statements is no more than eight pages, of double-spaced prominent type, something that would fit on one page of the *Financial Times*.

6663. *Professor Gower*: You are much stricter than we are in prescribing the size of the type?—Yes, we are. We do have some requirements with respect to the size of the type. Prospectuses, as I say, in the beginning were fairly substantial and this was understandable. Bankers, issuers, and their attorneys particularly, were much concerned about responsibilities and liabilities under the statute, and they tended to veer towards more than less disclosure. The Commission throughout its history has sought by whatever means are available to it, even to the point of taking proceedings against the registration statement, to keep the document to a reasonable size. We also have rules which indicate that unless a reasonable effort is made to bring the document within reasonable competence, the Commission will deny certain privileges. I will not burden you with the detail. The fact is that except in certain

situations—such as an exchange offer—prospectuses are now fairly small and compact, even with the largest company.

In regard to some large companies it is easier to draw up a small prospectus than in the case of some small companies.

(Adjourned until 2.30 p.m.)

On resumption.

6664. *Mr. Watson:* I would like to ask Mr. Cohen a question about the American system of offering shares for public purchase. As I understand it, the regulations of S.E.C. provide that a prospectus is to be available some 20 days before the issue is actually offered for subscription, and in that prospectus is a complete and comprehensive catalogue of the company's affairs, its assets, and so on; but that document does not contain any reference to the price at which the particular security is to be sold. Now, it seems to me that there is a definite difference existing there, if I am right, between the practice in the United States and in this country where, when stock is being offered for sale publicly, a prospectus appears by advertisement and in three days time one may apply for this particular security at the price which is stated in the prospectus. The private investor in this country sees from the prospectus what he is expected to pay, and he can make up his mind in three days. In the United States he may never know, until the offer is actually available to the public, just exactly what price he is expected to pay for the security.—

Mr. Cohen: In the case of a new issue, which is not already being traded—and I have in mind two types of new issue; a new enterprise, or the shares of a private company which do not enjoy a trading market—in those cases it is customary for an agreement to be reached between the issuer and the banker on the price. This price will be fixed and may be on the file for as long as two or three days. So that you do have all the information that you require. The situation you refer to normally does arise in the context of an issue of shares which do enjoy a trading market, which may vary from day to day. The Statute in theory requires that all the information must be in the registration statement. Because of this 20-day arrangement, the Commission has recognised that perhaps it is

unreal to expect the underwriters to be on the hook for as many as 20 days, and the Commission bent its procedures a little within the general statutory framework, so that we permit the filing of what is known as the price amendment at almost the last moment. This may be one, two or three days before the intended offering date; it often is at least one day, and frequently as many as three days before the intended offering date. Occasionally it may be the very morning of the proposed offering date. The theory in all those cases is that all the relevant information is provided on a basis on which the investor can arrive at some conclusion whether he is interested, and he knows that the offering price will have some relationship to the current price at which the securities are being quoted. Therefore, I do not think the position is in any material way different from the position in the United Kingdom.

6665. And does it really mean in practice that the private investor has to rely on advice that he gets from his professional adviser?—You mean, as to the actual price?

6666. Yes.—In order that he may be informed as promptly as possible, I think, he might call on his dealer or the person through whom he is going to purchase the shares to advise him as soon as he is informed of the price. Normally, this price amendment is filed at least two or three days before the expected offering date; it becomes a matter of public information almost immediately, and the price becomes known through the securities industry anyway, and I am sure that it is communicated to the investor. If the investor is that concerned about the price, he may communicate with the issuer or the bank, so that he is informed directly, if he desires. I understand that you require that the prospectus indicates the price in the advertisement that

appears in, say, the *Financial Times* almost three days before the sale. There is that little difference.

6667. And often in the short space of three days conditions can alter in such a way as to make an offer unattractive three days later, or even more attractive?—This is true, and this is one respect in which underwriting in the United Kingdom is different from underwriting in the United States.

6668. *Professor Gower*: On the other hand, they are more reluctant here to give information to the investing public?—Your prospectus contains less information than we require.

6669. I was thinking of the fact that the issuing houses over here do object to any suggestion that they should make available everything except the price to the investing public for, say, 20 days. When we asked them about that, they said it would be quite unnecessary.—Well, we are a larger country and it takes a little longer for the information to get round. Nevertheless, many offerings are rather complex; many offerings do require some assistance to the investing public in determining the nature of the security, and we have felt that three days is an inadequate period in which to reach an appraisal.

6670. *Mr. Watson*: You are not satisfied that three days is a reasonable period within which to fix the price at which the stock is to be sold?—In most cases that price amendment is filed two or three days before the actual offering date—sometimes it is longer. In many cases it is on the file for as many as 20 or 30 days. There are cases in which the price amendment comes in at the last moment, and we do agree to the request of the bankers that the statement should become effective almost immediately. The Commission normally requires at least two days.

6671. *Professor Gower*: And there is this difference too, that over here the lists will open and close almost immediately, while in the United States the probability is that the shares will remain on tap for several days to the investing public at the issuing price?—That is quite true, but of course it depends on

the nature of the issue. We may have an issue where sometimes the lists probably close before they open, in a real sense, but there are more situations in which the issue is available to the investing public over a longer period than is customary in the United Kingdom.

Professor Loss: But it is true that in a typical case the issue of an established company is sold within a matter of one or two hours after the effectiveness of the registration statement.

Mr. Cohen: Well, it is sold very shortly after the effective date, and I would say that in the very good issue it is probably within the same day, and that is because the information with respect to this issue has probably been on the file for 20 days and has been studied and in many cases a price has been available.

6672. *Sir George Erskine*: The three days is only the period between the publication of the prospectus and the opening of the list, but in fact the price is known for a considerably longer period because the price is known as soon as the issue is underwritten, and the issue is underwritten some days before the prospectus is published. So that we in fact have a period of at least seven days, sometimes considerably more, during which the price is known to the public generally.

6673. *Mrs. Naylor*: Would you think that there might be some advantage in the late determination of the issuing price? Do you think this early determination means that many new issues are placed at a price which is too low?—I am not sure that I am prepared to express an opinion on that point, but I did want to say something about what Sir George Erskine said. If I understand the methods of underwriting in the United Kingdom, the situation is somewhat different. First, I should say that one of the things which amazed me when I first came to this country was to view the size of the underwriting agreement between the issuer and the underwriter. I think I saw some of no more than one page. Now, underwriting agreements in the United States are very lengthy documents, but the British underwriter when he underwrites the shares has already laid off the shares. His stockbroker has been around to see the institutional investors and others who would

normally subscribe, and they agree to be underwriters on the theory that if it is a sticky issue they will get the issue with a slight reduction, and if not they will subscribe normally. Many of these people who are treated as sub-underwriters in the United Kingdom are in the United States treated as investors. But I am not sure that in the final analysis there is a great difference so far as the offering price is concerned.

Mr. Watson: I have one further comment. Sir George referred to the fact that the price was known to underwriters some seven days before the issue date, but I think he might agree that individual investors have not access to that information, and they receive the information just three days before the issue.

Sir George Erskine: I do not agree, because the normal practice of the issuing houses is that as soon as the underwriting is sent out the information is given to the Press. It is public knowledge as soon as the issue has been underwritten.

6674. *Mr. Watson:* The investor does not have full information until he sees the prospectus, and with the prospectus he sees the issuing price three days before he has to make up his mind; in the United States that is not so in every case?—I would imagine, if I were asked to give an estimate, that in between 60 and 70 per cent. of all cases the offering price is known at least 20 days before the offering date. I have in mind the fact that for several years about half the issues filed have related to securities of companies for which there has been no public market. In all those cases a price has been fixed and it is filed immediately, and it is on the file for 20 or 30 days. In the case of a rights offering the price is fixed, and in many cases the price may be available for as many as 20 days. There are any number of other types of offering, such as an exchange offering, where the price is fixed and available. I would say that in probably up to as many as 70 per cent. of all cases the price is known two or three or four weeks before the actual offering.

6675. *Mr. Scott:* That applies in this country so far as the rights offer is concerned, which is open for 21 days; and similarly with a merger that is open for

21 days. So it really only applies to public offerings by prospectus where that three days applies in this country?—The only area in which this problem arises is in connection with the securities of a company which enjoys an active trading market, where, in all fairness to existing shareholders and to the company, the offering price should have a fair relationship to the then current market price of the shares. In that connection, the Commission has certain rules to ensure that the price is a free price, unaffected by any artificial elements.

6676. *Mr. Watson:* Thank you; and in practice probably you would say that it works all right?—I think it does, yes.

6677. Would you include in the last category the case of a company which wants to sell a \$7 preference share and delays until the last moment the price at which it will market it?—In the case of a \$7 preference share, the price would probably be fixed in the initial filing or a substantial period before the offering.

6678. *Mr. Althaus:* In comparing the two systems, it is a material factor that the prospectuses are advertised in the Press in this country and therefore they not only have much wider publicity but they are more readily available to the public, and that therefore the time element is different in the two cases. It takes time for the prospectus to percolate through in the United States, whereas here it is simultaneously published in the Press and Exchange Telegraph cards are available and so on.—It is a fact that there is a difference in practice. First, you do require publication in the newspapers and we do not. We do have some publication in the newspapers and in other financial journals, but that is usually the exception rather than the rule. There is a very wide circulation of the preliminary prospectus during this period of 20, 30 or even 40 days. So I think that the difference disappears, particularly since these prospectuses receive wide circulation among prospective clients of the dealers who would be concerned with the distribution of the issue. There is another point, too: the financial journals in the United Kingdom generally do a far better job in regard to new issues than our financial journals in the United States. I was much

impressed with the way they commented upon, analysed and treated new issues. In the United States it is rare to see comparable treatment—even in our Wall Street Journal; and I think this is a view that is shared by our financial journalists in the United States.

6679. On the general question of the waiting period, it appears that over here not only can the financial journals form a judgment in a relatively quick period of time, but that the sub-underwriters to the issue, who never have more than 24 hours to make up their minds often make them up very much quicker and have no difficulty. Of course, they are trained observers and judges, but in this country at any rate it appears that that relatively brief period for study seems to suffice in many cases?—Well, I am not familiar enough to comment fully on that—and I am now talking off the top of my head—but I would be very surprised if an issuing house did not get word round to the people who would normally be the sub-underwriters that a certain issue was in the offing, so that the people concerned with such matters would not waste time in studying the documents; and I would hazard a guess that it does not come as a complete surprise to them, so that they actually have more than 24 hours. Also, these people are perhaps more skilled than the lay investor in reaching conclusions. Finally, they are in a somewhat favoured position in the sense that they are being offered the issue at something of a discount.

6680. *Professor Gower:* May I turn now to the Securities Exchange Act and in particular the proxy rules. We have had plenty of evidence about the general nature of them. Whenever a listed company or other company which is registered solicits proxies, or whenever some shareholders try to solicit proxies from fellow shareholders, they have to file with you a proxy statement giving a considerable amount of information; and among other things, if the directors are soliciting proxies they have to give certain information about their interests in the company?—Yes.

6681. To what extent do you scrutinise these proxy statements? And is that the same sort of scrutiny as you give to the original registration statement?—Yes,

they are subject to a similar scrutiny. There are more than 2,000 companies which file proxy statements with the Commission. We receive them mostly about this time of the year (when I should really be in Washington instead of over here) at a time when financing is at its height too. The proxy statement is very largely a device created by the Commission under a very broad grant of authority given by Congress to the Commission to regulate solicitation of proxies from shareholders. The Commission, relying on the provisions of the Securities Act and the Exchange Act regarding information which should be given to investors, has devised a regulation. The Commission has referred to it in earlier reports as probably its most effective disclosure device, because it is an annual affair and it does require a fairly broad spectrum of information regarding the management. And when the matters are presented to the shareholders for their action, then additional information of various sorts must be furnished so that the franchise exercised by them is an informed franchise. But again, we do not try to shape the issues. As I say, these are done every year; they are processed by people in the S.E.C. who are familiar with the companies, and because of the time problems of the annual meetings, we make an extra effort to do the job as shortly as possible. The rules require that the material be filed with the Commission 10 days before release to the shareholders. Frequently we will complete it long before the 10 days are up. If we find some fault with the documents, then we call the people and these difficulties are usually ironed out. One aspect of the proxy rules is that in connection with it the management is required to send the shareholders an annual report which fairly presents the position of the company at the time and its operations for the preceding fiscal year. These rules only come into force when an issuer seeks to solicit proxies. The Commission has no authority to compel a company to solicit proxies, and if it does not choose to solicit proxies then these rules do not come into play.

The New York Stock Exchange now requires all companies having securities listed on that Exchange to solicit proxies; therefore these rules apply to all its companies. But this is not true of some of the

other Exchanges—about 20 per cent. of all companies do not solicit proxies. Moreover, these rules do not apply to companies whose shares are not traded on exchanges. The rules do apply to investment companies and certain public utility companies which are subject to the jurisdiction of the Commission under other statutes.

This is the normal process. We have a procedure in the United States which arouses as much heat as your take-over bids, namely, the proxy contest. There were about 14 of them going on when I left Washington, and one of them is expected to be the largest ever, the most difficult ever, and the one creating the most problems. It is in this particular area that every S.E.C. man hopes that he can take off between February and May of each year, because of the shower of paper that is visited on shareholders almost every day by the contending sides, and, because of the necessity for prompt action by the Commission; unfortunately some staff people are required to spend almost 24 hours a day over an extended period of time in the office of the Commission in order to give service as required.

6682. What it comes to is this, that if in fact anybody solicits proxies then you use this opportunity for two purposes—(a) to ensure that there is no misleading information in the solicitation, and (b) to get out information to the shareholders which, in your view, they ought to have? You are really using this as an opportunity to insist upon the dissemination of vital information about the companies?—The dissemination of information regarding the management of the company and regarding proposals put before them for their action; and indirectly through the annual report information regarding the company.

6683. Then, if a proxy fight does develop, there will probably be a follow-up on both sides, and each side will be inundating the unfortunate shareholders with solicitations. To what extent do you vet this follow-up literature?—We vet all of it. We have a statutory responsibility in that respect and we examine it all. We are in the position, with regard to those matters, of something in the nature

of a referee standing between the parties. The Marquess of Queensbury's rules are to be found in the Commission's regulations, and we try to ensure that each side lives up to these rules. If our persuasion is not satisfactory or does not achieve this result, then we retire from the fray, since we have no administrative authority, and go to Court to seek an injunction to compel compliance with the rules or to prevent the use of proxies obtained by means of materials which materially violate the rules.

6684. And would you say that this has in fact served to eliminate indiscriminate mud-slinging?—Yes.

6685. But would you regard that as perhaps less important than the primary role of using this as an opportunity for making sure that the members get full information about the management of the company?—Yes.

6686. And that is really why you think this is so valuable, is it?—Yes. The proxy contest is an exciting thing. Fortunately, it is an infrequent occurrence. The most valuable part of our work relates to the yearly transmission of information to the investor.

6687. And you would be somewhat critical of our system because we have no statutory rules about what must be disclosed?—Well, I am not critical of that, but I am rather surprised.

6688. *Sir George Erskine*: Do you consider that it is necessary for this information to be given in the proxy statement? If so why do you not make them compulsory?—This is an excellent question and one which is near and dear to my heart. In 1941, in a programme designed to effect certain amendments to the Act (in which Professor Loss had an important role) it was suggested that some such scheme be provided—or that the Commission be provided with authority to compel this result. That statutory programme did not come to fruition largely because of the War. From time to time it has been suggested that the Statute might be amended to achieve this result, and I would hazard a guess that within the coming year or two a suggestion of this character may be brought forward.

6689. *Mr. Lawson*: Do you ever find that the S.E.C. appears to be put in the

position of favouring one of the parties as opposed to the other? Our Board of Trade have suggested that they appear to be put in that sort of position.—During the contest, each side is convinced that I am favouring the other side—and when that happens then I know that I am right in the middle, where I should be. This is inevitable. We are not quite as liberal as each side wants us to be with regard to the amount of mud-slinging that he would like to indulge in. At this time of the year I have no friends but many enemies. After the spring season has gone and the summer comes along, then both sides begin to feel that, had not the S.E.C. been there, things would have been far worse, and that one or the other side would have been subjected to the sort of mud-slinging short of libel with which it would have been unable to cope in the ordinary course of the law.

6690. *Professor Gower*: The rules also contain the so-called stockholder's proposal rule, whereby any stockholder can insist on his resolution and a supporting statement being circulated at the company's expense with the notice of the general meeting. This is rather like our section 140. Messrs. Davis Polk were rather critical about this: they said it had done more harm than good and had been largely used by publicity-seekers. Would you agree with that?—*Mr. Brownell* (who undoubtedly was the gentleman to whom you are referring) had perhaps within the week before his appearance here been in a little controversy with the Commission regarding one such proposal, and his views were probably stimulated by his efforts. I do not say that by way of criticism. It is quite true that a number of people have criticised this rule as being used largely by publicity-seekers. I would only say that while the rule has been used by a fair number of individuals, there are one, two or three individuals who use it each year a great deal. These individuals have received some fame (or notoriety) as a result of their activities. I would rather believe that these people do it out of a sincere effort to act as a sort of champion of what these gentlemen conceive to be appropriate. They argue: "If we are to live under this capitalist system under which the shareholders own the company, then the shareholders should

have an opportunity to express their views and to communicate freely with their fellow-shareholders". Now, I know that some people feel that this is a relic of old and is best discarded, but this view is not shared by all. I would not characterise these people as publicity-seekers—although some do receive a little publicity.

6691. Would you like to add anything to that answer, Professor Loss?—*Professor Loss*: I think inevitably any such rule will be used by people who, for one reason or another, like to make proposals. It seems to me that as long as we operate within the philosophy that the managers are responsible to the shareholders—although in some respects that philosophy is taking on some fictional qualities—the rule is, from the management point of view, a relatively cheap safety-valve for letting off steam, and from the management point of view a relatively inexpensive and harmless symbol of managerial subservience to the shareholders. I do not know that any of these shareholders' proposals has ever been carried directly. I am aware that a number of them have become management proposals, and Mr. Gilbert can take credit for the fact that more shareholders' meetings are now held in convenient places and so on. I would keep the rule pretty much as it is.

6692. *Chairman*: Do you get the type of person who buys one share in each of 12 different companies and then makes himself the spearhead of revolt and opposition in each of them?—I think there is some of this. Mr. Gilbert owns a considerable number of shares in a considerable number of companies; and there are people who have bought one share. On the other hand, if one follows the theory that they are volunteer spokesmen for the lot, then I suppose the answer is that it does not make any difference how many shares they own—any more than it does in a shareholder's writ of action.

Mr. Cohen: Not every or any proposal submitted by a shareholder is required to be included in the management material. The Commission has a regulation which is designed to remove from the scope of the rule people who are submitting proposals out of a sense of personal grievance, or proposals which are not properly the subject of shareholders' action. For

example, we have had cases where a large radio-manufacturer received a proposal from a shareholder that all shareholders should receive a radio at 60 per cent. discount! Now, we do not consider that to be an appropriate stockholder's proposal. We also provide that matters which are properly within the ambit of management responsibility in the ordinary conduct of their business may not be included in the management material as a mandatory stockholder's resolution. In such cases the resolution may be in the nature of a recommendation or a suggestion. We also have other rules: thus, if a proposal does not receive in one year a certain minimum acceptance, it may not be required to be included in the material of the company for the next two or three years. So that there are certain limitations which are designed to bring this whole matter within a reasonable compass.

Professor Loss: We like to pretend that companies are ultimately controlled by the shareholders. With the larger companies, that is more pretence than reality. Ideally any proposal which could be made at the meeting should be able to be made through the proxy statement. One can attack the whole philosophy—and I do not know the answer to it.

Mr. Cohen: There has been a great movement, both over here and in the United States, to invite interest in securities by people who so far have not had such an interest, on the theory that they are acquiring an equity interest in the company, and it is somewhat anomalous to suggest to them that they should acquire such an interest and then to tell them that they have no right to offer fair comments among their fellows.

6693. *Professor Gower:* Turning now to section 16, we are interested in this first because it is obviously a considerable problem how you prevent the abuse of inside information, and secondly because we have had a large amount of evidence suggesting that we should try to cause at least some nominee shareholders' ownership to be disclosed, and section 16 links up with both of those problems. There is section 16 (a) which says that all directors, officers and 10 per cent. shareholders shall register particulars of their share dealings?—Yes, Sir, section 16 (a) so requires;

and it further requires that any person within any of those three categories shall file with the Commission, within 10 days of the month within which he has had a transaction in the shares of the company, a report indicating the nature of the transaction.

6694. But the Register does not require the date of the actual contract to be shown: is that right?—I cannot recall whether we do require the actual date, but we do get the date in most cases. We have just recently amended the forms, and that is the reason why I cannot specifically recall whether we do in fact require the specific date. However, this is not a matter of great moment, because if the report shows a transaction and another transaction within 6 months afterwards, then immediately the dates can be established through other channels.

6695. Then, section 16 (b) is a section which requires the person concerned to hand over to the company any profit that he makes on dealings within a period of 6 months?—Yes. The Courts have been very strict on this. The Commission does not enforce this provision. We cannot bring an action on behalf of the company. Section 16 (b) provides that the company may, or upon default a shareholder may, sue to recover whatever profits are realised by any one in these three categories from any purchase and sale, or sale and purchase, or any combination of them, within 6 months, which results in a profit.

6696. And finally there is section 16 (c) which forbids short sales?—Yes.

6697. Would you say that this section has been loyally observed by those concerned? Do people in fact register their dealings, because we have heard the view that if a man is going to abuse inside information he will conceal the fact and not register?—We think it is fairly loyally observed. We have many ways of checking this. There are now approximately 40,000 persons who are subject to this reporting requirement; we receive approximately 40,000 reports a year from them. That does not mean one report per person, but it is something in excess of 3,000 reports a month. We think that it is a rare case when a report is not made,

although there have been some instances, and when they have come to our attention we have taken the appropriate action to compel the filing of a report. There is a potent civil remedy when the report is not filed—the statute of limitations, so far as 16 (b) is concerned, does not apply until the transaction is notified—all this contributes to the fact that the report is filed.

6698. And you think that in fact it is loyally observed?—Yes, Sir, there have been very few instances in which there has been a failure to file the report. We do have a fair amount of dilatory filing, but we catch up with them.

6699. *Mrs. Naylor*: Do you rely on outside informers at all?—We have a great many outside informers who write to us, but we have many ways of checking this information. For example, an annual report is filed, and in that some indication must be given of all holdings by officers and directors. The proxy statement requires certain information, the prospectus requires certain information, and our people are cross-checking this information all the time as a matter of routine. Each month there will be as many as 25 per cent. late reports.

6700. *Professor Gower*: But you cannot be quite sure how far this is observed because if it is not observed you will never know?—I am convinced that there may be some such cases, but we have no basis for suggesting that this is material.

6701. You think that, sooner or later, they will be found out—and the statute of limitations will not run until they are found out?—Yes. Sooner or later we catch up with most of them.

6702. *Mr. Althaus*: Do you think that some people who might wish to avoid this regulation might deal through their friends or their relations?—No doubt there may be some such concealment. I think the civil and criminal sanctions are such as to minimise such activity. In relation to the proxy contest situation, where concealment may be of some consequence to the person, our experience has been that the information is provided. In fact our requirements go beyond this limited area in the case of a proxy contest: we require information regarding associates and other persons.

6703. *Professor Gower*: It has been suggested that that could be got round in the case of the 10 per cent. shareholder by having an agreement with other people, or by forming a syndicate?—Undoubtedly that is possible, but I have no basis for believing that there is any material evasion of this requirement. Of course, the Statute speaks in terms of a "person". However, "person" would include an unincorporated association, so that even such a syndicate in a proper case might be held to be such a holder. I can only repeat what I have already said, that I am not aware of any material violation or evasion of this requirement.

6704. And do you think that it has tended to eradicate the abuse of inside information in dealings in companies' securities?—This section, of course, only deals with trading in the company's securities, and there is no restriction on trading in the securities after 6 months and one day; section 16 (b) does not then apply. It is a rule of thumb, and a crude rule of thumb, but it is one which has been devised by Congress to deal with this matter, and we think it has been effective. Within this area, however, there are other sections in this Statute which deal with other aspects of use or misuse of inside information by insiders which, in their totality, have cut down the area of possible misuse of inside information, although quite clearly this is an abuse which can never be completely eliminated.

6705. We have had a number of disturbing cases over here recently where, just before merger proposals have been announced, there have been considerable dealings in the company's shares by people who presumably have some inside information. Has that sort of thing been eradicated in the United States?—Cases of this kind come to our attention from time to time, and we deal with them. We also know of cases where shares are acquired without notice in anticipation of a merger transaction and that kind of thing. Where these matters come to our attention we deal with them.

6706. In other words, you think that section 16 (a) has been fully effective; but is it is 16 (a) plus (b)? I mean, would public

disclosure have been almost equally effective, or is it only 16 (a) coupled with the provisions of 16 (b)?—I am not sure that 16 (a) is alone an effective provision. I think section 16 (a) has another purpose: I think 16 (a) is designed to provide investors currently with information as to what the company's officers and directors are doing; the investors may be beginning to wonder why they are selling the stocks of their company, or if they are buying some stock this may be of some interest and may prompt some questions. I think, so far as section 16 (b) is concerned, that hits where it hurts—in the pocket-book—and therefore I think it is an effective sanction.

6707. *Mr. Lawson*: If company A is about to make a take-over bid for company B, is there anything in your regulations preventing company A from buying shares of company B in the market before anything is announced about the take-over bid?—No, Sir. I am assuming that company A has no prior connection with company B.

6708. Yes, but it has decided that it wants to make a take-over bid, and a week before it is announced it buys up stock.

6709. *Professor Gower*: But it would have to register as soon as it had got 10 per cent., would it not?—Yes.

6710. *Mr. Lawson*: But there is nothing else to prevent it?—No. If there is a rise in the price of the shares stimulated solely by normal purchase, then there is no problem; but if, in connection with a possible take-over bid, there are some artificial stimulants on the market, then this may create a problem.

6711. *Professor Gower*: Mr. Brownell asked me to ask Prof. Loss for his views on section 16 (b).—*Professor Loss*: As I said in writing 10 years ago, section 16 (b) is probably the most cordially disliked single section in the entire S.E.C. armoury by those it affects. Nevertheless, I think Mr. Brownell did say, and I agree, that it is not likely to be repealed. But there is nothing in section 16 (b) to prevent a director or an officer from giving inside information to his best friend; it is very easily evaded. Backscratching of that sort would not be

covered by 16 (b); it might well be covered by rule 10 b-5. The original bill of 1934 would have gone further than section 16 (b). It would have made it a criminal offence for insiders improperly to disclose confidential information to other people, and the trading profits of the latter as well as the former would have been recoverable by the company. I think these strictures were taken out of the statute before passing it in the full realisation that section 16 (b) would not by any means provide a full answer but that it did take care of the crude cases. By hypothesis, if you want an arbitrary rule of thumb you cannot also have equity and fairness. But rules of thumb do have their place. The section would hurt insiders more than it does except for the tax laws. If you hold for less than 6 months, you pay tax at the surtax rate on ordinary income instead of the lower rates on long-term capital gains. It is true that we do not use the same rules for tax purposes, in that for tax purposes we apply "first in, first out" if we cannot trace the shares, whereas for section 16 (b) purposes, if we did that, anybody by holding an inventory could avoid section 16 (b). Therefore the Courts have made the 16 (b) rule "lowest in, highest out". Also, 16 (b) applies if you sell first and buy back later within 6 months at a lower price.

6712. *Professor Gower*: You have referred to rule 10 b-5. Perhaps the best way of illustrating the way the whole thing works would be if I gave you a case: supposing in the United States that a director of a company, with knowledge that a take-over bid was about to be made at, say, \$15 per share, was to go out and buy shares at the market price of, say, \$10, and then afterwards accepted the take-over bid of \$15—thus making a \$5 profit—what would be the probable effect, in common law, and of section 16 (a) and (b) on this?—One has to go into the common law and then into sections 10 (b) and 16 (b). We have the same problem that you have, and most of our States follow the same rule that you do. On the other hand, a few of our States, like Kansas, Georgia and so on, have adopted a trusteeship concept; even at common law they consider that the director has the status almost of a

trustee, with the obligation to make full disclosure. Then we have a third, in-between view of the common law, which dates from a case which came up in the Supreme Court from the Philippines in 1909; the Supreme Court stated that there might be special circumstances in which there might be a duty of disclosure, and a number of States have followed that view. It is probably fair to say that the so-called "special circumstances" doctrine has become the majority view now, and when you analyse what the special circumstance is, it seems to be any material fact. So perhaps the net result is that even at common law most Courts will apply something like the fiduciary standard of full disclosure when a director deals with shareholders. So much for the common law . . .

6713. *Professor Gower*: Even at common law, the view today would be that shareholders, who have sold their shares to directors without full disclosure by the latter, have a remedy against the directors?—I would say that the growth of the common law has not been unaffected by the S.E.C. statutes.

The Securities Act of 1933, although primarily aimed at distributions of securities, does have in it a general anti-fraud section, section 17, which makes it unlawful for any person in the sale of any security to engage in any fraud or tell half the truth. That applies only to the sale of securities because the whole focus of the Securities Act occurs on the sale side; fraud by buyers does not happen so frequently. The 1934 Act was designed to supplement the Securities Act by having an impact on the process of trading in securities, as distinct from the initial process of distribution of securities, and the Exchange Act has a number of provisions which you have not asked about and probably are not interested in. But it must be remembered that that statute was not passed as a company law. Its title is the Securities Exchange Act; that is to say, the Stock Exchange Act. Sections 9 and 10 (a) have a number of provisions dealing with manipulation of the market, short sales, and so on; and the S.E.C. is given a rule-making power in a substantial number of particulars in sections 9 and 10 (a). Then section 10 (b) was thrown in as an omnibus provision. It says that

it shall be unlawful for any person in the purchase or sale of any security to engage in any practice which the Commission may by rule declare to be fraudulent or manipulative. The Administration's spokesman in the legislative committees that considered that section said, "section 10 (b) says 'Thou shalt not devise any other cunning devices.'". And for years the Commission did not even use section 10 (b). But then they discovered in the late '30s. that there were a number of cases in which directors had taken advantage of shareholders by buying shares in when there was a prospect of a favourable merger which would materially enhance the value of the shares. The Commission were concerned about this, because they had no means of handling it. If there was fraud in the sale, they could handle it under section 17. But this was another sort of animal. And the Commission suggested to Congress in 1941 that section 17 be amended by adding the words "or purchase" after "sale". No one opposed this, but Congress never got round to doing it. As these cases increased in frequency, someone at the Commission had a bright idea one day. He looked at section 10 (b), which had been hardly used at all, and said, "All we have to do is to adopt a rule under section 10 (b) which will amend section 17 by adding 'or purchase'"; and that was done in five minutes one afternoon.

The Commission had in mind simply giving itself a weapon as a basis for criminal prosecution at the Federal level, and even more as a basis for injunction. The next step followed automatically. There was a case of a company with altogether four shareholders—a father and son on one side, and two brothers on the other—each owning a quarter of the shares. Two of them (I cannot remember which two) bought out the other two, the first two having worked out a favourable merger about which they did not tell the other two. When the sellers discovered it, they were not at all happy. Their counsel realised that if he were to sue at common law he might be faced with the doctrine of *Perceval v. Wright*. But he remembered that certain criminal statutes create common law tort actions in favour of the class intended to be benefited by the statute—a doctrine which goes back to an English

case about a century ago (*Couch v. Steel*) in which a seaman recovered because of a violation of a criminal statute requiring certain drugs to be kept aboard ship. And so the lawyer sued under rule 10 b-5 in the Federal Court in Philadelphia and recovered. The Commission supported that decision. But it was not the Commission's idea in the first place. And, although that doctrine has not gone to the Supreme Court, it has gone to four or five of our Federal Courts of Appeals and a number of District Courts, and no judge has dissented from it. The Supreme Court might prick the bubble, but I doubt it.

The net result is that if you can show some incidental use of the mails—even perhaps when the banks clear the cheques—then you are no longer concerned about which view your State Court will follow at common law. I think that has been a salutary development, although it has perhaps served, in an unintended way, to federalise an important aspect of our company law.

6714. *Professor Gower*: Failure to disclose this material information will give the sellers a civil remedy in damages, and the company can recover any profit?—If the shares were also listed and therefore subject to section 16 (b), and if the buyer were to resell at a profit within six months, then I suspect he might be liable doubly. Certainly if he were to pay the company under 16 (b), I cannot see that there would be a defence to the fraud complaint of the seller.

Professor Gower: It is quite a striking contrast to the probable position in English law.

6715. *Mr. Mackinnon*: Do you think if we were to apply rule 10 b-5 here, it would provide a remedy by itself which would be sufficient to cope with the difficulty of a director buying shares on inside information? Do you need any more?—I would not think so. The more careful lawyers today write what is almost a reverse prospectus in this kind of case. Reputable counsel advising a reputable take-over bidder, if that is a proper phrase, will suggest that he make disclosure in writing in the form of a reverse prospectus as a guarantee against this kind of suit.

Mr. Cohen: I think one of the reasons for section 16 (b) which has not been exposed so far is recognition that proof of misuse of inside information would be almost impossible in most cases. If you had rule 10 b-5 alone, it is true that it would be sufficient where there was a proof of a misuse of information, but section 16 (b) is intended to obviate the need of proof in a crude sort of way.

Professor Loss: Perhaps I misunderstood your question. I did not mean to say I thought rule 10 b-5 precluded the usefulness or desirability of section 16 (b). But I quite agree with Mr. Cohen that, for us, section 16 (b) is perhaps more useful than rule 10 b-5.

6716. *Chairman*: Why can one not add to the list of contracts to be disclosed, a contract between a director and one of his own shareholders for the sale of most of his shares? If the opportunities a director has of obtaining inside information would put him in so much of an advantage over shareholders, he ought to make full disclosure?—I should think so, without prejudice to Mr. Cohen's point. When there is a quick turnover, as in section 16 (b), perhaps there ought to be a preclusive provision of that nature.

6717. *Mrs. Naylor*: He would not be able to buy on the market at all then?—Directors do a great deal of buying on the market quite legitimately, and, first of all, if he does not sell within six months after the purchase, section 16 (h) does not operate. But, so far as rule 10 b-5 is concerned, I am sure there is no problem in most cases. In one of our cases that went to Court, one company, Trans-America, learned that a small tobacco company had a very large tobacco inventory which had quadrupled in price because of the tobacco shortage during the war. Having learned this, Trans-America bought up the shares of this small tobacco company, captured control and then sought to liquidate the company, and, by selling tobacco to other cigarette manufacturers, made a very handsome profit. Those who sold their shares at a little over market value then sued successfully.

Mr. Cohen: So far as buying is concerned, we receive almost 40,000 reports a year covering, I would say, between

75,000 and 100,000 transactions by these individuals. Finally, Professor Loss referred to the fact that rule 10 b-5 has not reached the Supreme Court, but a petition has just been filed seeking leave of the Supreme Court to hear a matter relating to rule 10 b-5.

Professor Loss: There have been lots of petitions filed, but they have all been denied.

Professor Gower: Perhaps one of the weaknesses of our system is that although we have pretty sweeping criminal provisions—section 13 of the Prevention of Frauds Act for example, I would have thought, is quite as widely worded as your rule 10 b-5—I think the accepted view here is that this merely imposes criminal sanctions and does not give rise to civil liability; and although people occasionally are fined or sent to prison, it is never used by litigants to recover when they think they have been done.

6718. *Mr. Mackinnon:* Our section 13 already imposes a penalty in the section, and our laws put a gloss on the statutory tort by saying that where a penalty also accompanies the section, that exhausts the remedy under the section.—*Mr. Cohen:* This is clearly a steadily developing part of the law; and I think it is probably one of the most effective sanctions in the entire armoury of sanctions the Commission administers.

6719. *Chairman:* Take a law like the Factory Act which provides that anyone who fails to fence machinery shall pay a fine; that has been held for years to give a right of action to a workman who is injured by the failure to fence machinery, on the grounds that a crime is created to protect a certain class of person. If a crime is committed and damage ensues, a person in that class can sue.—This is a principle under which the law has developed in the United States.

Chairman: But it has not been extended in this country to breaches of the Companies Act.

6720. *Professor Gower:* The Prevention of Frauds Act is, however, intended for the protection of investors, just as the Factory Act is intended for the protection of workmen. One final point on the Securities Exchange Act. You have

talked about the control of Stock Exchanges and so on, and I was wondering if there was anything either of you gentlemen wanted to mention about that. You, for example, Mr. Cohen, looked at our Stock Exchange. Did you get the impression that manipulation of the market was equally effectively eradicated over here?

—Let me speak about our surveillance of the market situation. There is a real partnership under your statute between the London Stock Exchange and the Government, if I might put it that way. I think our partnership, perhaps, is closer. The Commission has certain jurisdiction, a control, over the activities of the Exchanges and members of the Exchanges that I do not think can be found in your statutes. In consequence, the Commission has, largely through persuasion, been able to effect real changes in the operations of the market and in the activities of members of the Exchanges, with the result that we feel now we have a free, open, unfettered market in nearly all the Exchanges.

Professor Loss: I think all the Exchanges.

Mr. Cohen: All right, all the Exchanges. Apart from this close relationship, the Commission has specific authority in the statute to make representations to the Exchange with respect to a fairly extensive category of procedures and exchange practice, to the end of securing changes in the rules; and the Commission has done this from time to time. In fact, only recently—and this may raise a question—the Commission persuaded the New York Stock Exchange to reconsider its schedule of fees in certain limited areas. The Stock Exchange did, and it is now making a study of the entire matter on the basis of which there may be further discussion of the problem. Apart from this, the Commission maintains a staff in Washington and New York notably, which has the job of watching the market during all the hours in which the market operates. If there appears to be unusual activity or very wide swings in the market, then inquiries are immediately instituted to determine the nature of the transactions which led to these matters. In most cases they are perfectly normal, proper transactions, and nothing comes of it. But every now and again we run into a situation

which is questionable. We pursue it further and, if it is in fact questionable, we secure prompt correction. We have prompt communication with the Exchanges to secure, where appropriate, almost immediate suspension of trading if a situation has arisen which may endanger public interest or the interests of investors. We also carry on this activity in the over-the-counter markets. It does not have all the trappings and machinery of the Exchange, and it is perhaps a somewhat more difficult job to maintain surveillance in the over-the-counter markets, but we have a comparable arrangement for the surveillance of those markets. In this area, there is a difference between your practice and ours, and I think it is a very substantial one. However, I wish to make this perfectly clear. The Exchange people and our people work hand in hand. There is no question of one superimposing himself upon the other. They bring information to our attention, and we bring it to their attention so that they can act on it. We do prefer that the Exchange should deal with its own people, rather than have the Commission impose itself; but there are occasions when the Commission must impose itself. This works very well, but it is not something I could find in the United Kingdom practice.

6721. *Mr. Althaus*: You have the power of suspension yourself?—Yes, Sir.

6722. How often would you use that power?—Very rarely. Let me explain about the power of suspension. I think I referred this morning to the fact that where an annual report required to be filed by such a company materially violates the requirements of the statute, the Commission may institute proceedings seeking either the de-listing of the security or the suspension of trading for a time. The Commission also has an extraordinary power to suspend trading for ten days, and this is used where something suddenly comes to our attention, where the situation is unclear and it is necessary to suspend trading so that the facts can be examined promptly. The Commission has employed this power a number of times in the last several years but, in relation to the entire picture, it is almost insignificant. Finally, the President himself has emergency power to suspend trading on all the Exchanges, but this is in a national

emergency such as wartime. We have now at least two securities which are under suspension of trading on the ten-day basis, and we can renew a ten-day order if, at the end of that period, we are not aware of all the facts so that all the public can trade in an informed way.

6723. *Mr. Brown*: Have you a precise definition of what is an officer?—We have a definition, but it is not very precise. It creates some difficulty, particularly in these days when we have multi-business companies. They have divisions, and there is a president of a division rather than a president of a company. This has created a number of problems; in point of fact, it is a matter of current interest and some little controversy in and out of the Commission. But we do have a definition. It indicates that the officers are the persons named in the bye-laws—the president, vice-president, secretary and treasurer—or the persons carrying on those functions. In a case some years ago in the Court of Appeals for the Second Circuit, one Judge on the panel raised some question about the definition and suggested that the Commission's definition was too narrow.

6724. *Professor Gower*: Now may I turn to investment companies? There is a great contrast here between the positions of the two countries. As I understand it, you have an Act which applies to investment companies, whether they be companies or what we should call unit trusts, and you subject both open and closed-end investment companies and unit trusts to pretty stringent control. We have fairly detailed regulations, made under the Prevention of Fraud Act, relating to unit trusts, but we have no special regulations at all about investment trust companies, and I think it is probably the view of most people in this country that there is no need for special regulations about closed-end investment trust companies. What is your reaction to that?—Our statute resulted from a four-year study conducted by the Commission, in which the Commission studied carefully the position in the United Kingdom and issued a report on the unit trust movement here. Our statute is a very long, complex statute. It is, depending on how one views it, a lawyer's nightmare or paradise. It has many provisions, some of which are not necessarily consistent with others; and it

does provide a great deal of opportunity for interpretation. But, apart from those faults, it does contain a fairly broad pattern of regulation of investment companies—and I use that expression to include investment trusts as well. There are distinctions between the open-end—the company which is continually offering its shares and is prepared to redeem its shares—and the closed-end company which does not. But in major respects the pattern of regulation applies equally to both categories of companies. This springs from the study the Commission made which indicated there were abuses in both types of companies. Our statute springs from the special circumstance of the development of trusts in the late 'twenties and early 'thirties in the United States. I must confess I am not as familiar with the unit trust situation in the United Kingdom, and I am not sure that I can answer more specifically on that particular point. I would be glad to treat with the Act itself, if you wished me to.

6725. *Mrs. Naylor*: On the question of investment companies, the closed-end ones, you prohibit interlocking shareholdings; one investment company must not hold the shares of another?—Yes, we do have a provision which is designed to prevent cross and circular ownership. Where it existed at the time of the enactment of the Act, a time limit was provided for the elimination of this situation.

6726. What evil was that intended to get rid of?—It was part of the evil this Act was designed to prevent, known as pyramiding. Other sections of the Act deal with this situation. What we found was that promoters of these companies, with little equity and by the issue of senior securities and the acquisition of other companies having layers of senior securities, created pyramids which were, to say the least, a little shaky. This cross and circular ownership was an aspect of this pyramiding arrangement. It also produced a number of other abuses, and, in consequence, Congress decided to outlaw it almost entirely.

6727. *Mr. Lawson*: Does that rule about cross holdings only apply to investment companies?—Yes.

Professor Loss: And there is also similar legislation applying to utilities like gas and

electric companies. But there is no Federal Act in respect of other companies except for our general anti-trust laws.

6728. *Professor Gower*: Why is the view taken that a shareholder in an investment trust company needs special protection, but not if he is investing in an industrial holding company?—*Mr. Cohen*: I think Congress reached the conclusion that the simple disclosure scheme was inadequate to the problems, that the investment trust is a method intended to tap the savings of perhaps the least sophisticated person interested in investing in securities, that these securities were sold on that basis, and therefore that disclosure in itself was not enough. Congress also felt that even if investors were fully appraised and able to appreciate the consequences of some of these things which had been created, the economy itself was being affected by the creation of these highly pyramided situations or these terribly risky arrangements. In consequence of both of these motivations, I believe Congress determined to adopt a special statute to deal with this problem. I think the third reason is the most interesting of all. The investment trust industry wanted a statute and wanted regulation, because there had come into the industry a great number of people not concerned with the interests of investors. The people who were concerned with the interests of investors were afraid that with a few more difficulties the entire business would attain such notoriety that it might make difficult the further sale of shares. The industry, therefore, sought legislation.

6729. *Mrs. Naylor*: Is there a definition of an investment company? Could you distinguish between an industrial holding company holding shares in 20 or 30 different companies, and an investment trust as we understand it?—This is an area of some difficulty. The United States Steel Company is a holding company. I am not sure it carries out any operations at all. Nevertheless, it is not an investment company. We have two definitions which are perhaps relevant to your question. Any company which holds itself out as engaged in the business of buying, selling and investing in securities is an investment company. Then there is what we call an inadvertent investment company, and this refers to a company which has a certain proportion of its assets

invested in what are described as investment securities. If more than 40 per cent. of the value of its assets on an unconsolidated basis are invested in investment securities, then, willy-nilly, it is an investment company. However, there are further provisions in the Act whereby such a company, upon a proper showing, may obtain an order from the Commission to the effect that it is not in fact an investment company and that it is primarily engaged in another business.

6730. *Mr. Lawson*: How do you eliminate circular shareholdings? Do you say that if Company A holds shares in Company B, it is illegal for Company B to hold shares in Company A?—Essentially, that is it, though the definition itself is somewhat more complicated.

6731. *Professor Gower*: I think I am right in saying that all recently formed investment trusts in the States have been formed in the company form and not in the unit trust form?—Not all, but the majority of them have been.

6732. Are there any practical advantages of one form over the other? Why is one more popular? Over here, when it was suggested to the unit trust movement that we might enable them to operate in the form of companies, most of them said they did not want this?—*Professor Loss*: It is not so much a matter of whether there are any advantages in being a company. There are no longer advantages in being a trust. One of the reasons that investment trusts were organised as trusts in the old days was that until about 1925 they were taxable as trusts, whereas a company would have to pay income tax and the shareholders would have to pay a tax on their dividends. Until about 1925, it was generally thought that in the case of a trust, even though it was a business trust, the trust as such would be taxable only on undistributed earnings, which is the rule today with ordinary *inter vivos* or testamentary trusts. In about 1925, our Supreme Court held that what was essentially a business trust should be treated as a company for tax purposes. It was some years later before Congress granted special tax treatment to regulated investment companies, and that legislation does not distinguish between trusts and corporations. Another advantage of the trust

form in the old days was thought to be freedom from State "blue sky" laws. The third great advantage was self-perpetuation of management: the trustees appointed their successors and so gave the shareholders no say in the management at all. Under the Investment Company Act, no matter how you are organised, the shareholders must vote annually for the management. So, with all the advantages gone, there is no reason today why they should not be organised as companies.

Mr. Cohen: I think one other answer relates to the British position. Until recently, there were not many States that permitted a company to repurchase its shares, as is true in the case of these so-called open-end companies. Maryland and Delaware were among the first to start this, and I think New York is now permitting it. This was part of the reason why a great many of these companies were organised as trusts: to avoid that problem under State law. But I think many States are now liberalising the situation.

Professor Loss: In Massachusetts, also, there are restrictions on a company's holding more than a certain percentage of the shares of a domestic public utility, but there are no such restrictions on trusts.

6733. It is argued over here that having independent trustees is excellent protection for the unit holder, and therefore, on that ground, they would be reluctant to change over to the company form? Your Act does require provisions about the custody of the portfolio securities, does it not?—*Mr. Cohen*: We have provision in the statute.

Professor Loss: Some people might like the ring of the word "trustee", yes.

6734. You can still have custodian trustees, even if you form as a company?—*Mr. Cohen*: This was another element. It was a sales point to urge that these shares were under the jurisdiction of XYZ trustee, on the theory that this provided some further protection than under the auspices of XYZ company. Some advantage is still thought to be obtained in this way. However, the Commission has been able to deal with that problem when it has arisen. As Professor Loss indicated, we do have provisions in the statute and these have been implemented by rules of the Commission which

require that the assets of the trust be maintained in such custody that ensures they can be found when needed.

6735. Do you allow door-to-door selling?—We do.

Professor Loss: Except under the Holding Company Act.

Mr. Cohen: We have not reached the sophistication that exists in the United Kingdom and Canada in this area.

6736. You think it is sophisticated not to allow door-to-door sales, do you?—You have had experience in this area which led to your share-pushing report and the Prevention of Frauds Act. In the United States, we do permit door-to-door selling, and in fact in the mutual fund area a vast amount of securities are sold in this way.

6737. Has that given rise to abuses?—I am not sure that it has given rise to any greater abuse than sales in the ordinary way.

Professor Loss: An interesting fact is that the New York Stock Exchange used to have a rule prohibiting its members from engaging in door-to-door selling, but it no longer does.

6738. *Mr. Lawson:* Door-to-door selling is enormously more expensive, is it not?—*Mr. Cohen:* I would hazard a guess that those who are engaged in that aspect of selling investment company shares are doing better than those who sell through dealers.

6739. *Mrs. Naylor:* Presumably the salesman has to be registered with the Commission?—That raises another type of problem. Any person who is engaged in the business of buying and selling securities is, by our definition, a broker or dealer and must register under the Securities Exchange Act of 1934 unless he is a member of an Exchange. Since most members of the Exchange do engage in the sale of securities off the Exchange, most members of Exchanges are also registered with the Commission. Employees of a registered broker/dealer are not required to register with the Commission. In this respect, your Act goes beyond ours. However, there is one other thing which we did not mention earlier today.

Under the Exchange Act, we also have the National Association of Securities Dealers registered. This is a large organisation of securities dealers, and it, too, is in a partnership with the Commission, somewhat closer than the partnership that exists between the Commission and the Exchanges. By that, I mean that the Commission has greater authority over its activities, its rules, the sanctions it exercises with respect to its members, and so on. The organisation does require the employees of its members, all of whom are registered with the Commission, also to be registered with it; and it has undertaken a programme of education and other things intended to achieve the result that if one is engaged in this activity, one is not, as someone suggested this morning, a rogue.

6740. *Sir George Erskine:* If a company is classified as an investment trust company, are there any restrictions as to the percentage of its portfolio in any one security or as to the status of its investments?—When an investment company registers with the Commission, it is required to indicate its policies. Certain of the policies which are required to be stated are enumerated in the statute. In addition, it may state further policies. Most of the required policies may not be varied by the company, except on approval after a vote of its shareholders. The policies, however, reach into a wider area of the operations of the investment company. As I have indicated, these policies may not be varied.

Professor Loss: If the company wants to be known as a diversified company, there are restrictions then.

Mr. Cohen: Yes, the diversification is the 5 and 10 type company, that is not more than 5 per cent. of its assets may be invested in any one issuer and it may not own more than 10 per cent. of the voting securities of such issuer.

Professor Loss: Moreover, the "blue sky" laws in every State except three or four do require salesmen to be registered, and some States control the initial charges on investment companies' shares. Wisconsin, for example, sets a limit—7½ per cent. of overall selling price—and some companies will not try to qualify because they charge more than 7½ per cent.

6741. *Mr. Lawson*: What is the highest figure, more than 7 per cent.?—*Mr. Cohen*: The usual sales charge is between 8 and 9 per cent., but there are many companies that make no sales charge and there are a number of companies that make a nominal sales charge. Normally there is no charge on liquidation or redemption, though some companies make a nominal charge in connection with redemption. There is no statutory limit except with respect to certain types of companies with periodic payment plans, in which case there is an overall 9 per cent. limit.

6742. *Mr. Althaus*: What sort of numbers of people would be registered with you as security dealers?—We have over 4,000 security dealers registered with the Commission.

6743. There would be many more salesmen?—Oh, yes, indeed.

Professor Loss: The N.A.S.D. has some 90,000 registered representatives.

6744. *Professor Gower*: This is a point we have not brought out. In addition to the registration with the S.E.C., you have some control over N.A.S.D. and they cause people to register with them?—Just as the Stock Exchange does.

Mr. Cohen: That is an area of United States practice which is most interesting. With regard to the relationship between the S.E.C. and the N.A.S.D., in 1938 the Securities Exchange Act of 1934 was amended to provide for registration with the Commission of an Association of Registered Dealers. It provides a whole network of requirements as a condition of registration. This organisation is designed essentially to deal with the problems of its members in the area of trading and business ethics. There is what I would call roughly a dichotomy between the law in broad outline, as the Commission deals with it, and business ethics, which are the concern of the N.A.S.D. It undertakes to adopt rules and regulations, statements of policy; it undertakes to review the activities of members, to impose sanctions where there are violations of the rules. These sanctions are imposed essentially by lay bodies of members of the organisation. However, these sanctions are reviewed by the Board of

Governors of the Association, and further review may be taken to the Commission, and if the Commission are challenged an appeal can be taken to the Courts. There is a real hierarchy of levels of appeal, but the relationship between the two and the control which the two have been able to effect over actual trading I think has been remarkable, and it is well worth study.

6745. *Mr. Althaus*: This very large number of dealers and salesmen would be some indication of the different nature of the problem in the two countries?—Well, we are a larger country, and perhaps our people have been able to persuade more people to be interested in securities, but I understand there is a movement of a similar character in the United Kingdom and perhaps you may reach 90,000 salesmen here!

6746. *Professor Gower*: Could I ask you a few questions about the Investment Advisers Act? We have never really faced this problem of what we ought to do to control people who hold themselves out as advisers on investment. You have tackled this problem by a special Act which was given some teeth last year. Could you tell us a little about this?—At the time the Investment Company Act was enacted, in 1940, Congress adopted the Investment Advisers Act of that same year. The Act as then adopted was rather ineffectual. It was described as something which permitted the Commission to do little more than take a census of persons engaged in giving advice with respect to the purchase or sale of securities. After a number of years the statute was amended—in fact it was amended last year. It now does vest in the Commission a variety of authority and responsibility which the Commission is now in the process of implementing. The Commission is now adopting rules requiring the keeping of records and regulating the methods of conducting the business; the Commission also has authority to make investigations and to impose sanctions against investment advisers who violate the statute as amended. We are now in process of developing our own procedures in this regard.

6747. You take the view that it is essential to have some sort of control over investment advisers?—We do very

strongly, and I might say the States are beginning to take a real interest in this. In fact, some of the States have developed statutes that were stronger than ours before we amended ours.

Professor Loss: My own view is that now that we have a Federal Act with teeth in it there is little need for State registration.

6748. Would a financial journalist have to be registered under this procedure?—*Mr. Cohen:* No. There are clear exemptions for lawyers, accountants, financial journalists and others.

6749. *Mrs. Naylor:* Can an investment adviser who quotes a fee for giving advice or for managing portfolios act as principal as well, or would he have to be registered under some other procedure?—He would probably have to be registered as a broker-dealer.

6750. *Professor Gower:* What about the problem on T.V. and radio? You have faced this already; we are beginning to face it.—You mean about the Westerns on the T.V.?

6751. Not quite. There are two problems as I see it. One is advertising of new issues over radio or T.V., and the other is people who give financial advice over radio or T.V. How do you control that sort of thing?—We have had some little difficulty now and again in this area, but I cannot say it has been a material problem.

6752. *Chairman:* What about the man who drives slowly round the streets of a town with a loud-speaker advertising shares in such-and-such a company—he would be a difficulty, would he not?—He might present a problem. If he did it in the District of Columbia we would send a policeman after him, but it may be different in some States. If he were offering securities in one State only he could take advantage of an exemption from the Federal legislation. The only way we could reach him would be on the theory he was committing fraud, otherwise we would have no jurisdiction.

6753. *Professor Gower:* Do the State Blue Sky Acts cover this at all?—*Professor Loss:* A few State laws have exceeded the federal legislation, but if

they have any *raison d'être* today it would be where there is a purely local situation. Today 40-odd of our 50 States require registration of securities; Nevada and Delaware are still without "blue sky" laws of any kind.

6754. *Mr. Watson:* Do you prohibit the use of radio and T.V. for the selling of securities?—*Mr. Cohen:* We do not. However, there are restrictions.

Professor Loss: Any advertisement on radio or television is defined to be a prospectus; that is to say, the definition of prospectus is any offer, written or by radio or television. Therefore, you can make offers on radio and television only in the same way that you can make offers in writing, which is only by using a statutory prospectus.

Mr. Cohen: For this reason it has its limitations.

Professor Loss: It is expensive, too. Someone once suggested the prospectus might be shown in the background while the advertiser talked about the security. The S.E.C. took a dim view of that.

6755. *Professor Gower:* Under the Trust Indenture Act you control the contents of indenture trust deeds and secure that the trustees shall be independent. We in this country have virtually no statutory provisions about indenture trust deeds at all. The Cohen Committee did consider whether it was possible to provide in a statute for independent trustees and decided it would not be possible to have a statutory definition of independence. I believe you have defined it?—*Mr. Cohen:* We have a definition in section 310 of that statute. There are nine specifications of the definition which are intended to deal with this problem of independence. Because it is a statutory definition and subject to criticisms in some areas, it may be deemed crude. We think that within those limitations it is a very effective device.

6756. Apart from that it has led to a kind of uniform deed being adopted in most cases?—It has with this difference that the lawyers will understand: there is a model indenture which was prepared some years ago by one of the financial publishing houses, and it is used largely by the New York practitioners. I should say that

the model consists of the provisions of the indenture which are required to be included therein by the statute. For some reason the Boston lawyers and the Chicago lawyers and the San Francisco lawyers will not use the model; they have their own versions. All of which means that the job of the people at S.E.C., who have to review the documents to see that they conform with the statute, becomes somewhat more difficult. However, this is not a great problem. The statute requires that the indenture should contain a specified number of provisions, all of which are designed to ensure that there is an independent trustee, that at least one of the trustees is a corporation having a certain financial stability, that the trustee acts as a prudent man would act in the conduct of his own affairs, and that clauses should not be included in the indenture exculpating him from this duty. There is a final provision to the following effect: "even if the indenture does contain provisions conflicting with the required provisions, the required provisions shall be deemed to control".

6757. *Chairman*: All you would want for that last definition would be a blank sheet of paper!—*Professor Loss*: The theory of the statute is perfectly sound, and it is simply this: that the indenture has in it provisions requiring the trustee to take certain action in the event of default, instead of the "ostrich clauses" which permitted heads to be buried in the sand. If those provisions are in the contract, particularly if the trustee is independent, the S.E.C. need have no continuing jurisdiction—the ordinary law will take care of it. The trustee will do what he should do or he will be held liable to pay damages. The other point is this. I think there is no need for these 20 pages of statutory provisions to be repeated in every indenture. If I were redrafting the statute today, I would simply say "Every indenture qualifying under this statute shall be deemed to contain the following provisions. . .".

6758. The equivalent in this country is a most voluminous document.—*Mr. Cohen*: I might mention that the American Bar Association has just set in motion a study designed to develop a simplified indenture for a secured and unsecured debt issue. The people concerned with this

project have felt that many of the provisions have developed because an attorney faced with the drafting of an indenture copied in some provision even if he did not understand it because he was afraid to leave it out, and maybe lacked the time to reconsider these provisions. It is expected that within the next two or three years this will be brought within some reasonable understanding. So far as the Trust Indenture Act is concerned it actually presents no real problem. As I say, there are models and the drafting is very simple, although, as Professor Loss has indicated, perhaps the whole procedure could be simplified somewhat.

6759. *Professor Gower*: Section 316 limits the extent to which debenture holders can agree to a moratorium. Davis Polk were rather critical of this, and said they did not like it. It seems to me that complete power for a majority to agree to a moratorium can lead to considerable abuses. I was rather taken with your section 316, which seemed to me to impose some reasonable limit on the extent to which that is possible.—That section was born of a great deal of experience, not all of which was very good. It has very definite limitations. A moratorium can only come into effect on the voting of 75 per cent of the debenture holders and for a three-year period, and, subject only to the moratorium, there can be no provision in the indenture which in any way inhibits the investor from suing to recover the principal or interest on the due dates.

6760. You think it has been useful?—I am not aware of any situation in which this has become a problem. I am surprised to hear Mr. Brownell has taken exception to it. I am not aware of any situation in which this has impeded the development of a proper plan of reorganisation.

Professor Loss: I too am surprised at Mr. Brownell's taking that view.

6761. With regard to the role of the S.E.C. under Chapter X of the Bankruptcy Act, as I understand it a Court can call on you in effect to help them by giving reports on schemes which they are asked to consider. I take it the sort of reports you give would be mainly on the accounting aspects?—No, Sir, that is not quite

correct. It is true that the statute specifically requires that with respect to reorganisation of a publicly held company where the amount of debt exceeds \$3 million the Court must refer the plan of reorganisation to the Commission for its report, and the Court may refer a plan to the Commission in certain cases where the amount of debt is less than \$3 million. The Commission has authority to appear as a party in all Chapter X proceedings, which is the chapter concerned with reorganisation of companies in which there is a public interest. The Commission plays a much more active role in the shaping of the development of reorganisation proceedings; it assists the trustee to the extent it can in making the necessary investigations with respect to past management and the development of causes of action, where that may be appropriate; it assists the trustee in all ways in which the competence of the Commission's personnel may be of assistance. The Courts usually seek the Commission's participation in these proceedings. The Courts are not equipped to deal with the multifarious problems involved in the reorganisation of a complex business enterprise of some size, and, with all due modesty, the Commission has received a great many kudos from Courts because of its action in this respect. The Commission has also helped the Courts in shaping the law with respect to reorganisation in regard to fairness, feasibility and things of that sort which go to the very essence of the reorganisation of these companies.

6762. In other words, the whole of the expertise you have in your office can be used by the Courts and by the liquidator, to use our term, to assist in the liquidation and reorganisation of the corporation?—Of course, we have budgetary limitations and we cannot, and do not, become involved in every case, but where there is a case of some moment, where there is an important legal issue involved, and certainly where the Court invites us into a case, we do appear and lend whatever assistance we can.

6763. When the Court invites you in, you do more than just comment on a scheme; you would be called to help to frame a scheme in the first instance?—We do not do that, but assist the trustee in

considering the relevant law and supply him with the facts he needs to develop the scheme. We do not take a hand in shaping the plan of reorganisation, but obviously in any plan the trustee is shaping he may consult with our people whether or not it meets the legal standards as set down by the Supreme Court, and recognised tests as to economic feasibility. To the extent we can be helpful we will give our advice. We do not undertake to develop a plan.

6764. Then you report to the Court on the fairness of the scheme as between the various classes of shareholders?—Yes, and that report must be furnished to the shareholders in connection with their vote if the Court finds the plan worthy of consideration by the shareholders and the debenture holders.

6765. The general opinion seems to be that this has proved very valuable?—Yes, it is very valuable. When I was personally engaged in this work I found it most satisfying because it was a very constructive thing we were doing.

6766. One of the problems we are faced with here is the lack of co-ordination in the various requirements in this field. One of the great merits of the S.E.C., as I see it, is that you are the overlord; nobody else does this but you. We over here, however, have the Board of Trade doing part of it, then the Courts do part of it, the Stock Exchange do part of it, indeed a variety of Stock Exchanges, with no actual co-ordination. I think most of us would say we would rather boggle at a set-up anything like as elaborate as yours. I do not know how many staff you have?—We have about a thousand people.

6767. On the other hand, I think we would like to co-ordinate our present arrangements more than we have. Are there any observations either of you can make which would help us in this regard. Has your experience with the N.A.S.D. any relevance in this connection?—So far as the 1,000 staff is concerned, you will understand we have only touched today on certain aspects of the Commission's work. A good deal of the Commission's staff is devoted to investigating violations of the law, assisting in prosecutions in cases of violation, seeking injunctions and various other things, and it does have a fairly

large staff of people in regional and branch offices. We also make available to the public advice as to the application of the law in order to avoid violations of the law. All these things require a fairly large staff. Whether or not any of this is appropriate for the United Kingdom is something on which I would not have an opinion. I think this is something that I am obviously not in a position to judge; I do not know the situation here, whereas you do.

6768. The other question is one you asked me to ask you: what have been the major criticisms of the S.E.C.?—There have been some criticisms of the S.E.C. Recently there have been two reports prepared with respect to the work of the S.E.C. One report was prepared at the instance of the Budget Bureau, which is the principal budget office of the President and is the overlord of the entire Government with respect to expenditure of funds. The Budget Bureau engaged a private engineering firm to conduct a survey and to study the Commission's work. A number of such studies have been made in recent years into other departments. Again, with all modesty, we happened to be the only one who received a good report, but despite that they made a number of criticisms. They indicated that there were areas in which our organisation could be strengthened. They felt there was something in our feeling that, despite our thousand staff, we do not have enough people, and thought we could make certain economies by re-organisation. That was the Booz Hamilton Report. There was another report prepared by the Special Assistant to the President, Mr. James Landis, a former Chairman of the S.E.C., a former Dean of the Harvard Law School and a noted practitioner in the area of administrative law. He too gave the Commission a good report, but had some notable criticisms. I am sorry to say these related largely to the work done in my division. He thought we paid too much attention to prospectuses of well-established companies that had already gone through the baptism many times, and thought we should devote our attention much more to the more speculative and newer companies. He

also suggested that the Commission's enforcement activities have not been anything as tight as they might be and suggested some strengthening in this connection. He further suggested that the Commission do away with what has got to be known in Washington as the institutional decision. Many independent agencies, the Commission among them, have power to make decisions in contested cases, and it had been the Commission's practice to issue a sort of *per curiam* decision. There has been criticism that the decisions have been written by ghost-writers or an opinion-writing office and not by the Commissioners who did not have the responsibility of reviewing the record themselves and of having to write the decision. Since that report the Commission has dropped the *per curiam* decision as the sole form of decision. Now cases are assigned to each Commissioner for decision, so that recommendation has already been achieved. I do not recall any other major criticisms.

Professor Loss: Nor do I.

Mr. Cohen: I think that about does it. I wanted that opportunity to indicate how little they criticised the S.E.C.!

6769. You have made the point, Mr. Cohen. I think we were rather left with the impression by Mr. Brownell that on an issue of voting trust certificates there is no S.E.C. control. Perhaps we misunderstood him. Is that right?—I think that is not so. The issue of voting trust certificates would be subject to the Securities Act upon an initial public issue and if it was sought to list voting trust certificates on a Stock Exchange they would have to be registered and reports would be required with respect to the voting trusts, and probably with respect to the underlying company.

6770. *Mr. Watson:* Would the purpose of the constitution of that voting trust be something on which you would be expected to pronounce?—In the case of an investment company this would be prohibited by law. In the case of a company subject to our Public Utility Holding Company Act of 1935 it would be prohibited. Apart from that we have no control and exercise no authority at all.

Professor Loss: I might say that it is quite common for our State corporation statutes to limit the terms of such trusts, usually to 10 years, and to require filing sometimes with the Secretary of State, but that is about all. Five or six States also require any voting trust set up by a number of shareholders, however small, to be open to all the members of that class. When that happens, willy-nilly there is a public offering, and technically there should be registration. As a matter of fact, there is a case in the Federal Court in Delaware where it was so held.

6771. *Mr. Brown:* One practice which is starting in this country is the remuneration of officers of companies by options. Have you any views for or against that as a practice, and what is the effect of that on the provisions relating to officers dealing in securities and selling within six months?

—*Mr. Cohen:* Under the Investment Company Act this would be prohibited. Under the Public Utility Holding Company Act, which is a regulatory statute, up to the past two months or so this was not permitted. Within the past two months the Commission permitted such a plan with respect to a public utility holding company. This is the first time in some 20 years.

Professor Loss: Some of us think it is one time too many.

Mr. Cohen: Yes, I think the Dean of the Harvard Law School has expressed himself to that effect. So far as the trading position is concerned the Commission at one time had a rule which exempted from the short-term trading recovery provisions the acquisition of securities under option so that such an acquisition could not be matched with a later sale of the shares. The Court of Appeals for the Second Circuit raised a question as to the validity of this rule. The Commission has since amended the rule and there is no longer any such exemption, so that the acquisition of shares under option would be matched by any sale of the shares within six months prior thereto or thereafter and would be subject to the recovery provisions. So far as the extending of options to employees and officers generally is concerned, provided that this amounts to a public offering, as we view the term, registration under the Securities Act

would be required with respect to both, and certainly in respect to the underlying security.

6772. *Professor Gower:* I thought Mr. Brown was asking for your views on the general advisability of remunerating officers by stock options?—I have no views to express about that.

6773. Any such scheme would require sanction by shareholders in every case?—I am not entirely clear on the position in all States. We do have certain rules relating to stock options, the result of which is to require the sanction of shareholders, certainly in the case of listed companies. I think in many States sanction would be required. I think there have been decisions in some limited areas which indicate that in some States sanction of shareholders is not required.

Professor Loss: I have some rather strong views on this. With us it is a matter of favoured tax treatment, which many people think is bad public policy. The restricted stock option parades under the theory that corporate executives need special incentives to do their job properly. It would be much fairer to cut the top surtax rate instead of giving favoured treatment to certain high-salaried people which is not available to others. This is a highly controversial question with us. I am glad to say that in recent weeks a few management people have taken the broader view that these things are not justified. So far as shareholder approval is concerned, it may not be required *per se*, but if the management seeks shareholder approval then the S.E.C. proxy rules usually come into the picture.

Mr. Cohen: If I might add one further point from the S.E.C. point of view, in certain reorganisations of companies under Chapter X of the Bankruptcy Act the view has been taken in the past that it would be unfair as part of the plan of reorganisation to issue options to any material extent to officers and directors because of the aspect of dilution and related matters.

6774. *Mr. Scott:* Are the rules of the S.E.C.—for instance the rule you make against forecasting profits—all statutory, or can the S.E.C. alter and vary its own rules from time to time?—This is not a

statutory rule. This is an interpretation by the Commission of what it believes the statute permits. The Commission could conceivably reconsider the matter and permit forecasts. I should have added that there have been cases where something like a forecast has been permitted. For example, there was the case of a pipeline company which had a firm contract with perhaps the biggest oil-distributing company in the world over a 20-year period. In that case some remarks were permitted with regard to that situation, which might be looked upon in the nature of a forecast but it was not really quite a forecast.

6775. I only instanced the forecasting rule as an example. My question was really directed to whether or not the rules you apply are of your own making, or whether they are imposed on you wholly by statute?—Our statute in this respect is like your Companies Act. We have two schedules, A and B. A is designed for industrial companies, whether domestic or foreign; B is designed for foreign governments. Schedule A contains some 40 categories of information. However, under the statute the Commission has power to vary the requirements, either to add to them or to subtract from them. In consequence of this authority the Commission has adopted some 17 forms of registration. These are really intended as guides to those who wish to register securities with the Commission and are designed to fit the exigencies of particular types of offerings or shares.

6776. There is a good deal of discretion open to the S.E.C., then, in that sense?—Yes, Sir.

6777. With the very extensive duties you have entrusted to you and the large number of highly-trained people you have, is the cost of the S.E.C. borne entirely out of federal funds, or do the companies who register have to contribute by fees, and so on?—There are certain fees paid by companies on registering under the Securities Act, and in addition there is a fee levied in connection with all exchange transactions. These fees produce approximately 25 per cent. or 30 per cent. of the cost of running the Commission. However, there are a number of Bills pending which are designed to increase the levy to

the end that the Commission may become more self-supporting.

Professor Loss: I think perhaps it should be added that the fees are minimal from the point of view of any one registering. The fee under the Securities Act is one hundredth of 1 per cent.—that is \$100 in a million.

Mr. Cohen: With a minimum of \$25.

6778. The main part of the cost is borne by federal funds?—Yes, by the general taxpayer. The fees we receive go to the Treasury.

6779. *Mr. Watson:* When the shares of a British company are introduced for dealings on the New York Stock Exchange, for example, do you require them to provide you with all the particulars for a normal registration statement as for an American Company?—We do. However, we have made an exception here and there for a British company, having in mind your different ways of doing business, where the exception in our view has not been material from the point of view of public investor protection.

6780. And that has not raised any difficulty—it has not discouraged the placing of shares in New York which otherwise might have taken place?—No, I do not think so. The only difficulty raised is that some of our domestic companies feel they are being discriminated against. As far as I am aware this has not resulted in any difficulty in placing shares on the New York market, and we have for some years now been receiving registration statements from all over the world. There is a Japanese one now pending, the first one since the war.

6781. It would be very difficult, would it not, to subject their statements of fact to the same close examination you would give to a United States domestic company?—I think there is some truth in that, but we do the best we can.

Professor Loss: The only way you can get perhaps an authoritative answer on this that is not just a guess—which is all I can give, and I suspect Mr. Cohen would agree—would be to get in touch with the Listing Department of the New York exchanges to see if they have met any resistance. I would like to know myself.

Mr. Cohen: In the case of British companies that have come for listing in New York they have been large companies which have been preparing for this eventuality over a number of years; they are familiar with our requirements and have been gearing themselves towards these requirements over a considerable period. I do not think there is any real problem. There is considerable information available as to these companies which we use to assure ourselves the information is reliable. There are a number of other companies, non-domestic, which do not have the same lineage and source and do give us a good deal of trouble. For example, there are a fair number of offerings coming from Canada which do provide considerable difficulty—or at least some of them do.

6782. *Professor Gower:* On general company law, we have been very interested in the greater power an American company has to purchase its own shares. Could I ask Professor Loss, has this led to any abuses? Are there any safeguards that we ought to provide if we considered doing this?—*Professor Loss:* There are certainly problems from the point of view of possible purchase out of capital surplus rather than earned surplus, or maybe even indirect use of capital, but I do not know of any informed opinion in the United States which would say that repurchase of shares is *per se* bad. It is a matter of proper draftsmanship.

6783. How do you prevent it being used for manipulation of the market?—That is another problem again. To come back to Rule 10 b-5, part of it is a question of company law and part of it is a question of securities law, and we would say that whatever affirmative obligation to disclose attaches to the officer also attaches to the company. A Court in Illinois, sitting in a common law case, held that as a matter of Illinois law, even if the director might not have an affirmative obligation—if he was not himself a fiduciary to the shareholders—surely the company ought not to cheat its own shareholders. Therefore, the Court required fair disclosure from the company buying its own shares. I think that would be the general rule under Rule 10 b-5.

6784. If a company is allowed to do this out of income surplus you would see no

particular dangers?—Indeed, I would see some advantages if the authority were properly circumscribed, certainly in so far as senior securities are concerned.

6785. We have virtually arrived at that already. We have got redeemable preference shares but companies here have not power to buy their own ordinary shares. Should it be extended to cover ordinary shares as well as preference shares expressly created as redeemable?—Subject to what you have said, I should think it would be advisable.

6786. *Mr. Brown:* What are the real advantages?—One advantage is that it makes possible open-end investment companies that are not trusts. Another advantage commonly given is that it permits companies to buy in shares to enable them to execute stock purchase plans for employees without diluting share capital. Another one is that if the shares are selling at a discount it helps the company to buy in the shares. I have always told my students the latter is something of a cannibalistic theory.

Mr. Cohen: Under the Investment Company Act of 1940 repurchases are permitted, but the company is required to notify its shareholders in advance so that they are aware of this situation.

6787. *Mr. Scott:* Such a purchase would help those who sell by providing another purchaser in the market?—*Professor Loss:* Making a market available, yes, subject to fair treatment. If the company were buying in because the shares were under priced, it would be an ethical question.

6788. The vendor need not sell. If the company cannot come in somebody else will buy?—The company would have more information, of course.

6789. If the company comes in that is one buyer more in the market?—With respect, perhaps that argument proves too much because it would also give an excuse to a director who bought at a favourable price. The answer is that the people who sell to strangers cannot recover, but the people who sell to insiders can.

6790. The company makes a profit if it buys its shares cheaply, whereas the director makes a profit in your case—there is a difference?—The company is owned

by the shareholders, and it seems to me to be a strange doctrine which says it is good for a company to buy shares cheaply when the shareholders who are selling are not getting enough, so that those who are not selling may end up with more.

6791. *Mr. Brown*: Is there abuse in the case of a company buying from privileged shareholders at a price above the normal? —We have had a good deal of litigation and a good deal of literature on this in recent years, particularly with respect to controlling blocks and selling at favoured prices when the minority are not given the same opportunity.

Mr. Cohen: If I may add a word, the situation would in most cases be reported

to the Commission in the case of someone in a privileged position. It would have to be disclosed in a personal or annual report; it would be brought out very quickly.

Professor Loss: The company would not have to file a special report unless its outstanding shares were increased or decreased by 5 per cent.

6792. *Chairman*: Well, Gentlemen, I think we have asked all our questions, and it only remains for me to say how very grateful we are to you both for coming and helping us. It has been a most interesting discussion.—It has been for me, my Lord Chairman, a great privilege and a very educational experience.

Mr. Cohen: I have enjoyed it immensely.

APPENDIX L

Memorandum by the United States Securities and Exchange Commission

Foreword

This memorandum was prepared in response to a request from the Committee of the Board of Trade of Great Britain for comments upon, among other things, the purpose, organisation and functions of the United States Securities and Exchange Commission in connection with the Committee's undertaking to review company law in Great Britain. It should be considered with the Note by Professor L. C. B. Gower entitled "Corporate Law and Practice in the U.S.A."* which concisely sets forth significant aspects of the United States' position. While certain duplication of material dealt with by Professor Gower was unavoidable to achieve a unified and logical presentation, no attempt was made to revise the areas treated by Professor Gower or to deal with each of them. His treatment of the matters considered in the Note is penetrating and generally in accord with the views of the United States observers of the activities and responsibilities of the Commission.

For this reason, and because of the nature of the requested comments, this memorandum covers only selected areas of the work of the Commission and is not intended to be comprehensive. The Annex refers to various sources for further discussions.

We have not undertaken to comment upon matters which in the United States are traditionally dealt with under the corporation laws of the several states. We understand that in these matters the Committee will have the benefit of the views of eminent counsel to supplement the treatment accorded them by Professor Gower.

Recently the Commission has been the subject of the following reports commenting on its authority and functions, copies of which we enclose for the information of the Committee: Report on Independent Regulatory Commissions of the Special Subcommittee on Legislative Oversight of the Committee on Interstate and Foreign Commerce, Report on Regulatory Agencies to the President-Elect, and Survey of Organisation and Operations—Securities and Exchange Commission (By Authority of the Bureau of the Budget, October 31, 1960).

We are also enclosing copies of the Commission's Annual Report for the fiscal year ended June 30, 1960, which provides considerable detail as to all aspects of the Commission's work and responsibilities.

In addition, the following reporting forms, referred to in the memorandum under the caption "Subsequent Trading: The Securities Exchange Act of 1934", are enclosed:

Annual Report on Form 10-K, the general reporting form.

Semi-Annual Report on Form 9-K.

Current Report on Form 8-K.

Form S-1, the registration form of general application under the Securities Act of 1933, and Regulation S-X, the general accounting regulation, are also enclosed.

I. Organisation and Functions of the Commission

General

The Securities and Exchange Commission (the "Commission") was created by the Securities Exchange Act of 1934, which vested in the Commission administration of that statute and transferred to the Commission the administration of the Securities Act of 1933, theretofore administered by the Federal Trade Commission.

* Appendix XXXIX page 1052 of 14th Day's evidence.

The Commission is an independent agency, exercising executive, judicial and legislative powers. It is composed of five members, each appointed for a term of five years by the President of the United States, subject to the advice and consent of the Senate. The Chairman is designated by the President and is given certain administrative authority.

The Commission is assisted by a staff which includes lawyers, accountants, engineers, security analysts and administrative employees. On June 30, 1960, its staff numbered 980 persons.

The Commission is not a component of the executive, legislative or the judicial branches, although it has explicit responsibilities running to the President of the United States and to the United States Congress. Each of these in turn possesses specific authority and responsibility with respect to the Commission. Final orders of the Commission are, in addition, subject to judicial review in the Federal Courts.

The essential concept underlying the organisational structure of the Commission at its operating level is functional. Assignment of responsibilities to its various divisions and offices is determined by the nature of the problem, and not by the particular statute involved.

Functions of the Commission

The Commission's statutory responsibilities are, in the main, defined in seven federal statutes. The Securities Act of 1933 is concerned with the offering of securities to the public by use of the mails or the means of interstate and foreign commerce (the federal constitutional jurisdictional elements) by or on behalf of an issuer or by a person in a control relationship with the issuer. The basic purpose of this statute is to provide investors in such offerings with information essential to an informed investment decision and to prevent fraudulent practices generally in the sale of securities.

The Securities Exchange Act of 1934 is directed to the problems of trading in securities on or off the national securities exchanges and with the maintenance of fair and honest conditions in the securities markets. The statutory aims are accomplished in part by requiring issuers whose securities are traded on the exchanges and certain others to provide on a continuing basis for the benefit of investors, and the public generally, information essentially similar to, but not as comprehensive as, that required in connection with offerings made under the Securities Act. This is supplemented by requirements as to the information which must be furnished to security holders when action by them is solicited by the execution of proxies, authorisations or consents. Officers, directors and certain other "insiders" are subject to restrictions with respect to trading in the shares of these companies. In addition, the statute provides for the registration and regulation of brokers and dealers doing business in the over-the-counter markets and for regulation of the national securities exchanges and of the National Association of Securities Dealers, the organisation of broker-dealers and their members. Finally, it vests authority in the Commission to deal with various market abuses and, together with the Federal Reserve Board, to control credit in the securities markets.

The Public Utility Holding Company Act of 1935 is concerned with interstate public utility holding company systems engaged in the electric utility business or in the retail distribution of gas. A basic objective of this Act is to free operating electric and gas utility companies from the control of absentee and uneconomic holding companies, thereby permitting them to be more effectively regulated by local authorities in the states in which they operate. The statute vests in the Commission control over the securities issues of registered holding companies and their subsidiaries.

The Trust Indenture Act of 1939 requires that debt securities which are offered to the public, unless specifically exempted from the Act, be issued under an indenture which meets the requirements of, and has been duly qualified under, the Act. This Act defines the duties of the company and the trustee toward the security holder and

requires that there be a corporate trustee who possesses a minimum combined capital and surplus and is free of conflicting interests which might interfere with the exercise of its fiduciary duty toward the indenture security holders.

Companies engaged primarily in the business of investing, reinvesting and trading in securities and whose securities are publicly held are subject to registration and regulation under the Investment Company Act of 1940. Registration is designed to elicit significant information concerning the nature, policies and personnel of such companies. These companies must file with the Commission and forward to their stockholders periodic reports. They are further subject to the proxy solicitation and "insider" trading rules of the Commission. In addition, the statute is designed to protect investors against the abuses which led to enactment of the statute and vests in the Commission authority to apply to the court to remove officers, directors and others associated with such companies upon a showing of gross misconduct or gross abuse of trust.

The Investment Advisers Act of 1940 requires the registration of investment advisers, that is, persons engaged for compensation in the business of advising others with respect to securities or of issuing analyses or reports concerning them. As in the case of broker-dealers, the Commission is empowered to deny or to revoke registration of such advisers and the Act prohibits fraudulent activities and gives to the Commission other regulatory powers. Its provisions are discussed in greater detail below.

Chapter X of the Bankruptcy Act provides a procedure for reorganising corporations in the United States District Courts. While the District Judge is required to submit to the Commission for an advisory report any plan which he regards as worthy of consideration in all cases in which the indebtedness exceeds \$3,000,000, he may refer to the Commission any plan which he regards as worthy of consideration regardless of the size of the debt.

The Commission participates in all phases of proceedings involving corporations having a substantial public interest in their securities and provides the courts with expert advice on the complex legal and financial problems involved in the entire reorganisation process, with particular emphasis upon the fairness and feasibility of plans of reorganisations submitted for court and security holder consideration.

In addition to its broad responsibilities under the above-mentioned statutes, the Commission is granted authority in certain other areas. Thus, while under the Bretton Woods Agreements Act, as amended, securities issued or guaranteed as to both principal and interest by the International Bank for Reconstruction and Development are exempt from registration under both the Securities Act of 1933 and the Securities Exchange Act of 1934, the Bank is required to file with the Commission certain information with respect to such offerings in the United States and annual and other reports with respect to all securities issued. A similar exemption, subject to identical conditions, has been provided for certain securities which may be issued by the new Inter-American Development Bank.

It is important to emphasise two matters. None of these statutes constitutes company law in the conventional sense. Nearly all business corporations are organised under the company law or authority of one or another of the 50 states. Most of these states also have, in varying measure, adopted special provisions designed to deal with some (but not all) of the matters over which the Commission has jurisdiction. In most areas in which the Commission has jurisdiction, it does not in any way supersede the authority or responsibility of the local authorities and control except in the case of conflict. Despite this, it is fair to conclude, as is suggested in Professor Gower's Note, that the federal statutes have had a marked effect upon company law, generally, in the United States.

Staff Organisation of the Commission

Administration of the disclosure requirements embodied in the various federal securities laws is assigned to the Division of Corporation Finance. The Commission's

responsibilities with respect to the securities markets and those who play professional roles in these markets are delegated to the Division of Trading and Exchanges. Regulatory matters involving public utility holding company systems, investment companies and advisory functions under Chapter X of the Bankruptcy Act are assigned to the Division of Corporate Regulation. These three major operating divisions of the Commission are located in the Washington, D.C., headquarters office and report directly to the Commission. Investigative and enforcement work and inspections of broker-dealer firms are performed primarily in the field by the nine regional and the eight branch offices of the Commission, subject to direction of the appropriate operating division, with overall enforcement responsibilities in the Division of Trading and Exchanges.

In addition, there are the following important offices in Washington: The Office of Opinion Writing is a small office which assists members of the Commission in reviewing the record of, and preparing opinions on, all quasi-judicial matters. The Office of Hearing Examiners consists of officers who are designated by the Commission to preside at quasi-judicial hearings and administrative examinations. The Office of the Chief Accountant conducts research activities and advises the Commission and the various divisions and offices on accounting and auditing matters. The Office of the General Counsel conducts appellate litigation in the name of the Commission arising under all the federal securities statutes, reviews all staff reports recommending criminal prosecution for referral to the Department of Justice, and renders interpretative advice to the Commission and to the staff regarding novel problems arising under all the statutes administered by the Commission. It is the principal legal office of the Commission and is also responsible for legislative matters in which the Commission may have an interest. The Commission is assisted by an Executive Director who has immediate responsibility for administrative matters pertaining to all offices and divisions.

The first decade of the Commission's existence was one of experimentation in the application of new statutes. The second decade was particularly highlighted by activity under the Public Utility Holding Company Act and by the consolidation of the agency's position in the midst of the life of the financial community. The third decade has been marked by the resurgence of enforcement and regulatory problems, bred of a rising market and the emergence of a body of financially sophisticated persons who prey on the confidence of the public in the fairness of the securities markets, by an unexpectedly large increase in securities offerings of new or relatively unseasoned issuers by investment bankers with little experience and resources for investigation, by the development of new patterns of securities distribution and trading, and by related administrative problems.

The Commission throughout its existence has encountered complex and novel problems. It is now faced with fresh problems arising out of the tremendous expansion of the capital markets, and the growing public interest in securities, the development of new forms of investment media, and the growing importance of the institutional investor. Moreover, there are certain gaps in existing law. Despite these problems, the status and powers of the Commission have proved satisfactory. Widespread criticism of the federal securities laws and the role of the Commission has been replaced by unanimous recognition of the desirability of federal legislation and general acceptance that the Commission has fulfilled its responsibilities in a creditable manner.

From time to time, various legislative changes are suggested which may fairly be characterized as not intended to affect the basic structure or philosophy of federal controls. These include suggestions for improvement of the enforcement tools of the Commission, for clarification of the rights of individuals and for elimination of asserted ambiguities in the interpretations and application of the statutory provisions and of asserted unnecessary duplication of administrative effort. One of the three recent reports, referred to in the foreword, and enclosed herewith, which has received some attention in the press, has recommended (a) a realignment of the Commission's enforcement staff and (b) a reconsideration of certain administrative techniques developed by the Commission, at least in limited areas.

II. Conditions Leading to the Creation of a Federal Securities Commission

Financial and corporate practices existing prior to 1933 demonstrated the need for federal legislation in the securities area. The Report of the Committee on Interstate and Foreign Commerce of the House of Representatives of the U.S. Congress referred to the "complete abandonment by many underwriters and dealers in securities of those standards of fair, honest and prudent dealing that should be basic to the encouragement of investment in any enterprise". Issuers and underwriters not only did not provide, in connection with new issues, the basic facts necessary to an understanding of an enterprise but frequently obscured and falsified the facts. The methods of securities distribution had developed in such a way as to require commitments by dealers and investors before information of any kind was available. Responsible persons in financial institutions, corporate executives and others entrusted with savings of investors had abused the trust reposed in them. Manipulation of the market price of securities, inflationary write-ups of assets, acquisitions of properties at grossly inflated prices, extensive use of credit to finance speculative activities or to purchase stock on margin, the failure of corporations to provide adequate information and the misuse of corporate information by management officials and other "insiders" resulted in a situation in which no one could be sure that market prices for securities reflected any reasonable relationship to intrinsic values or the impersonal forces of supply and demand. The investigation record demonstrated that, during 1929, the prices of over 100 stocks on the New York Stock Exchange were subject to manipulation by massive pool operations. All these factors contributed to the demand for corrective legislation. In addition, the major exchanges had not evidenced willingness or ability to control adequately the activities of their members.

Although recognition of the need for federal legislation in the securities field existed for a considerable period prior to 1933, precise attention to the problems in this area began with the study of public utilities undertaken by the Federal Trade Commission commenced in 1928 pursuant to a Senate Resolution. This study, which has been referred to as the most comprehensive investigation of any industry, detailed the factors underlying market weakness, the inflation of securities values and the fundamental difficulties in the entire process for marketing securities.

This study was followed by investigations into stock market practices by the Senate Committee on Banking and Currency between March, 1932, and June, 1934. The final report of the Committee pointed out that between 1929 and 1932 the total market value of stocks listed on the New York Stock Exchange dropped from approximately \$89 billion to approximately \$15 billion, a decrease of 83 per cent.

Common law motions of culpable deceit and the securities laws of the states had not proved to be effective deterrents to the revealed abuses. Generally speaking, the state statutes varied greatly (then and now) in their philosophy and content, and were inadequate not only because of the wide variations in their approach to securities regulation but also because the limitations of jurisdiction imposed by state lines made largely ineffective the controls over nationwide distributions and over the activities of those who operated from states with a more "liberal" approach toward enforcement and control.

The demand for corrective legislation stemming from these inadequacies and conditions which prevailed in the 1920's received its final impetus from the 1929 debacle and ensuing depression. While many different points of view were explored, the disclosure philosophy of the British Companies Act, 1929, was the basis for the original framework. However, it was determined that the government should play a more positive role in carrying out the legislative directives. The Securities and Exchange Commission was created to insist upon compliance with the provisions of the first two statutes adopted, the Securities Act of 1933 and the Securities Exchange Act of 1934. Later statutes departed from the basic disclosure philosophy and assumed the need for more affirmative investor protection in the particular areas encompassed by these statutes.

III. Co-Operative Self-Regulation: The Securities Exchange Act of 1934

The Securities Exchange Act of 1934 provides a comprehensive regulatory scheme which combines self-regulation by industry with supervision by government.

A primary objective of this statute was to convert the major exchanges from "private clubs" to "public institutions" by requiring registration with this Commission and insisting as a condition of registration that the exchanges adopt rules providing for the disciplining of members for conduct inconsistent with just and equitable principles of trade.

In practice, the exchanges and their members have been subjected to constant study by the Commission. As a result of the Commission's recommendations, the various exchanges have made many changes in their rules, practices and form of organisation.

As of June 30, 1960, 13 stock exchanges were registered under this Act. Once registered, the exchange enjoys considerable autonomy. Its registration may be suspended only if it violates the Securities Exchange Act or if it fails to enforce compliance with the statutory requirements by its members and by issuers of listed securities "so far as is within its powers". An exchange may adopt such rules as it pleases, provided they are not inconsistent with the statute and the regulations thereunder. It may select its own members and the securities which it will admit to listing, and it may conduct its own disciplinary proceedings. Trading methods also rest to a considerable degree in the discretion of the exchange, subject to the statutory prohibitions and the grants of rule-making power to the Commission with regard to floor trading and the activities of specialists and odd-lot dealers designed to achieve an open and orderly market free from unlawful activity.

An important area of authority granted to the Commission over the activities of the exchanges and their members is found in Section 19 of the Securities Exchange Act, which provides that in 12 enumerated areas of exchange rule-making, ranging from the listing and delisting of securities to the fixing of reasonable rates of commissions, the Commission may first request and then order the exchange to make "specified changes".

The major exchanges have used their listing requirements as a means to exclude companies or securities not suitable for trading on the exchange and to enforce standards of corporate conduct. As in the case of the London Stock Exchange, certain of these requirements go beyond the statutory provisions. For example, issuers of securities listed on the New York Stock Exchange are required to send annual and interim financial reports to their stockholders, to give prompt publicity to actions of importance to stockholders, and to secure stockholder approval for certain acquisitions, stock option plans or actions resulting in a change of control of the company. In addition, the New York Stock Exchange refuses to list non-voting common stock issues, and generally requires solicitation of proxies.

The self-regulating activities with respect to the over-the-counter markets are centred in the National Association of Securities Dealers, Inc. (N.A.S.D.), which had, on June 30, 1960, a membership of 4,372 brokers and dealers. Section 15A of the Securities Exchange Act provides for the registration with the Commission of national securities associations and establishes standards for such associations. The N.A.S.D. is the only association registered under this provision. The rules of the association must be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices and to meet other statutory requirements. The association serves as a medium for co-operative self-regulation of the over-the-counter brokers and dealers. It operates under the general supervision of the Commission, which is authorised to exercise an appellate review over its disciplinary actions and over its decisions which affect the status of members, of salesmen employed by members and registered with the association, applications for membership, and to consider all changes in the rules of the association. The N.A.S.D.

has adopted and enforces a code of fair practice governing the conduct of its members and their registered representatives and their relationships to investors.

This system of complementary self-regulation by the exchanges and the N.A.S.D., superimposed upon minimum Federal standards and supported by residual Federal power, has functioned successfully. As the Supreme Court of the State of New York stated in the case of *Avery v. Moffatt* (55 N.Y.S. 2d 215, 187 Misc. 576 (1945)): "The Federal Public policy as enunciated in the Securities Exchange Act of 1934 and construed by the Courts does not place upon the Securities and Exchange Commission the entire burden of policing the Exchange markets, but relies in some measure upon the Exchanges themselves to assure high standards of trade and to discipline members who violate those standards. . . . Moreover, securities trading is a highly complex field in which it is not always feasible to define by statute or by administrative rules having the effect of law every practice which is inconsistent with the public interest or with the protection of investors. As a result, there is a large area for the operation of Exchange rules on the level of business ethics rather than law, and in that sphere the statute leaves it to the Exchanges to carry on the necessary work of prevention and discipline."

A considerable number of functions falling within the general responsibilities of the Commission are discharged, in whole or in part, by the exchanges or the N.A.S.D. Thus, both the exchanges and the N.A.S.D. have assumed a responsibility for compliance by their members with the Securities Exchange Act of 1934 and the rules thereunder, thus relieving the Commission of considerable enforcement work, although the Commission necessarily also examines into compliance by such members. Members of most exchanges have been exempted from the Commission's capital rules, in reliance upon the more stringent rules of the exchanges on this subject. The exchanges have adopted, in a number of instances at the Commission's suggestion, elaborate rules dealing with the conduct of exchange trading, thus relieving the Commission from the need to adopt and enforce its own rules to cover many aspects of such trading.

Both legal and practical obstacles to further extensive delegation exist. These include the following:

- (1) The delegation of governmental powers to private organizations raises serious questions under the Constitution of the United States. A complete and unconditional transfer of any such functions would probably be unconstitutional. Ultimate authority must remain in the Government.
- (2) The exchanges and the N.A.S.D. are ultimately responsible to and controlled by their members. Functions of major public importance probably must be discharged by an agency responsible to the public and not to any private interest.
- (3) Many of the Commission's functions and actions have an important impact upon the rights and duties of persons outside the exchanges and the N.A.S.D., such as issuing corporations, non-member brokers and dealers, and investors. It is questionable whether final authority to determine such rights and duties of non-members should be entrusted to these agencies.
- (4) The exchanges, in particular, vary in their resources and capabilities. Some of them would have difficulty in assuming further major responsibilities.
- (5) The exchanges and the N.A.S.D. are essentially groups of businessmen organized on a business basis. Many of the Commission's functions involve primarily, or to a large extent, the making of legal and policy determinations, for which these organizations are not too well fitted. It was in recognition of this that Congress, in essence, divided regulatory responsibilities, giving the Commission ultimate responsibility for overall administration of the statutes, and the exchanges and the N.A.S.D., under Commission supervision, responsibility for questions of business ethics, and other matters as to which they have certain initial responsibilities.

IV. The Practical Value of Investor Safeguards under the Federal Securities Acts

The practical value of certain of the safeguards for investors which exist in the United States, but which, as Professor Gower's Note indicates, do not prevail in Great Britain, merits particular comment. These safeguards may be discussed in the context of the statutory provisions dealing with initial distribution, subsequent trading and certain special situations.

A. Initial Distribution: Securities Act and Trust Indenture Act

The prospectus, the basic disclosure document under the Securities Act of 1933, is designed to provide investors with information necessary to informed and independent investment decisions. The issuer, its directors and principal officers, the underwriter, certain experts and persons in control of any of these, are subject to liabilities for omissions of required information from the registration statement of which the prospectus is a principal part and for false statements or half-truths.

Exemptions from the registration provisions of the Act are provided for certain securities and transactions. These exemptions are usually limited to specific types of securities or transactions. In addition, the Commission has limited power, subject to appropriate conditions, to define by rule the terms and conditions of an exemption for a limited offering. Thus, offerings not in excess of \$300,000 in any one year are afforded a conditional exemption from full registration as a means of adjusting the registration procedure to small businesses.

The content of the registration statement is drawn from the statutory suggestions contained in Schedule A to the Act, as implemented by the various forms of registration, 17 in all, adopted by the Commission to assist issuers and underwriters in meeting the statutory standards and covering different types of security issues and issuers. A general form is available for those cases as to which a special form has not been provided. In general, the demand for prospectus disclosures is more comprehensive and more detailed than that required by English law in the area of information material to investment analysis.

A significant departure from the British scheme was the statutory insistence on a slowing down of the pace of securities distribution. Even as amended in 1954, the statute forbids the initiation of a sales campaign, no matter how indirect, prior to the filing with the Commission of a registration statement containing the required disclosures (usually found in the prospectus) and other specified documents. After the filing, offers may be made only in the manner permitted by statute, which includes the furnishing to the purchaser of a copy of the prospectus, but sales or contracts to sell are forbidden until the registration statement becomes effective 20 days after the statement or the latest amendment thereto has been filed or earlier if the Commission "accelerates" the effective date pursuant to certain statutory standards. The "waiting" period between the filing and effective date is designed to permit unhurried study of the statutory information and informed investment decision and commitment.

The 1948 amendment to the Companies Act did, of course, introduce the three-day waiting period into the British statutory scheme but it did not introduce the mechanism whereby the government (through the Securities and Exchange Commission in the United States) has the authority, and consequently the duty, to initiate proceedings to deny or suspend the effectiveness of the registration statement upon failure to comply with the statutory standards. This is perhaps the major point of difference between the British and the United States regulatory philosophy.

The registration forms are flexible and allow considerable leeway for the issuer and the underwriter to provide, and for the staff of the Commission to consider, disclosures appropriate to the type of issuer, security or offering involved, with the result that prospectuses vary considerably in length and detail. The Commission from time to time reviews its various registration forms with a view to eliminating unnecessary requirements and at the same time keeping pace with developments in industry and

securities analysis in order to provide investors with an adequate description of the significant aspects of a company's business and operations. The prospectus often contains an introductory statement which sets forth concisely the risks involved in the offering. These and other requirements for a summary of earnings, simple capitalisation tables and other basic data are designed to provide the lay investor with an opportunity to appraise the offering. Additional information is, of course, required to permit a more careful analysis by the qualified investor or by his adviser, by the financial journalist, and by all others whose collective judgments contribute to free and open markets for securities.

It is true that on occasion (and this somehow has been referred to as the rule rather than the exception which it is) a prospectus is somewhat lengthy. This may be due to the complexity of the offering or of the corporate organisation of the registrant. Thus, an exchange offering involving securities of companies within the United Kingdom is free of the prospectus requirements. In the United States, information as to each of the companies concerned must be furnished in order that the investor be adequately informed as to whether to accept the exchange. Nevertheless, the Commission has initiated proceedings to prevent a registration statement from becoming effective and, in other situations, declined to "accelerate" its effectiveness, where it was unduly prolix and its detail and organisation tended to obscure the facts essential to an adequate understanding of the enterprise.

To carry out the responsibilities of the Commission previously adverted to, its staff must examine the registration documents for compliance with the statutory demands and, except where wilfulness or gross disregard of the requirements demands the initiation of administrative proceedings to suspend effectiveness of the registration statement, the staff brings to the attention of the issuer and the underwriter such deficiencies as it uncovers, a process not unlike, in principle at least, the one which the London Stock Exchange follows in "vetting" the prospectus.

The staff's comments in its examination of prospectuses are directed toward adequacy of disclosure and emphasis, leaving conclusions to the investor. The Commission views the prospectus as intended to deal with relevant and material facts and not, generally speaking, expressions of opinion or predictions. It is basic to the disclosure scheme that the government shall not pass upon the merits of the issue or of the issuer. However, the necessity to make adequate disclosure frequently affects the nature or the terms of an offering. It is noteworthy that, however anxious the securities industry may be at times to liberalise alleged restrictions on the method of offering and selling, the feature of the Securities Act which nobody seems to want to eliminate is that which authorises the Commission to review or otherwise to investigate registration statements. The whole process generally produces information and reliable disclosures of facts material to investment analysis. It would be a serious omission, however, if a real measure of credit were not accorded to the many responsible issuers, underwriters, their counsel and others, without whose co-operation it would have been difficult, if not impossible, to achieve this result. This is not to say that aspects of the Commission's administration of the statute or specific requirements of its rules and forms may not be subject to appropriate suggestions and criticisms from time to time.

Section 19 (a) of the Securities Act is the basic source of the Commission's authority in the accounting field. This section gives the Commission power to define accounting terms, prescribe forms for reporting, outline the details of the items in balance sheets, earnings statements, methods to be followed in preparing financial statements, prescribe the bases for appraisal and valuation of assets and liabilities, to determine the method for accounting for depreciation and depletion, to require the segregation of recurring and non-recurring items, to require the separation of investment and operating income, to lay down rules for consolidation, and other matters. Similar authority is contained in the Exchange Act and more comprehensive power is embodied in the Investment

Company Act and the Public Utility Holding Company Act. Under the Securities Act and the Exchange Act, however, unlike the latter two Acts, the Commission does not prescribe a uniform system of accounts.

The Commission has adopted a single regulation, known as Regulation S-X, which governs the form and content of financial statements filed in accordance with the several acts. This Regulation is supplemented by the Commission's Accounting Series Releases which are designed to contribute to the development of uniform standards and practice in specific major accounting questions.

Schedule A of the Securities Act requires a balance sheet as of a date not more than 90 days before filing, together with a certified balance sheet as of a date within a year prior to filing if the later balance sheet is not certified, and certified profit and loss statements for the last three fiscal years, supplemented (if the filing date is more than six months after the close of the last fiscal year) by a similar statement covering the period from the close of the last fiscal year to the latest practicable date.

The Securities Act, like the Securities Exchange Act, requires that financial statements included in a registration statement be "certified by an independent public or certified accountant". Rule 2-01 of Regulation S-X provides that an "accountant will not be considered independent with respect to any person or any of its parents or subsidiaries in whom he has, or had during the period of report, any direct financial interest or any material indirect financial interest; or with whom he is, or was during such period, connected as a promoter, underwriter, voting trustee, director, officer, or employee."

The Commission has spelled out many of the relationships in which the independence of the certifying accountant is impaired. For example, the Commission does not deem the certifying accountant to be independent where the client has indemnified him against liability, or where the accountant was an officer of a holding company of which the registrant was a subsidiary. The Commission's insistence that requirements for independence be adhered to strictly, that financial statements be prepared in accordance with generally accepted accounting principles, and its encouragement of the development, to the extent possible, of uniform application of these principles, have not only increased public confidence in the reliability of financial statements included in documents subject to the Commission's surveillance but have added to the stature and strength of the accounting profession.

The importance of fair financial disclosures in the prospectus cannot be overestimated, since it is primarily through such disclosures that the investor is enabled to assess a company's performance and its potentialities in comparison with other companies in the same industry. The profit and loss statement, which is designed to disclose for selected periods the amount of net profit or loss, the sources of revenue, and the nature of expenses, provides a basis for analysing the results of operations and the course of the business. In addition, it may be utilised by the investor or his adviser to forecast future revenues, expenses and operating results of the enterprise. As the Commission pointed out in *American Sumatra Tobacco Corporation*, 7 S.E.C. 1033 (1939) in denying a request for confidential treatment of sales and cost of goods sold figures, an adequate profit and loss statement is essential for a sound appraisal of management. Specifically, gross sales and costs of goods sold provide the means for gauging the effect of such undisclosed items as changes in selling prices, wage rates, material costs and similar items upon which the profit figure is partially based. In addition, disclosure of a company's profit margin on sales is important, since it may be vital in appraising the significance to the particular enterprise of other known factors and trends, or may suggest the need for further analysis. Thus, a narrow profit margin may be indicative of a large volume of business at prices only a little above cost, or it may be the result of destructive competition. The Commission's views in the *Sumatra* case were upheld by the Court of Appeals and now are generally accepted in business and financial circles in the United States. The importance of this single element to adequate investment analysis cannot, in the view of the Commission and of security analysts in the United States, be overestimated.

Also significant in the marketing of new issues are the controls over manipulation and stabilisation of the markets for outstanding securities of the same issues. American underwriters are essentially distributors of securities. They do not, ordinarily, have the capital to acquire and hold a new issue and consequently they devote every effort to distributing it to the public as rapidly as possible. They thus have a strong incentive to influence the market price of outstanding securities in order to facilitate the distribution, and prior to the enactment of the Securities Exchange Act of 1934 this was commonly done. The Securities Exchange Act and rules adopted thereunder prohibit manipulation, thus making it impossible for distributors of a new issue to run up the market price in contemplation of the offering. Stabilisation presents a special problem. New issues are usually offered at a fixed price related to the market price at the commencement of the distribution. If the market price drops below the offering price, prompt distribution will become difficult or impossible and the mere making of the new offering alters supply and demand factors in the market. On the other hand, improper stabilisation of the market is itself manipulative and facilitates over-pricing with resulting loss to investors. Acting under statutory authority, the Commission has sought to resolve these problems by regulations permitting stabilisation subject to tight controls and disclosure requirements.

It is not clear to what extent the securities acts and their scheme for moderate government control over new issues and the securities markets have contributed to that increased public confidence which has made possible resort to the capital markets by more and more issuers each year—from the smallest company to the largest and from the most speculative to the most established. During the fiscal year ended June 30, 1960, there were 1,628 registration statements filed for proposed securities offerings of approximately 16 billion dollars. Of these, almost half were companies in which there was no prior public interest.

The Trust Indenture Act of 1939 supplements the Securities Act. It applies to debt securities publicly offered and was designed specifically to require an indenture which contains provisions: (1) To assure to security holders the services of an independent and disinterested corporate trustee with adequate rights, powers, duties and responsibilities to protect their interests and rights; (2) to designate the standards of eligibility and qualifications of the trustees and to minimise conflicting interests so that the trustees may truly act on behalf of security holders they purport to represent; (3) to outlaw provisions designed to exculpate the trustees from liability, and to impose the duty, after default, to use the same degree of care and skill that a prudent man would use in the conduct of his own affairs; and (4) to require the obligor to file certain reports, certificates and opinions with the trustee and security holders.

Experience has shown that the Act has achieved its desired objectives and that it has, in fact, stimulated legitimate debt financing. A total of 234 indentures were qualified during the fiscal year ended June 30, 1960, compared to a yearly average of 61 indentures qualified during the first five years subsequent to the passage of the Act. Moreover, the fact that an indenture has been qualified has gone far towards ensuring investor confidence in the securities offered, as is shown by the fact that issuers with an available exemption from qualification sometimes request permission to qualify an indenture under the Act.

B. Subsequent Trading: The Securities Exchange Act of 1934

The basic disclosure scheme of the Securities Act applicable to new issues was carried over by the Exchange Act to securities traded on the national securities exchanges with certain supplementary features designed to provide continuing information as to such securities through the medium of annual and other reports required to be filed with the Commission and the exchange. Thus, as a condition to trading on an exchange, an issuer must not only enter into a listing agreement with the exchange but must also file a registration statement with the Commission. This is in important respects similar to the registration form under the Securities Act.

Officers and directors of companies whose equity securities are listed and registered on a national securities exchange, as well as persons owning more than 10 per cent. of any class of such securities, are required to file reports with the Commission as to their ownership and transactions in all equity securities of such issuers. The statute also forbids "short" sales by such individuals and provides that any profits resulting from the purchase and sale or sale and purchase of such securities within a period of six months are recoverable by the issuer. The reports, 38,821 of which were filed during the last fiscal year, are available for public inspection at the exchanges and at the Commission.

Issuers whose securities are listed and registered on a national securities exchange, and certain other issuers which have an effective registration statement under the Securities Act covering a sufficiently large dollar amount of securities, are subject to the reporting requirements of the Securities Exchange Act.

These reports consist of annual reports on Form 10-K, semi-annual reports on Form 9-K and current reports on Form 8-K. Form 10-K essentially requires that information be furnished similar to that contained in a proxy statement concerning the election of directors (this information may be omitted in annual reports of companies filing such proxy statements within the fiscal year) plus certified financial statements. Form 9-K covers the disclosure of profit and loss and earned surplus data, and Form 8-K requires that material information on the following important and generally non-recurring events be set forth:

- Changes in Control of the Registrant
- Acquisition or Disposition of Assets
- Legal Proceedings
- Changes in Securities
- Changes in Security for Registered Securities
- Defaults upon Senior Securities
- Increases or Decreases in Amount of Securities Outstanding
- Options to Purchase Securities
- Revaluation of Assets or Restatement of Capital Share Account
- Submission of Certain Matters to a Vote of Security Holders
- Other Materially Important Events
- Financial Statements and Exhibits for Certain Matters.

The several reporting forms are under constant study and re-evaluation by the staff and the Commission with a view toward keeping the required disclosure current to the changing practices of the financial community.

These reports are given wide dissemination and are of paramount importance to an informed capital market. In the case of a great number of companies whose securities are traded otherwise than on a national securities exchange, the reports often furnish the sole means by which stockholders, and investors generally, can obtain reliable and detailed information on the company.

In addition, the reports have provided the Commission with information which has suggested appropriate investigations and ultimate enforcement action or private redress.

The statutory provisions also include authority in the Commission, under which it has adopted a comprehensive regulation, to require that in every solicitation of proxies, consents or authorisations from the holders of securities registered and listed for trading on such exchanges, information necessary and appropriate to the exercise of the security holder's franchise be provided to him. State law, under which most corporate enterprise in the United States is organised, does not regulate the content or compel the furnishing of proxy statements to security holders.

Proxy statements are frequently more complex than prospectuses, since they may relate to such matters as mergers, fundamental changes in the finances of the enterprise or material sales and purchases of assets, and other significant corporate matters

requiring security holder action. They are required to contain considerable information regarding management and its transactions with the company. The Commission has expressed the view that its requirements in this area represent probably its most effective disclosure device. Undoubtedly, the very existence of these disclosure requirements affects the practices and policies of the companies involved and of their managements. Thus, the requirements for disclosing executive remuneration through stock options, pensions, bonus and profit sharing plans, coupled with the latent possibility of a proxy contest in the event of excessive remuneration, undoubtedly affect management decisions in some cases.

The proxy rules provide a means for a shareholder to give notice and to secure inclusion of appropriate proposals for security holder action in the proxy statement sent out by management. State law does not normally impose on a company's management the duty of notifying stockholders in advance of a meeting concerning proposals not favoured by management but which will be submitted for their approval. During the fiscal year ended June 30, 1960, the proxy statements of 94 companies included 130 proposals submitted by 42 shareholders.

The statute also provides a comprehensive scheme for the regulation of the securities markets and of those who play important roles in these markets. The provisions for the registration and regulation of stock exchanges and of national securities associations are discussed above under the heading "Co-Operative Self-Regulation". In addition, brokers and dealers doing any securities business otherwise than on a stock exchange are required to register with the Commission. Such registration may be denied or revoked by reason of specified convictions, injunctions or because of violations of the statutes. Registered brokers and dealers are subject to an extensive body of statutory provisions and regulations dealing with such matters as capital requirements, the maintenance of books and records, the handling of customers' securities and the treatment of customers. This regulatory scheme is similar to that provided under the Prevention of Fraud (Investments) Act, 1958, but is somewhat more detailed. Significant differences include the following: (1) Members of stock exchanges are subject to registration and regulation if they do any underwriting or other over-the-counter business, as most of them do, (2) the statute does not provide for registration of salesmen or other employees of a broker or dealer but does make their principals accountable for their conduct; (It is estimated that there are approximately 119,000 securities salesmen in the United States, most of whom are required to be registered under state law.) and (3) the Commission, unlike the Board of Trade, is not authorised to pass upon the character or suitability of registrants or salesmen, but must register those whose records are clear of violations.

The statute in addition specifically prohibits fraudulent practices by brokers and dealers as well as others. Significant in this connection is the doctrine, consistently followed by the Commission, that a registered broker-dealer in entering upon a transaction impliedly represents that the customer will be treated fairly and in accordance with the standards of the profession. This doctrine, which was upheld in *Charles Hughes & Co., Inc. vs. S.E.C.*, (139 F 2d 434, C.C.A. 2 1943) gives the Commission substantial scope in dealing with unfair practices and overreaching by brokers and dealers.

The controls upon manipulation and stabilisation of the markets for new issues have already been referred to. The prohibition of manipulation, both by specific statutory provisions and under the general anti-fraud statutes and rules, also applies in the trading markets, both on the exchanges and over-the-counter. The provisions provide a vitally important safeguard to investors against rigged or other artificially influenced markets.

Both the Exchange Act and the Securities Act contain anti-fraud provisions enforceable by the Commission providing criminal sanctions. Such provisions are generally similar to those contained in the Prevention of Fraud (Investments) Act, 1958. Of greater interest from a comparative standpoint are the civil liability provisions of

Rule 10 b-5 of the Exchange Act. This Rule, implementing Section 10 (b), makes unlawful any fraudulent conduct "in connection with the purchase or sale of any security" whenever the federal jurisdictional media are used. Professor Gower's Note concisely points out the development and the implications of this Rule. The coverage of the Rule is significant. It applies broadly to all purchases and sales of securities, on or off an exchange, by professionals and non-professionals, and by insiders and non-insiders. The Rule provides a more comprehensive and less strict criterion of fraud than at common law, and for this reason and others (such as a longer statute of limitations that may be available under state law, no requirement for the posting of security for costs) it may often be more advantageous for a plaintiff to use this rule rather than the specific civil liability sections of the Securities Act and Exchange Act.

The law in this area is constantly being refined by the courts, and the scope of protection afforded by the Rule being expanded, due, in part at least, to the participation as *amicus curiae* of the Commission in many of these cases. The courts, moreover, have shown a willingness to find an implied civil liability in damages to persons aggrieved by violations of this Rule on a number of theories. As Professor Gower has pointed out, this has proven to be a most useful method for the redress of private wrongs.

C. Special Statutes

1. The Public Utility Holding Company Act of 1935

The Public Utility Holding Company Act was passed by Congress in 1935 as a result of the exhaustive study by the Federal Trade Commission, referred to previously, which uncovered abuses in the ownership and control of public utility holding companies which are specifically enumerated in Section 1 of that Act. The public utility companies, generally, reflected a concentration of economic power too large for local regulation and presented dangers of monopolistic control. The Act was intended for the protection of both investors and consumers.

The key provisions of the Act are contained in Section 11, which requires the limitation of holding company systems to an integrated system or systems and related other businesses, and the corporate simplification and equitable distribution of voting power of companies in holding company systems.

It is generally agreed that far from proving to be the "death sentence" that it was originally termed, the Section 11 program has freed the public utility industry from unhealthy practices and encroachments and has given a new impetus to its development and growth. More often than not the liquidation of holding companies has resulted in increasing the market value of the aggregate security interests affected. Many companies at one time subject to the Act have ceased to be so following reorganisation proceedings but as of June 30, 1960, there were 18 "active" registered holding company systems still subject to regulation under the Act, controlling assets of over eleven and one-half billion dollars.

Section 12 (h) of the Act, in general, prohibits registered holding companies and their subsidiaries from making contributions to political groups or in connection with any public office. It reflects the judgment of Congress that the influencing of legislation by means of contributions to candidates for office is harmful to the public interest. The fact that a particular contribution may be relatively minor or that it might benefit the company's consumers is considered to be irrelevant.

The Commission has carried on several investigations of alleged violations of section 12 (h), the most important of which involved the Union Electric Company of Missouri and other subsidiaries of the North American Company. The Commission discovered that these companies had made substantial disbursements to certain persons purportedly for expenses which were rebated to the company and used to set up a special fund. Part of this fund was used to supply contributions to political organisations and to entertain certain public officials. In *Egan v. United States*, 137 F. 2d 369 (C.A. 8,

1943), the Court of Appeals held section 12 (b) to be a valid exercise by Congress of its constitutional power and sustained the conviction of the company and its former president of violating this section.

2. *The Bankruptcy Act—Chapter X*

The role of the Commission under Chapter X of the Bankruptcy Act, which provides a procedure in the United States District Courts for reorganising corporations, differs from that under the various statutes which it administers in that the Commission does not initiate Chapter X proceedings or hold its own hearings. It has no authority to determine any of the issues in these proceedings. However, at the request of the judge, or with the judge's approval, the Commission may participate in such proceedings to provide independent, expert assistance to the Court and investors on matters arising in such proceedings. Where the Commission considers it appropriate, it may under certain circumstances file advisory reports on reorganisation plans. Normally the Commission does not file its appearances until after the petition for reorganisation has been approved. In some instances, however, the Commission has participated prior to approval, either to urge that the petition be approved where it appeared that reorganisation was needed and appropriate, or to recommend that the petition not be approved where the proof did not show insolvency or necessary acts of bankruptcy.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart from the burden on the staff involved in such participation, many cases involve only trade or bank creditors and few security holders. The Commission has sought to participate primarily in those proceedings in which a substantial public investor interest is involved. This is not the only criterion, however, and in some cases involving only limited public investor interest, the Commission has participated to prevent the creation of a bad precedent where an unfair plan had been or was about to be proposed, the public security holders were not adequately represented, the reorganisation proceeding was being conducted in violation of important provisions of the Act, or other facts indicated that the Commission could perform a useful service or the Court requested Commission participation.

Since the enactment of Chapter X, the Commission has participated in approximately 465 reorganisation proceedings involving assets of nearly \$3,600,000,000 and liabilities totalling more than \$2,500,000,000. The number of reorganisation proceedings in which the Commission has participated has increased every year for the last three years. During the fiscal year ended June 30, 1960, the Commission actively participated in 52 reorganisation proceedings involving 80 companies with stated assets of approximately \$567,094,000.

The Commission's usefulness in Chapter X proceedings has been widely recognised as illustrated by the following comment by Chief Judge Charles E. Clark on behalf of all the active judges of the Court of Appeals for the Second Circuit:

"We regard the service being rendered by the Commission to the Courts in connection with the reorganisation of corporations to be most valuable, if not indispensable, for the proper disposition of this vital segment of court business according to the Congressional intent. The Commission affords the necessary expert knowledge, the skill and the uniform approach which individual judges cannot have; and to the district judges in particular, the assistance is unique in its usefulness, and not otherwise to be obtained. The judge is not bound to observe all suggestions of the Commission, but the very fact that he has them before him is assurance of his complete preparation for adjudication, with the public interest adequately protected. We regard it as peculiarly unfortunate if considerations of economy (which must be of small and petty character as compared to the value of the interests protected) are allowed to curtail such worthwhile activities."

3. *The Investment Company Act of 1940*

The Investment Company Act of 1940 was evolved from a bill which was based upon the conclusions and recommendations of the Commission, following an extended investigation conducted at the direction of Congress. The legislation, as adopted, was desired by the investment trust industry itself and passed both Houses of Congress virtually without debate and without a negative vote.

The abuses which developed in the investment company industry, and which the Act sought to prevent, were related to the nature of investment companies, their assets, and the affiliations of their management. The legislative record showed clearly that publicity alone was insufficient to eliminate these deficiencies. The following objectives of the Act are sought to be achieved by affirmative requirements or prohibitions: (1) honest and unbiased management, (2) greater participation in management by security holders, (3) adequate and feasible capital structures, (4) adequate financial reporting and accounting and (5) responsible selling practices. This statute is truly regulatory and contains a variety of statutory prohibitions or demands as supplemented by administrative techniques which are available to the Commission to achieve its goals. It also vests in the N.A.S.D. authority and responsibility to control methods for determining prices and to prevent dilution of shareholders' interests and other abuses. The statute requires that each company have a certain number of non-affiliated directors. It contains provisions designed to prevent self-dealing, dumping of securities, pyramiding, cross and circular ownership, and a variety of provisions relating to the distribution, redemption and repurchase of the shares of these companies. It also contains provisions regulating the contractual arrangements between these companies and their investment advisers and underwriters as well as other provisions concerned with special types of investment trusts and companies. Authority is provided to the Commission to enjoin unfair plans of reorganisation, violations of the statute, and to compel removal from office of persons guilty of gross abuse of trust or other gross misconduct.

The Act vests in the Commission authority to grant exceptions appropriate in the public interest and the interests of investors. It has proven to be successful, in part due to the continued co-operation between the industry and the Commission, and has restored public confidence in investment trusts and companies. This is illustrated by the tremendous growth since 1940 of these trusts: at the end of 1941 there were 436 registered investment companies (a substantial number of which have since ceased doing business) with estimated aggregate market value of assets of \$2.5 billion as contrasted to 570 registered investment companies with an estimated market value of assets of \$21.5 billion as of June 30, 1960.

4. *The Investment Advisers Act of 1940*

The Investment Advisers Act resulted from an investigation conducted by the Commission ancillary to its study of investment companies. As originally enacted it was largely ineffectual. It required most investment advisers to register and prohibited certain activities, but the Commission's power to deny or revoke registration was very limited, and the Commission had practically no regulatory power.

It was considerably strengthened by amendments adopted in September, 1960. The Commission now can deny or revoke registration if it finds that such action is in the public interest and that the investment adviser, or any controlling or controlled person, is subject to any of the following disqualifications: (1) has been convicted within 10 years of any felony or misdemeanor which involves the purchase or sale of a security; which arises out of the conduct of the business of a broker, dealer or investment adviser; which involves embezzlement, fraudulent conversion or misappropriation of funds or securities; which involves mail fraud, or fraud by wire, radio or television; or (2) is enjoined from acting as an investment adviser, underwriter, broker or dealer, or as an affiliated person or employee of an investment company, bank or insurance company, or because of activity in connection with the purchase or

sale of a security; or (3) has wilfully made any false statement or misleading omission in any application or report filed with the Commission; or (4) has wilfully violated any provision of the Securities Act, the Securities Exchange Act, the Investment Advisers Act, or any rule or regulation under any of such Acts, or has aided or abetted any other person's violation thereof.

Investment advisers subject to registration must now maintain books and records prescribed by the Commission. Many of such books and records may be inspected without notice by Commission representatives, and all of them can be reached in a more formal investigation. Such investment advisers may not execute or perform a contract which provides for compensation on the basis of a share of the profits, or which fails to provide that it cannot be assigned without the client's consent.

Most important of all, in addition to prohibiting investment advisers from engaging in fraudulent or deceptive practices or transactions, the Act now empowers the Commission, by rules and regulations, to define such acts and practices and to prescribe means reasonably designed to prevent them. Like the other Acts administered by the Commission, it also empowers the Commission to conduct investigations and to institute actions to enjoin unlawful activity; and it also provides for criminal penalties.

The Commission is now drafting rules and planning other regulatory programs to implement the statute as amended.

D. *General matters*

The following comments deal broadly with the legislative, judicial and investigative roles of the Commission, matters which have been mentioned previously in this memorandum in other contexts.

Under all the statutes, the Commission has a duty to report to the Congress with respect to its work and authority to make recommendations with respect to amendment or revision of the statutes administered by it or to recommend additional legislation.

Proposals to amend the various federal securities acts based upon accumulated experience are submitted from time to time by the Commission to Congress for its consideration and action. Hearings are usually held by appropriate committees of the House of Representatives and the Senate, at which the Commission and other interested persons are invited to express their views. In addition, various legislative proposals submitted by others which may affect the work of the Commission, or as to which the views of the Commission may be desired because of its expertise, are referred by Congress to the Commission for study and comment.

Under each of the statutes administered by the Commission, it has the power, and in some instances the duty, to adopt rules and regulations. These vary from rules designed to assist persons subject to the jurisdiction of the Commission to comply with relevant statutory requirements to more elaborate regulations which implement the very general statutory objectives reflected in the statutes. Nearly all rule proposals are first announced to the public in tentative form and the views and comments of interested persons are solicited. These are carefully reviewed by the staff and by the Commission. Apart from the assistance afforded to those who must comply and to those who must administer the law, an additional important aspect of these rules lies in the fact that each of the statutes provides that *bona fide* reliance on the rules of the Commission, even if the rules are later rescinded or found to be invalid, affords immunity from any provision of the Act imposing liability by reason of any act done or omitted in accordance with such rules.

Due to the technical nature of the statutes that it administers, the Commission maintains a staff in its central office and in the Regional Offices which provides interpretative and advisory service to attorneys and the general public concerning the application of, and problems arising under, these statutes. The Commission publishes releases which discuss important questions or practices of general interest.

There are two basic types of formal, quasi-judicial proceedings under the federal securities statutes. One type arises on an application for an administrative order by a person seeking relief from a statutory restriction or seeking a statutory benefit. The second type of proceeding is instituted by the Commission itself and relates to such matters as the denial or revocation of the registration of broker-dealers, stop orders denying or suspending the effectiveness of registration statements and the suspension or withdrawal of the registration of a security from national securities exchanges. In addition, the Commission acts as an appellate tribunal reviewing the disciplinary actions taken by the N.A.S.D.

The procedure governing these formal proceedings is prescribed to some extent in the statutes themselves and related rules. The Commission has also adopted formal Rules of Practice and it is subject to the provisions of the Administrative Procedure Act of 1946. The Commission's orders are subject to judicial review by the federal courts.

The Commission has power to investigate complaints and other indications of violations of law under each of the statutes which it administers. In practice, investigations may result from complaints from members of the public, communications from other federal or state agencies, the examination of filings made with the Commission, its broker-dealer, investment company, and investment adviser inspection program and its continual surveillance of the securities markets to detect manipulative and other illegal activities. The investigations instituted by the Commission are private in nature except for the relatively rare case in which the public interest demands that the investigation be public. Authority to initiate a formal investigation, to issue subpoenas and to compel testimony under oath requires an order of the Commission. Whenever it appears that a person is engaged, or is about to engage, in any act or practice which constitutes or will constitute a violation of law, the Commission may, in its own name, bring an action in the United States District Court to enjoin such act or practice, and, upon a proper showing, the Court is authorised to issue a permanent or temporary injunction or restraining order. The Commission is also empowered to seek, and the Court may grant, a mandatory injunction compelling compliance with the statutory requirements and the rules or order of the Commission thereunder. In certain cases of serious violation which may involve continuing damages to the company or its stockholders, the Commission may suggest the appointment of a receiver or conservator to effectuate the order of the Court or to preserve assets or as may otherwise be necessary and appropriate.

The several statutes contain a number of specific civil liability provisions giving rise to rights of recovery by investors, which may, in many cases, be asserted in state as well as federal courts. The development of implied liabilities, arising in the main under the Securities Exchange Act and to a lesser extent under the Securities Act, is illustrated by Section 10 (b) of the Exchange Act and Rule 10 b-5 thereunder, discussed previously.

The Commission exercises powers of inspection under several of its Acts. For many years the Commission has regularly inspected the activities of registered broker-dealer firms. These inspections involve, among other things, a review of broker-dealer pricing practices, financial condition, and safeguards taken in handling customers' funds and securities. A few years ago it initiated a program for periodic inspection of investment companies pursuant to statutory authority under the Investment Company Act. As already noted, under the recent amendment to the Investment Advisers Act, the Commission is authorised to conduct periodic inspections of the books, records and business conduct of such advisers.

January, 1961.

ANNEX

Appendix I to the George Washington Law Review of October, 1959, contains a comprehensive bibliography on the Federal Securities Acts, including their legislative history, edited by the Librarian of the Securities and Exchange Commission.

The following selected references are specifically enumerated because they are particularly germane to the subject matter of this memorandum.

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MINUTES OF EVIDENCE
TAKEN BEFORE THE
Company Law Committee
TWENTIETH DAY

Friday, 24th March, 1961

Present :

THE RT. HON. LORD JENKINS (*Chairman*)

MR. F. R. ALTHAUS

MR. E. A. BINGEN (*Questions 6965 to 7161 only*)

MR. L. BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E. (*Questions 6965 to 7161 only*)

PROFESSOR L. C. B. GOWER, M.B.E.

MR. W. H. LAWSON, C.B.E., F.C.A.

MR. J. A. LUMSDEN, M.B.E.

MR. K. W. MACKINNON, Q.C., M.B.E.,
T.D.

MRS. M. NAYLOR

MR. G. W. H. RICHARDSON

MR. C. H. SCOTT

MR. W. WATSON, C.A.

MR. P. E. THORNTON (*Secretary*)

MR. J. A. E. DAVIES (*Assistant Secretary*)

SIR RICHARD POWELL, MR. J. LECKIE, MR. R. J. W. STACY, MR. E. W. DEAN,
MR. P. J. MANTLE, MR. H. OSBORNE, MR. J. M. CLARKE and MR. W. B. LANGFORD
called and examined

6793. *Chairman:* Gentlemen, it is very gratifying to see you turn out in such force. For the purposes of the record, may I now read out your names: Sir Richard Powell, Permanent Secretary of the Board of Trade; Mr. Leckie, Second Secretary; Mr. Stacy, Under Secretary, Insurance and Companies Department; Mr. Dean, Principal Assistant Solicitor; Mr. Mantle, Assistant Secretary, Insurance and Companies Department; Mr. Osborne, Principal, Insurance and Companies Department; Mr. Clarke, Inspector General of Companies; Mr. Langford, Registrar of Companies.

We propose to direct our questions to administrative matters, or mainly so, that is to say, to the administrative implications of the law as it is now and any further administrative implications or difficulties which might arise if the law were altered this way or that. We do not propose to trouble you with those questions of principle on which there are in the evidence differences of view which the

Committee will have to resolve in due course.

We might begin with the large number of registered companies now on the Register. In paragraph 191 of your memorandum it is stated that there are now some 370,000 companies on the Register and they are increasing at the rate of 35,000 a year. Is that approximately right?—*Sir Richard Powell:* Yes. I will give you the detailed figures, if I may, in a moment, but I would like to make one preliminary general observation. I am grateful for what you have said about the direction of questions, because as officials it would not be appropriate for us to discuss policy which may be considered by Ministers after your Committee has reported and on which we shall have to advise them at that stage. Secondly, may I apologise for fielding such a large team, but I thought it would be right that the real experts should come and deal with your questions. I make no pretensions to be an expert in company law. I am here

really as the General Manager of the Department which among its other responsibilities has this responsibility laid upon it. My chief concern in that capacity is, first, to see that the burden of administration is kept as low as is consistent with the public interest and is not made more onerous than it need be, and second, to see that the enforcement of the law is practicable and that it is not brought into contempt by not being capable of being adequately enforced. So I would hope you will allow me to pass the ball to one of the other witnesses on all detailed questions and I would regard Mr. Stacy, who is the Under Secretary in charge of the Insurance and Companies Department, as the principal witness, if that would be agreeable to you.

6794. By all means.—On the figures at the moment, I understand there have been some 628,000 incorporations. The register now totals 370,000. The rate per year increase has gone up in the following way, taking England, Wales and Scotland together. In 1948, 16,344 companies were registered; in 1953, 13,329; in 1958, 22,370; in 1960, 34,312; and this year it is going to be something like 40,000 if the average so far is kept up. So it has risen startlingly since 1958. As a result of that, the staff of the Registrars of Companies including the small staff in Edinburgh, has had to be increased from 211 in 1948 to 265 in 1953, 333 in 1958 and is 454 at the present date.

6795. It is an extraordinary growth, and there seems to be an insatiable appetite for limited companies.—So far as I can see, there is. It is steadily rising and there is no sign of any decline.

6796. Perhaps Mr. Stacy would tell us of any particular difficulties which he has to contend with in regard to these very much greater numbers.—*Mr. Stacy:* We have had, as the Secretary has just said, considerable difficulties in finding the numbers of staff and space for them. The accommodation is extremely tight. We have in fact had to think in terms of a new building for the Registrar of Companies, so as to make life tolerable both for him and his staff and the persons who visit the office, and we have had very considerable difficulties under that head. It

has resulted in quite a fair amount of public dissatisfaction at the difficulty of getting prompt answers and of getting companies registered quickly; all very much due to these difficulties of staff and accommodation. It also presents us with a severe problem, which is perhaps more relevant under another head, of seeing that the companies are not registered by names to which objection can be taken. The more companies get registered, the greater that particular problem becomes.

6797. As you exhaust possible names?—Yes, and you end up by satisfying nobody and taking a long time to get done what is regarded as perhaps the first job of the Registrar, which is to get the company registered.

Sir Richard Powell: I think that is the principal problem here, the time it takes to get these things cleared, which leads to impatience on the part of the public and also impatience in the Board of Trade.

6798. What is the average period from the time the memorandum is deposited to the time a certificate of incorporation is issued.—*Mr. Stacy:* Some 18 months ago it was taking an unconscionable time to launch a company, running into weeks.

Mr. Langford: As regards actual registration of the company, about seven days, but not clearing of the name—that takes much longer.

6799. Seven days one would think was pretty quick.—As quick as one can do it at the moment.

6800. Can you suggest any remedy, short of making it more difficult to incorporate, short of discouraging incorporation, to decrease the number of companies coming on the register every year?—*Mr. Stacy:* The immediate practical answer is to find more staff and accommodation, and I think we may be over the worst of that. The next thing, and this lies behind many of our recommendations, is to make it more difficult to register companies and to take a tougher line in getting rid of them if they are not serving a useful purpose.

6801. I believe that of the 370,000 companies on the register there are some

which are doing no business.—*Sir Richard Powell*: Yes.

6802. Would it help matters if you could get rid of this accumulation of defunct companies? Do they do any harm?—They take up some storage space, when we are so pressed for room to keep the Register.

6803. And I suppose they monopolise certain names?—They do.

6804. *Mr. Mackinnon*: A lot of people just register companies to match a name or trademark. That would account for quite a substantial number. It would be rather interesting to know what the number of those would be.—*Mr. Stacy*: Yes. Companies are being formed which have nothing to do with the idea, perhaps a little out of date, of creating a corporate body of persons to carry on a particular business. They seem to want to register a company for many other reasons: in fact fairly recently we had people who told us that they wanted the company registered in order to strengthen their trademark; they chose the same name as their trademark, and told us that this company would do no business.

6805. Purely passive?—Yes.

6806. I suppose there might be some piece of property which for one reason or another a person would rather have vested in a company than keep himself?—Yes. Then you get the case of the company which is formed for one particular piece of business, and then, that finished, the company is left to serve no particular purpose.

6807. *Mr. Lumsden*: Would it be that where perhaps four companies amalgamate into one, the other three companies are continued merely to stop others using their names?—Yes.

6808. *Professor Gower*: Some of these, I take it, are moribund companies which you just have not had time to strike off under section 353?—*Mr. Langford*: We do strike off about 5,000 a year under section 353.

6809. That is an enormous number.—We have recommended in evidence

further grounds for which we might be entitled to strike off companies.

6810. *Chairman*: If they fail to make their annual return, that could be a ground?—If they are persistent defaulters. One of our major problems at the moment is chasing up the company which does not file its annual return.

6811. You can at present strike off under section 353 if the company is not carrying on any business or not in operation?—Yes, and it depends on the interpretation of the words "in operation".

6812. Would it be easier to make some specific failures or defaults grounds for striking off?—I think the main point is persistent default.

Mr. Dean: I think we have in mind that in that case we should apply to the Court to decide whether the company should be struck off.

6813. *Professor Gower*: Increasing the fee for registering the annual return might help, might it not? At the moment it is cheaper to file the return than to wind up the company. If it cost £5 a year people might not be so willing to keep it up.—*Mr. Stacy*: Then you would be faced with chasing the £5.

Sir Richard Powell: It would be helpful from my point of view, to make the accounts balance.

6814. *Chairman*: In your memorandum you state: "Conditions prescribing a higher minimum membership or a minimum capital could easily be evaded." How would they evade these requirements?—*Mr. Stacy*: You could appoint persons who were not really active persons in the corporation.

6815. The nominee who comes into the one-man company to comply with the requirement?—Yes.

Mr. Osborne: Yes, at present they have pure nominees to sign the memorandum.

6816. So that to increase the statutory minimum membership would not be much use?—It could be evaded.

6817. By use of nominees?—Yes.

6818. How about a statutory minimum capital?—I think that it is probably quite easy, once a company has been formed, to recover capital that has been put in, by various devices. If we are talking about evasion, they could not evade the condition of having the minimum capital on incorporation, but it might be rather difficult to fix a flat minimum rate.

6819. That is the difficulty which occurred to me, because a sum which might be derisory in one case might be penal in another.—Yes, and if you did it by putting liability on the signatories to the memorandum, then one has to think of the typist and so on in the office who are usually asked to sign as nominees, and it would not be right to subject them to a substantial liability.

6820. *Mr. Richardson*: It would be possible, although the subscribers might still have the same liability as now, to provide that if paid-up capital did not reach a certain level by a certain time, the company could be struck off.—*Mr. Stacy*: That would be fixing a minimum paid-up capital.

Mr. Osborne: There are two possibilities, to fix a minimum on which tax is paid, or a minimum paid-up capital.

6821. *Chairman*: It occurred to me that one might have something analogous to the minimum subscription of a public company, a statement which somebody might have to sign. Would that be a possible way? You could if necessary make it a requirement before commencement of business and not at the moment of incorporation.—There are, of course, companies without share capital at all.

6822. You mean guarantee companies?—Yes.

Chairman: That is another thing again. There you might do something about the number of members.

6823. *Mr. Lawson*: If you had a minimum capital requirement in the private company, would not the promoters who subscribed for the shares immediately

borrow the money back again?—That is what I had in mind at first when I said it might be easy to recover the money. You may borrow the money to form your company. In the case of a private company it can be recovered from the company and control would perhaps be rather difficult.

6824. *Mr. Althaus*: Would you regard the formation of a company purely for the purpose of protection of a name as undesirable?—*Mr. Stacy*: I suppose it is difficult to describe it as an abuse, but I should doubt whether it is an appropriate use of the corporate set-up.

6825. *Chairman*: So that you do not think these expedients would be very much good, but you think it would be a help if all companies were required to file accounts. That, of course, goes to the abolition of the exemptions for private companies, which is one of the issues which this Committee will have to consider.—Yes, I think the general feeling is that the more the public know the better, and insofar as requiring properly audited accounts from all companies, if this also serves the purpose of reducing the number of companies that is all to the good.

6826. *Mr. Lumsden*: Would it be practicable to provide that when a company went out of existence, the name that the company had used should not be available for use by any other company for five years, or ten years, which might avoid the practice of immediately incorporating another company to protect the name of a company you have wound up?—*Mr. Langford*: I think from my point of view it would be almost impossible to operate. I would rather have companies registered to protect names than that.

6827. *Chairman*: Supposing one required all candidates for incorporation to file statutory declarations stating really what they proposed to do and gave the Board of Trade or the Registrar power to refuse registration if they did not think there was any solid or reasonable ground for granting incorporation?—*Sir Richard Powell*: I do not think it would be practicable to administer. We should

have to have an enormous corps of inspectors to go around and police it.

6828. *Mr. Richardson*: Returning to paid-up capital, if it was thought desirable to fix a minimum paid-up capital of, say, £10,000, would you not think that would have the effect of making a most dramatic reduction in the number of companies incorporated each year?—*Mr. Langford*: It certainly would. The great majority of companies have a paid-up capital of £1,000 or less, many of them £100.

6829. *Chairman*: Some even as low as £2. You suggest all companies should be required to pay an annual registration renewal fee?—*Sir Richard Powell*: Again with the object of getting companies who have gone out of business to get themselves wound up or struck off instead of just remaining on the register.

6830. It would be a neat and clear default on which the proceedings to strike off could be taken?—Yes, it would be a strengthening of the existing powers.

Mr. Stacy: We also have a feeling that it would create an impression that being a company was a more serious business, and not something to be had just for the asking.

6831. What sort of figure would one have? Would it have to be a flat rate, or linked to the amount of issued capital, or what? Would one have any kind of sliding scale?—We have not in fact thought this one through, but I would have thought it would have to be a flat rate.

6832. Then of course one is apt to consider political factors to some extent. I am never quite sure how far they should enter into these enquiries. If a specific paid-up capital or annual renewal fee were required, might not a cry be raised that the door of incorporation was being closed to the little man?—Yes, there might well be that criticism.

6833. The other side of the picture is that unless the person has sufficient means, he ought not to embark on a limited liability company, but that is not

so easy to present as the other.—I would have thought it is a perfectly defensible line, as you say, and I would have thought that it could be defended in Parliament if it were thought right to take that course.

6834. That and the filing of accounts are probably the best suggestions that you have been able to think of, are they?—*Mr. Langford*: I think there would have to be some effective means of removing the companies from the register if they failed to pay the annual renewal fee.

6835. Partly the object of having one is to create a possibility or probability of default on which there could be striking off proceedings?—Yes. There would be a lot of administrative work involved in such a scheme, though I do not say it is impracticable.

Sir Richard Powell: It would mean moving more rapidly than now. You could not allow failure to pay a fee to continue for as long as failure to provide an annual return now continues, otherwise the system would be brought into disrepute.

6836. *Chairman*: Yes, perhaps 21 days in arrears?—I was thinking of something like three months, but it would certainly mean a considerable burden on the Registrar's staff, to police the system. We would have to give them a warning that if they failed to pay within a certain time, proceedings would be taken to strike them off, or whatever it was.

Mr. Langford: I think in the first year or two there would be a tremendous number of companies defaulting. You might get down to an even keel in a few years.

6837. *Professor Gower*: Would it not be administratively much easier if annual returns all had to come in on the same day? At the moment you are keeping check on each company to see whether they put in their annual return at a particular time. If every company had to have its return in within three months from 1st January, you would know where you were. It would make a rush at a particular time of the year, of course.

6838. *Chairman*: It would be worse than the football pools for the Post Office. —At the moment we do at certain times of the year pursue the defaulters.

6839. *Professor Gower*: At that time some of them are two years in default. —I agree.

Mr. Dean: One of the difficulties of this use of the striking off procedure might be that the Courts would be inundated with restoration proceedings, where creditors wanted to get their money back.

Sir Richard Powell: At the moment I gather about 90,000 companies default each year in filing their annual returns, of which about 10 per cent. or less are old well-established companies, new companies 50 per cent. or more; it is a considerable job chasing up these 90,000.

6840. *Mr. Mackinnon*: The 5,000 that are struck off each year are the ultimate residue of those that do not come up to scratch of the 90,000. —*Mr. Langford*: Yes, some request us to strike off, others we cannot trace at all and decide to strike off on our own responsibility.

6841. *Chairman*: That seems to exhaust the possibilities as regards our first point. —*Sir Richard Powell*: There is one point on that, about the pre-fabricated company, which we mentioned, and we hope that the Committee will express a view on that, whether it is desirable in the public interest to have these off-the-shelf companies which are not in business at all until somebody buys them.

6842. One of the witnesses for the Law Society said that he found this a very valuable aid in his own practice and there is no reason why it should be limited. Does it do any real harm? —*Mr. Leckie*: Until they are bought and become active, they are in continual default.

Mr. Langford: Yes, and when the business is sold, those people again default. There is very great difficulty in tracing the people responsible for the submission of returns.

6843. Do you think it would be administratively possible to stop this? —

Sir Richard Powell: I agree it is very difficult. I cannot see any easy way of doing it.

Mr. Scott: If the sale of existing companies were prevented, in some ways would that not accentuate the problem we have already referred to? You would have more people forming new companies.

6844. *Mr. Mackinnon*: You said it takes seven days from the date the papers are lodged before the registration is put through. How long does it take, before those seven days, to clear the name? —*Mr. Langford*: That depends on the name asked for. If it is a name that the Registrar considers desirable, you will get it within a week. If it is a pretentious name or one which has to be justified, if we have to write back for justification and consult other people, it can take time.

6845. So in a straightforward case you could confirm in a fortnight? —Yes.

6846. *Mrs. Naylor*: I do not quite understand why it is difficult to trace those responsible for making the returns in respect of off-the-shelf companies. —A certain person who sold companies, lost some of his records and does not know to whom he sold the companies. We do not know whom we should follow up. We have no director's name on the file, we have no effective registered office.

6847. *Chairman*: Are these companies put into cold storage, so to speak, after they have been incorporated until they are sold? —Yes.

6848. They could be incorporated saying their registration will be in England or Scotland, but they need not particularise? —Yes, they put in an address of the registered office but that address will cease to be the registered office when the company is sold; it is the address of the vendor.

6849. *Professor Gower*: If you require a substantial minimum paid-up capital on incorporation, you would put these chaps out of business. —Or a substantial annual renewal fee.

6850. *Mr. Watson*: Have you thought of any flat rate figure for the annual

renewal fee? £5 would produce about £2 million a year.—I would not think of it in terms of revenue producing, but something resulting in better enforcement.

6851. But it would enable an extension of your organisation to take place and the cost to be met from this source.—

Mr. Stacy: I think, as regards the off-the-shelf company, the general feeling is again whether the incorporation of companies has not become too light-hearted, too frivolous in some cases. This all seems to be part of the over-facility with which companies can be formed.

6852. *Chairman:* My suggestion of a statutory declaration showing that the company has been formed for some sensible definitive purpose, I think you all say, would probably be administratively impossible because the Department would be inundated with applications each of which would have to be adjudicated on? —*Sir Richard Powell:* Yes.

6853. *Mr. Lumsden:* Would it be of assistance if some further information had to be lodged along with the incorporation papers? I am thinking of the notification of the proposed registered office, and possibly the name and address of at least one proposed director, to be lodged with the incorporation papers.—*Mr. Langford:* I think it would help a lot, at least in enforcement.

6854. *Chairman:* Given this very large number of companies, predominantly private companies, one ought to consider, in thinking about making it more difficult, what actual abuses there are. Very roughly, of the private companies incorporated in any given year, how many are still living, say, three years after? How many have gone out of business through insolvency and how many have simply faded away? It would be helpful if one knew what abuses there were, how many people lose money through dealing with a small company and how many lose just as much through dealing with a little partnership.—*Sir Richard Powell:* I think we might look and see if we can give you any information like that, but I am sure it would be difficult to do. We could certainly see.

6855. The winding-up figures are not dramatic. One would expect some to get wound up on the ground of insolvency, but there would remain some who just faded away, leave their shop or registered office and disappear.—Yes, they go to make up the 370,000.

6856. *Mr. Brown:* On this question of exempt private companies filing accounts, there is quite a lot of evidence on both sides of this case. Would there be any difficulties if the statutory maximum number of shareholders were reduced from the present 50, so that the larger exempt companies were knocked out and the smaller ones with, say, 10 or 20 shareholders were allowed to continue exempt? —*Mr. Langford:* I think the majority of exempt private companies are very small, with no more than 10 or 20 shareholders.

6857. If one did not wish to affect them, but only to affect the £1 million companies?—I don't think there would be many in that category. It would not be helpful.

6858. It may not be helpful to the Board of Trade—you are looking at it from a different point of view—but would there be any difficulty?—Not to us.

6859. *Chairman:* We might pass to another matter, private companies. The first point here is whether anything should be done to ensure continuity of management on the death of a sole director or one of two members. Is there anything in the proposals which have been made for a statutory minimum of two directors and/or three members. If we made it obligatory on a private company to have two directors, that probably means that the two founder members will also be directors. When one of them dies, there would be a director who could secure continuity under Table A; the continuing director would act for the purpose of making up a quorum.—*Sir Richard Powell:* We think this would be a helpful thing; from our point of view it would be a good idea.

6860. Then we will note that as *primo facie* a good idea. I do not see that it could do any harm.—No, we certainly

think it would do some good in maintaining continuity of management and carrying on the business.

6861. As to the suggestion that you should have a minimum number of three members, that has its attractions I think, but I do not know what you think of the objection that it would rather cut across the quite common case of two brothers, or a husband and wife, say, starting a small limited company and who would not want to have an outsider there?—*Mr. Stacy*: Yes, it would cut across that case, but we were looking at it from the point of view of the continuity of management. The husband and wife might both be killed in the same car accident.

6862. I do not know whether that requirement would create difficulties?—*Sir Richard Powell*: Only the same sort of difficulty as has already been mentioned, namely, if we make things more difficult, and this would be in a sense making things more difficult, what sort of criticism might be made in Parliament. Should we be able to defend it?

6863. If we are to do anything at all, you would prefer having a minimum of three members to a minimum of two with at least two directors?—We would like to have both. I cannot myself see why it should be any handicap to the conduct of a legitimate business.

6864. Then we must consider that. The other point on private companies concerns the nature and size of the administrative problems involved if the exemptions now conferred on exempt private companies were withdrawn so that they all had to file accounts.—*Mr. Stacy*: I think we could cope with that. We might have to find more space. It is true that some 300,000 more companies would have to file accounts, but administratively it is not very difficult. Already the Registrar has to make sure that the certificate of exemption is there and is in order. I do not think the difficulty of seeing that the accounts were there would present a great problem.

Sir Richard Powell: As the filing of the accounts and of the annual return are

simultaneous, it would simply be a problem of finding room to keep the documents.

6865. *Professor Gower*: You would make a lot of room if you could cut out the requirement that the annual returns should contain a list of members.—Yes, but at present a full list of members is only required every three years.

Professor Gower: Anyone who wants to see who the members are only has to go to the company's office.

6866. *Mr. Scott*: It is very valuable to know who are the members of a company, even if it is only obtained every three years. If you know that the members of company A are also in company B, you don't mind if the information is three years old.—Yes.

6867. And they can make their search at the Registrar's office without the company being aware of it?—Yes.

6868. *Chairman*: So that problem would not be an insurmountable one? Then, as regards the prohibition of partnerships with more than 20 members, the upshot of the view you express in your memorandum is that you see no difficulty in this restriction being abolished so far as professional partnerships are concerned, as distinct from trading partnerships?—*Mr. Stacy*: Yes, but we did mention the professions who had made representations to us and where it did seem to us that there would be a case for consideration, namely, the solicitors and accountants. I think we mentioned those specifically in our paper.

Sir Richard Powell: I don't think I should like very much to be put in the position of deciding what is a profession. If it could be limited to those who made representations on this, they are in fact solicitors and accountants only, it would be perfectly easy but if we widened it extensively and we had to try to decide what was or was not a profession, I think our life would become rather difficult.

6869. Yes, I should have thought so too. How do you propose to cope with it?—I think we would simply

say that certain recognised professions would be exempted, and particularly these two, solicitors and accountants, which are the ones where the main problem lies and the only ones which have pressed us for this modification in the law.

Mr. Stacy: I suppose we could have the bodies in question specified in a schedule to the Act, but we would not want provision for professions to be added at the discretion of the Board of Trade.

Sir Richard Powell: We would prefer to leave it for the next Companies Act but one.

6870. You think that would be too difficult?—I think we might get into great difficulties.

6871. There are some insoluble problems; the optician who prescribes for glasses at the back of his shop and is exercising his profession as an oculist, then makes the spectacles and sells them in the front of his shop and then he is trading. You get lines of demarcation which it is really impossible to act on. You would be prepared to operate the thing if it was done with a schedule and specific bodies only included?—Yes, I do not think there would be any difficulty.

Mr. Leckie: Retain the present prohibition but have an exception for people who were members of specific bodies in the exercise of their profession.

6872. *Mr. Lawson:* What is the point of retaining the prohibition at all? Would there really be any harm in allowing a commercial partnership to have more than 20 persons?—*Mr. Stacy:* We had it in mind that it was causing no difficulty in the commercial field and we thought there might be difficulties about agreeing to the removal of the limit there. It was stated in a famous law-suit that the limitation was intended "to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies so that persons dealing with them did not know with whom they were contracting". We have not found any evidence that this restriction is causing difficulty in the commercial field.

Mr. Osborne: There is no penalty for this, of course.

6873. *Chairman:* The old difficulties of suing a partnership have been largely done away with for practical purposes by the Rules of the Supreme Court—you can sue the partners in their firm name and get judgment against the firm—but that does not alter the fact that if your judgment is to bear fruit at some time, you have to hunt out the individual partners and levy execution on them. Whether that would be at all a handicap if there were 200 partners, I do not know.—*Sir Richard Powell:* I think the system of registration of business names would break down very quickly if you had constant change over a large number of partners.

Mr. Lawson: It is extremely unlikely that many commercial undertakings would take advantage of a larger number of partners if it were allowed. I was wondering if we could get over your difficulties by removing the prohibition altogether, bearing in mind that only a few professions would be likely to take advantage.

6874. *Mr. Scott:* There are sometimes occasions when, say, 21 or 23 companies, just over the minimum, combine together to build some big thing like a steelworks in a foreign country. They are in fact carrying on business in partnership in that particular venture. That is not the sort of thing we have been considering, but these *ad hoc* partnerships are not infrequent. They sometimes do in fact form companies to act as a centralising agency, but it is not unknown for some 20 companies to want to combine together in the organisation of some big construction. Strictly speaking it would fall within that section. Does it do any good? Is it desirable to restrict them from doing that?—*Mr. Stacy:* If you maintain the existing limit, and wish to deal with this sort of case you would, I agree, be faced with having to allow exemptions in particular cases such as that one.

6875. I wonder how you would exercise your discretion in such a case, whether it really serves a useful purpose to have them in at all?—*Sir Richard Powell:* I think it is something that should be looked at. It is not a thing I have personally considered at all. I think we should look at that again.

Mr. Stacy: I suppose if conditions of incorporation were made more difficult, conditions could change and there might be more interest in trading partnerships. Then you might find difficulties if the restriction were removed.

Chairman: One of the witnesses we have seen, from the United States, was one of 187 partners I think, and they met together once a year.

6876. *Mr. Althaus:* There are in fact a number of activities which are normally carried on by way of partnership other than the two which have been mentioned. I suppose it would not be too difficult to include all these in a schedule.—*Sir Richard Powell:* Do you mean civil engineering and that kind of thing?

6877. Yes, various activities which are carried on habitually by way of partnership.—*Mr. Stacy:* Which might be readily accepted and placed in the schedule.

Sir Richard Powell: I think we would accept anything which did not leave the description to us to decide whether a particular body should be exempted or not. We would not mind how long the list was.

6878. *Professor Gower:* If you remove the restriction on commercial partnerships, are you satisfied that advertising for partners would be an offence under the Prevention of Fraud Act?—*Mr. Dean:* The first difficulty is whether that is in the Act at all—it is doubtful.

6879. If you made reckless or fraudulent statements you would be covered by section 13 if you were inviting people to subscribe for shares. But I am not sure, if you invited them to come into a partnership, what the position would be under the section?—I doubt if the offer of a partnership, as such, is covered at the moment.

6880. *Chairman:* I do not think that we can carry that much farther this morning. Has anyone any thoughts on the limitation of banking partnerships to ten? I do not think we have had any evidence on that.—*Mr. Stacy:* No, we have had no representations on banking partnerships.

6881. Then the next point is a change of objects by companies licensed to dispense with the word limited. The point here is that there is a fair body of opinion in favour of the view that the alteration of a company's objects ought in general to be made easier. If companies were therefore in future able to change their objects to any extent by special resolution, I take it that the Board of Trade would want to be assured that they would still have a voice in a change of the objects of section 19 companies?—*Mr. Stacy:* Yes, we would. All we can do at the moment, if there is an unauthorised change of objects by such a company, is to invite the company to pass another resolution putting it right, rescinding it or amending it. If they declined to do that, then we would revoke the section 19 licence. I cannot think, as a matter of fact, that that has ever happened, or that we have had any difficulty upon that score. But we would agree that is not enough and we should like to have power to veto undesirable changes. Our feeling is that if a company has built up assets by obtaining money from the public under certain conditions with our blessing, they should not be free to turn those assets to some other quite different type of purpose, not a section 19 purpose, adopting "limited" in the process.

6882. Supposing the law were altered so that objects could be changed by special resolution without any of the present restrictions in section 5 (1), would you like to see a provision under which alterations in the case of a section 19 company should not be effected except by special resolution of that company approved by the Board of Trade?—Yes.

6883. And then you would have a provision that that approval must be annexed to the special resolution and bound up in all copies of the articles—that type of provision?—Yes, we would want that.

6884. You think that would probably be more convenient than the rather roundabout way of taking away the licence, except that that would remain as a sanction?—*Mr. Leckie:* That may not be effective; they can add the word

'limited' and they are free to go ahead as they like.

6885. But one would get over that if one said in the first place there is to be no alteration in the objects until it has been adopted by special resolution and approved by the Board of Trade?—Yes.

6886. *Professor Gower*: You do want to retain this power to license companies to dispense with 'limited'?—*Mr. Stacy*: It gives us a lot of trouble to work and also entails much thought, but we think it does serve a useful purpose.

6887. It enables some companies to acquire a kind of cachet which others do not get?—Yes.

6888. Is this really one of your jobs, to decide what are highly respectable associations and what are slightly less respectable associations?—We have been doing it for a long time, and we have got rather to like it!

6889. *Mr. Lumsden*: Does Mr. Stacy mean that once a company is a section 19 company it must always be a section 19 company?—In effect, that is what we are saying.

6890. So that there would be no power by any means to convert a section 19 company into an ordinary company? That seems to be the implication of what you were saying and I wanted to clear that up.—The change must be made with our permission.

6891. Yes—with your permission, not without it?—No.

6892. *Chairman*: The Charity Commissioners do not much like the section 19 arrangements?—I think, Lord Jenkins, they have a feeling that charities are not appropriate bodies to be within the Companies Act and should be taken out. There may be a case for that, but we do not see how we should be able to implement that; any company could include among its objects one or two which were not charitable, and so they would have to be registered under the Companies Acts. The definition of a charity is I gather by no means easy; it is a very controversial

matter. So that it might not be easy to make sure that charities did not in fact come under the Companies Act. There has been criticism of the provision which is in our model form of memorandum under which we do in effect take away the benefit of limited liability from the directors of a section 19 company in so far as the company holds property subject to the jurisdiction of the Charity Commissioners. Our feeling is that there is probably some force in that objection and we are in fact not too happy about that provision. But the Charity Commissioners think that it does not go further than the existing law and would like to see it kept. We rather defer to their wishes in this matter at the moment, but we do think that there may be a case for the objection that has been raised to it.

6893. Yes. I do not think we can do much about that today because it brings in charities which, as you say, is a very complicated matter. What the Commissioners want to be sure about is that property devoted to charitable purposes should be held in trust for those purposes.—Yes.

6894. I do not think, unless anyone has got any solution to this problem, that we can usefully discuss it further. Then the next point is the proposed highway code for directors. I gather you think that would not be a bad thing for what it was worth?—*Sir Richard Powell*: Yes; we think it might be quite a useful thing if it could be done, but I do not think we would suggest that either the Board of Trade should do it or that it should be given any statutory force. But it would be a useful thing to have—rather comparable to the rules the City drew up for take-over bids. We had in mind that it would be a good thing to have the statutory requirements set out fairly clearly and some digest—if that is the appropriate word—of the case law on the subject that could be available to all directors. But we hope that some outside body might take it on and do that. I do not think it could be given legal force because I am sure it would be impossible to make it comprehensive; something would certainly be left out which would then be creating a gap in legislation.

6895. In fact, it would have to be made plain really on the cover of the document that it had no statutory effect, but was intended as general guidance to directors in finding out what their duties were?—Yes. We do send out now to companies a sort of digest of the provisions of the Companies Act relating to directors, I think, when people inquire, and this would be an elaboration of that.

6896. Yes. The next one is directors' dealings in the shares of their own companies, which is dealt with in paragraph 34 of your memorandum. That deals with the register kept of directors' shareholdings under section 195; and you think that "there is probably a case for requiring that the register should be open for inspection by members and debenture holders at all times". I think that most of our witnesses have taken the same view, that is to say that the register ought to be kept open at all times during usual business hours like the register of members.—Yes; we can see no objection to this on administrative grounds; it would certainly mean no problem for the Board of Trade and I do not think it would put any unjustifiable burden on the companies.

6897. Forgive me, I ought to know this, but does a copy of this register have to be sent to the Registrar of companies and filed?—No.

6898. Then it would not affect you?—Not at all.

6899. Then we have had a good deal of discussion as regards leakage of confidential information, and we did have some figures in particular relating to various recent take-over bids in which it was made clear that there was very active dealing in those shares before the bids were announced, which suggested that somebody was acting on inside information. Whether he was a person who ought to act upon it or not, one would not know. It has been suggested that where there are significant movements of share prices in such circumstances there ought to be some sort of inquiry as to who is responsible, where he got his information from, and so on; and of course this recommendation goes on to suggest that the Board of Trade should undertake such an

inquiry. What would your view be about that?—*Mr. Stacy*: I think you would be asking the Board of Trade to take on something which would be extremely difficult. In the first place, I imagine we would be asked to make inquiries of this sort on quite a large number of occasions. Whenever there was any wide fluctuation in share values, it would be suggested that there was something suspicious and that the Board of Trade should look into it. Then I am not at all sure how we could in fact ever discover whether, for example, a director had given a friend of his, over lunch, a friend who might have nothing to do with the company, some private information which enabled that friend to make something. The favour might perhaps be returned in due course the other way round. I do not see how one could possibly discover whether anything of that sort had happened.

6900. No, because there are so many different ways in which information can be passed on or picked up by astute people that it is rather difficult to sort out?—Yes.

6901. *Mr. Althaus*: And there may be so many different factors which gave rise to the price fluctuations; a rise or fall in shares might not necessarily be only because of this kind of indiscretion?—But that would not prevent an immediate appeal to the Board of Trade to inquire. We would have to say on a good many occasions that we did not think there was a case. And then, once again, the criticism would be made: "Well, the Board of Trade have the power which they do not use."

6902. *Professor Gower*: Yes, but surely you have got the power already?—Yes, we have already got power to investigate the ownership of shares but we do not want it to be assumed that when there are fluctuations in share values it is for the Board of Trade at once to make inquiries to see whether information has been given improperly.

Sir Richard Powell: I think if we were expected to act in this sort of way there would have to be some sort of preliminary screening—for example, after a request from the Stock Exchange. I am sure we

could not just plunge straight in and investigate any complaint from any member of the public: it would put us in a most difficult position if we had to decide whether there was a *prima facie* case for investigation.

Mr. Osborne: The disclosure of information in itself is not an offence.

6903. *Chairman:* The answer, then, to this is that you would not object to being concerned in such an inquiry in a case where the material available was sufficiently definite in character to enable an inquiry to be conducted with some hope of success?—*Sir Richard Powell:* Yes, exactly, if by that you mean, Sir, that the evidence had been sifted by somebody before it came to the Board of Trade at all.

6904. Then there is a question which I think really is one of the policy questions which I said at the beginning we were not going to trouble you with, but it really follows on from the leakage of confidential information that we have been mentioning, and that is the question whether a director or others profiting from inside information should be made accountable to the aggrieved shareholders?—I think we would feel this would be extremely difficult to do. Who would the "others" be and how would you prove that they had got their information from some unauthorised source, and how could you get at them? There are so many ways of doing this kind of thing that it would be almost impossible to police a provision of this kind.

6905. Inside information would not necessarily be information improperly obtained?—No.

6906. But it would rather be information improperly used?—Yes.

6907. A possible line of approach would be to say that a director contracting with shareholders in the company for the sale or the purchase of shares would be under obligation to disclose everything he knew about the shares?—I think that might be easy if it were a director you could control, but I should have thought a director might tip off a third party to act on his behalf to acquire shares or do the dealing,

and it would very likely be very hard to catch him.

6908. I appreciate that.—I am sure that if you made a director liable it would be almost an encouragement to proceed in that indirect way.

6909. *Mr. Lumsden:* Have the Board of Trade received many complaints on this score, that there has been improper dealing?—I do not know of any.

6910. *Chairman:* One has had I think in some of our evidence, of which there is a great deal, cases of people grumbling that their directors have approached them and bought their shares at half-a-crown and then, in a fortnight's time, there was some take-over arrangement and the directors sold their holdings at a considerable profit. I think we have had a certain amount of evidence of transactions of that sort.—The Board of Trade have not had a great volume of complaints about this but I agree with you that that does not mean that it has not occurred.

6911. There has been no great volume of complaints. On the other hand, it is not simply a hypothetical point brought out to seal an imaginary leak.—No, I should have thought not, and I should have thought there was ground for thinking that this sort of thing did happen.

6912. I am reminded that there was the case of the General, London and Urban Properties Limited, in which Mr. Fay was the Inspector, and that that kind of complaint arose there.—*Mr. Clarke:* I think to some extent that may have happened in that case.

6913. I do not think there is any great volume, but I think cases have occurred.—*Sir Richard Powell:* I am sure that is true.

6914. And not so long ago?—No.

6915. Then we might turn to the protection of minorities; and that raises the question of the exercise of the Board of Trade's powers of inspection; and reference is made to section 165 (b) and section 169 (3), which we might perhaps look at. Section 165 (b) (i) enables the Board of Trade to appoint inspectors if it appears to the Board that there are circumstances suggesting "that its business is

being conducted with intent to defraud its creditors or the creditors of any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive of any part of its members or that it was formed for any fraudulent or unlawful purpose". And then there is section 165 (b) (iii): "that its members have not been given all the information with respect to its affairs which they might reasonably expect". Then, in certain circumstances, section 169 (3), gives the Board power to present a petition for the winding up of the company. Now it is suggested that the Board does not make full enough use of those inspection provisions and of those two sections in particular, and complaints are made that the whole process is too slow. Have you anything to add upon that in addition to what you have said in paragraph 49 of your memorandum?—*Mr. Stacy*: The trouble we often find is that when representations are made to us of a case of oppression the facts which constitute, or are alleged to constitute, oppression are already known: we are presented with the full case of oppression; there is therefore no case for us to appoint an inspector (whose job after all is to discover the facts) when the parties affected have already discovered the facts for themselves. It is a fact-finding investigation. If we are already presented with the facts of the alleged oppression, then the oppressed members already have—this has been our view—their remedy under section 210. I know it has been said that that section has not provided as good a remedy as may have been expected, although I believe, according to evidence given before this Committee by Mr. Registrar Berkeley, that there has been an improvement in that respect particularly since recent decisions by the Courts.

6916. There was *Scottish Co-operative Wholesale Ltd. v. Meyer*, a Scots appeal decided by the House of Lords, and *re H. R. Harmer Ltd.* decided in the Court of Appeal—Yes. We feel that if the facts are known the parties have a remedy and can go to the Court under section 210, if necessary getting a legal aid certificate. If in fact they do not fall within the category of persons entitled to a legal aid certificate,

and therefore cannot avail themselves of that remedy, that perhaps is a question of the limit set for the application of a legal aid certificate. If in the light of an inspection there was a good case for the Board to seek an order under section 210 then we would be ready to undertake it. In fact we have not found that sort of case because so often the facts are already known and the remedy is there.

6917. *Professor Gower*: But is not this a bit of a vicious circle? The attitude seems to be that if one makes out a *prima facie* case of oppression, then you say, "We are not going to appoint an inspector because you already know the facts." On the other hand, if you do not make out a *prima facie* case, you say, "You have made out no *prima facie* case and therefore we cannot appoint an inspector."—*Mr. Dean*: But that is not so, if you mean *prima facie* in the legal sense.

6918. With respect, I have known from my own personal experience one or two cases where you certainly required some evidence before you of a pretty strong character before you were prepared to do anything, and have turned people down because they have not produced that evidence.—*Sir Richard Powell*: Surely that is right of the Board of Trade, because I do not think we can plunge in without being reasonably satisfied that there are grounds for it. This is a very difficult problem where we are holding the balance between protecting the public on the one hand and interfering with legitimate business on the other. It is a difficult act of judgment. I think we should be more criticised for interfering unnecessarily than for being perhaps rather slow or reluctant to use these powers.

6919. *Mr. Mackinnon*: But surely section 165 is designed as a sort of prelude to section 210, because it says: "If it appears to the Board of Trade that there are circumstances suggesting. . . ." That seems to me to be a long way short of a *prima facie* case of oppression under section 210. I quite agree the Board of Trade will be criticised for interfering if they do intervene, and they will equally be criticised by minority sufferers for not intervening if they do not intervene, and it

may be a difficult balance to hold, but I do venture to suggest that there is a no-man's land there which the Board of Trade can cover. One gets cases where the circumstances may be highly suspicious and the minority shareholder can get no information from the directors and he gets completely stuck. In those circumstances there is nothing in section 210 to assist him, and there could be a very strong case for intervention by the Board of Trade. Do not think I am being critical of the Board of Trade, but I would venture to suggest that you could intervene long before you reach section 210.—I quite agree and I hope I did not suggest that was the line we would take. I was taking more the point that I think the Board of Trade has got to be reasonably satisfied that there are grounds for intervention before it does intervene.

6920. Of course.—I think, as I have said, that we would be more criticised for excessive use of this power, in circumstances where it turned out it was not justified, than for not using it sufficiently. Whether such circumstances as you have mentioned have arisen I do not know; I have not been long enough at the Board of Trade to know the answer to that.

Mr. Clarke: In fact, there has been an appointment under this section to deal with that particular aspect of the case, but what we find in oppression cases frequently is that they are family cases where both sides have full knowledge of what is going on. They come to us, not really because they want further facts but because, quite naturally, they think they may be able to bolster up their application under section 210 by going to the Board of Trade. If the facts are known, we have not thought that it is the duty of the Board of Trade to start inquiries.

6921. *Professor Gower:* Surely your powers are a little more than that, taking all these sections together, are they not?—I was addressing myself to the point that we were discussing—oppression.

6922. Yes, I was thinking of that. Under the scheme of those sections where you have appointed an inspector you can then, under section 169 (3) and (4) yourselves institute proceedings instead of

leaving it to a shareholder to do this at his own expense, and if you decline to appoint an inspector you strike at the whole possibility of invoking that remedy. Did not whoever drafted this visualise the Board of Trade as a kind of guardian of oppressed investors to act on their behalf? If you turn down the original application for an inspection you hamstring yourselves here, because you then have no power yourselves to take proceedings under section 210 or in the name of the company, and you have no power then yourselves to petition to wind up the company.—That is a question, of course, of interpretation.

Mr. Dean: I do not think the Act intended that the Board of Trade should act as a lawyer for every oppressed minority. I think that if once we have appointed an inspector to find the facts, and if in that case there is public interest, then we might take proceedings. But it is not the case that whenever we have an inspection and find there is oppression the Board of Trade should act as a lawyer for the minority concerned.

6923. You have power to do so?—We should be overriding the legal aid scheme if we started acting for every minority concerned.

6924. Have you ever in fact exercised this power?—Not yet.

6925. Or taken proceedings in the name of a company?—No.

6926. There is one case where, under the wording of the Act, you are told you must appoint unless you are satisfied there are not any grounds—that is section 172 (3) I think—and there is at least one case, I think I am right in saying, where, although the required number of shareholders applied for an investigation, you declined to do so unless they could produce some evidence, which surely is completely contrary to the section.—That would depend upon the application. If the application discloses that the purpose of the parties was not a proper one, or if there seemed to be no good reason for it; we cannot just be used by any party which wants to discover information. I agree the onus is upon us to justify refusal but as I

say it depends very much on the application. If the application is for an inquiry for some purpose which we cannot regard as a good one, then we are bound to refuse it.

6927. Surely in a particular case, which I expect you know as well as I do, there was no difficulty about saying there was a proper purpose? You just played for time by asking for more information. As a result of that the facts came out and the application was withdrawn.—Yes; but the application there was certainly for two purposes, which the Board of Trade certainly at that time did not regard as proper ones. There were reasons given in the application, if I remember rightly, which the Board of Trade were satisfied were not proper reasons, and therefore they turned it down. What they did say was that if the 200 applicants gave a good reason then there would be no difficulty.

Sir Richard Powell: We presumably took the view that the application was vexatious. We have to be satisfied that the application is not vexatious; there is a duty laid upon us to satisfy ourselves about that.

6928. I thought you said that you were not satisfied at that moment that it was vexatious?—*Mr. Dean:* There was no good reason given by all the applicants.

6929. There does not have to be under section 172.—Reasons were given which, in the view of the Board of Trade at that time, were not proper reasons. That must be at the discretion of the Board. If they are so satisfied, I do not think they can exercise that power.

6930. If you said that you were satisfied they were vexatious, that would be one thing, but you did not say that: you said: "At the moment we are not satisfied: it may be vexatious. Give us more information and more evidence."—I think we said that it was being made without good reason, which is part of the definition of 'vexatious'. I think 'vexatious' means "without good reason or for an improper purpose", and if I remember rightly I think it was said that it was 'without good reason'. That was the ground why we would not appoint.

6931. *Chairman:* 'Good reason' seems to have been given a rather special meaning.—The Board took advice on this particular matter.

6932. We have had complaints that this inspection procedure is too slow in its operation, and the effective answer of the Board of Trade to that is that, after all, you cannot go round charging companies with improper conduct, as you are doing by implication if you appoint an inspector, unless you are satisfied there is something in it; and in order to find that out you have got to investigate to some extent, and that takes time?—Yes, unless some good reason for investigation is given at the beginning. In fact, in one case, we made an appointment within four days of the matter coming to our notice. It depends entirely on the case that is presented. If it is merely some sort of wild allegation obviously we cannot move upon it, and it frequently takes a long time to get any definite evidence of any grounds from the complainant. We have gone so far as to suggest in one case that if there was a witness, let him come to see us and he did, and in fact he convinced us that we were right not to appoint!

Mr. Stacy: We have such a large number of appeals made to us to appoint inspectors that if every time we said, "Look, there may be something in this; let us appoint an inspector to find out", we should be appointing inspectors the whole time and doing damage all the way round to the company and to its members generally, and I think it is certain there would be a protest at intervention by Whitehall on this scale.

6933. Then there is another point made, that, having got the statement of facts from the complainant, the Board of Trade sends a copy to the board of the company concerned and puts them on their guard.—First of all, we get the agreement of the person who has made the representations to our passing on his representations to the board for their comments, but that is all part again of the process of making certain that we do not intervene on a one-sided case, because we must hear what the other side have to say.

6934. Can you suggest any means—various people have mentioned this—of evolving some form of procedure under which the order appointing the inspector can be kept secret?—*Sir Richard Powell*: So far as I know, Sir, there is no need to have any publicity at all. We can have a private investigation. I think that it is considered on each occasion on its merits, whether it is or is not in the public interest to make an announcement, but the fact that an inspector has been appointed soon becomes known.

Mr. Clarke: In private companies we do not normally publish—in fact, I remember only one case where we have published a notice of the appointment. As the Secretary has said, it is done in the case of public companies usually because it is thought that already there is a good deal of publicity; and the fact that the application has been made has usually appeared long before in the Press, whether or not an appointment has been made.

6935. Mr. Fay made the suggestion that two inspectors should be appointed for all important investigations, one a lawyer and the other an accountant and he also rather stressed the importance of more clerical assistance than he had when he acted as an inspector.—That, of course, Sir, is generally done in important cases, to have a member of the Bar, frequently a Q.C., and an accountant is also appointed, but there are cases which are not of an accountancy nature and, again perhaps, cases which are not of a legal nature. So that it would probably be right that the Board of Trade should have a discretion. In the case about which you spoke it was certainly thought at first that there was no need for an accountancy inquiry, but in asking Mr. Fay to act we did tell him that we were allocating a qualified Board of Trade accountant to assist him in his inquiry. We always had in mind that if at a later date it became necessary we would certainly appoint a joint inspector. The question of clerical staff is always a most difficult one. If a member of the Bar were appointed alone, of course, then he would need clerical assistance and, as I have said, it is usual when there is an accountant also appointed, that the accountant uses his own clerical staff.

6936. The accountant provides his clerical staff?—Yes, and that is paid for as part of the costs of the investigation.

6937. Yes. So that Mr. Fay's experience was perhaps a little unfortunate, although I appreciate that he was given high grade accountancy assistance.—The Board of Trade, had they thought he was not getting the necessary assistance, would certainly have been only too happy to appoint an accountant.

6938. That seems to be covered. Then Mr. Fay suggested that the inspector should be empowered to take possession of books and documents.—That would be most difficult. It might be helpful to him, but it would be most difficult because as far as books of account are concerned the Act says that they must be at the registered office of the company, or some other place of business, so that they are available to the directors, which is surely very proper. Then again all statutory books, minute books, registers of shareholders, and all that sort of thing, have to be at the registered office of the company, so there again it would be difficult. I think I am right in saying we have not found much difficulty in obtaining, as indeed we are entitled to, information on inspection, and, in fact, when we have gone into most of our inspectors' offices we have found all the company's books lined up being inspected and examined, and so there has never seemed to be a great deal of difficulty, although, of course, it could arise.

6939. Then Mr. Fay's third suggestion, as I have got it noted here, is that the Board of Trade should have power to order an investigation into companies allied to but not actually subsidiaries of the investigated company.—*Sir Richard Powell*: I think that if the inspector engaged on a particular investigation recommended to the Board of Trade that he should have power to extend his investigation into the affairs of a company allied to the one actually under investigation, we should have power to authorise that.

Chairman: I think it might be convenient now if members of the Committee could put any questions they have got on what

we have been discussing so far—and then we could resume after lunch.

6940. *Mrs. Naylor*: Can you conceive of any alternative system to the Board of Trade appointing their own inspectors? I am thinking of the possibility of ensuring minority representation on the board of a company in a situation such as is presented to you, when people are applying for an investigation. At the back of my mind I have the American system of cumulative voting, but I am not asking you to comment upon that, but merely on the general principle that, if there is an application by 10 per cent. of the members for a meeting to be convened, a representative of that 10 per cent. minority might have a seat on the board, say, for a year?—*Mr. Leckie*: Do you mean, in effect, that on a petition by not less than 10 per cent. of the members, the Board of Trade should have power to appoint a particular nominee as a director willy-nilly?

6941. Yes: if the 10 per cent. voted for a nominee, they would in effect be acting as their own inspector?—*Mr. Dean*: Giving that director the powers of an inspector?

6942. No, giving the representative of a minority of a minimum of 10 per cent., the power of a director?—Yes, but such a power would not help very much if he was in a minority.

6943. You do not think that access to books and being present at board meetings would help?—I think in the case of General, London and Urban Properties one of the complainants did get on the board, and it certainly did not help him very much. I think this goes to the whole question of minorities, whether there should be involuntary minorities, or not, and that is really a much larger question. I do not think one can go much further than an inspection if one has minorities.

6944. But it seems to be such a vicious circle. There is the stigma of inspection; one cannot appoint an inspector until the stigma is already there, and so many of these inspections turn out to be mere post mortems because you insist on a case being proved.—Not proved. I still say what is required is some evidence, not

merely a statement of suspicion, but it is certainly not a question of proof before there is an appointment of an inspector.

Sir Richard Powell: I should have thought that a resolution appointing somebody a director by direction of the Board of Trade would have been quite as bad as appointing an inspector, because it would cast just as much of a cloud over the affairs of the company, I should have thought.

6945. *Mrs. Naylor*: Have you any views about cumulative voting as a general principle?—*Mr. Stacy*: No, I think not.

6946. *Mr. Richardson*: If the Board of Trade appoint inspectors is there any difference in practice between the powers they exercise under section 164 and section 165 (b). Section 164 lays down the requirement of an application by a certain proportion, or whatever it may be, in order to make the application valid, and specifically, under subsection (2), the requirement is laid down that "the application shall be supported by such evidence as the Board of Trade may require. . .". Section 165 (a) is mandatory. Section 165 (b) contains words to which Mr. Mackinnon has already referred, but which seem to me to give a wider power than the Board of Trade might wish to exercise under section 164. Does that in fact guide you in practice or not?—*Mr. Dean*: I doubt if in practice there is a great deal of difference because if the application under section 164 is based merely on the inefficiency of the management, then clearly it is not a starter, but if it is in fact based on fraud or misfeasance, then it comes very much into the same sphere as section 165 (b). Therefore, it is very difficult in practice to say that there is any great distinction between the two.

Mr. Clarke: Mr. Richardson, are you suggesting that we should go through the same formalities?

6947. No, I am wondering what different nature of evidence you require, because it is difficult on the face of it to see, as Mr. Dean has said, what is being got at by the section.—Section 165 is not necessarily on an application at all.

6948. No, certainly not.—So that we do not have to sift an application before we go in.

6949. But in practice, although formally there is no application under section 165, I should have guessed that the Board of Trade in fact would act upon a complaint, which in a sense is an application?—Usually, but not always.

6950. Then the other question I want your help upon which concerns me a bit arises out of the General, London and Urban Properties case. I think that during the course of that inspection a take-over bid was in fact made for the company, and my calculation is that the price of the ordinary shares very much turned on whether or not there was a case for misfeasance which could be substantiated. *Prima facie*, it does seem an extraordinary situation that a bid can be made while the inspector is investigating, especially since the bidder probably cannot say what he thinks he knows.—That is the difficulty of the difference between liquidation and inspectorship. If you have a liquidation you have it as a protective measure to look after the assets, whereas with an inspectorship there is an inspection and, until the report is made, not much else.

Sir Richard Powell: There is no standstill.

Mr. Clarke: There is no stopping the directors who still go on with their business as the law stands at present.

6951. Can you think of any measure of protection that might be adopted?—

Mr. Dean: Where it is possible, which might be a rare case, we can get an interim report from the inspectors and publish that; that is, as I say, if it is possible in a particular case. We have published interim reports in other cases, admittedly because there has been a criminal offence; but it could be done in an appropriate case if the inspector could produce an interim report which would indicate the position. But that is going to be very rare because, if he is only halfway through his investigation, he is not able to report very much.

6952. Would the Board of Trade, if those circumstances arose, when inspecting the circular that it was proposed

should be sent out, require something to be inserted dealing with the position?—It has never arisen in practice.

Mr. Osborne: No; but if there were an interim report we should require it to be mentioned before we gave permission; a circular can go out without our permission; and that is not one of the conditions in our rules for licensed dealers. But if a circular came to us for permission, then I am pretty sure that we should in fact require that sort of information to be included; we would consider it relevant information.

6953. If there were a report extant?—Yes.

6954. But if there were no report you would require a statement that an investigation was proceeding?—We have in one case.

Mr. Clarke: If it were a public company we should have published that an inspector had been appointed; and that is one of the important things why perhaps we are right, or why we consider we are right, to publish. There would have been notice given in the Press so that in that way people would know.

Mr. Richardson: I see the force of that.

6955. *Mr. Lumsden*: Could you give us an approximate idea of the number of inspectors who have been appointed under these two sections in the last two years?—I think that there were some figures given in our memorandum. But, to bring those up to date, we have appointed 54 since the new Act came into operation. That is divided between sections 164 and 165.

6956. *Chairman*: Have you separate information about sections 165 (b) (i) and 165 (b) (ii)?—We do not divide them. When we appoint under section 165, under advice we appoint under 165 (b) and we do not appoint under a particular head. Under section 164 there have been 18 inspections and under section 165, 36.

6957. *Professor Gower*: Could we have a breakdown as between public and private companies?—I could give you a note on that, I have not got the information with me at the moment.*

* See supplementary memorandum on page 1607.

6958. *Mr. Lumsden*: Has the Board of Trade ever appointed an inspector entirely on its own?—Oh, yes.

6959. *Professor Gower*: Is it the Board of Trade's view that section 165 (b) would not justify them in appointing an inspector where there was an allegation that the directors had been grossly negligent? Do you regard it as restricted to cases of fraud?—*Mr. Dean*: No. It depends on what the negligence is. If it in fact looks like misfeasance, yes, we would appoint; if it really only boiled down to a complaint about inefficiency, then we would not.

6960. You would appoint so long as in your view an allegation was sufficient to give rise to a legal claim against the directors?—I might so advise.

6961. I think that I am right in saying that in the new Kenya-Uganda-Tanganyika Ordinance, in addition to this power to appoint an inspector, there is power given to the equivalent of the Board of Trade to ask questions of the company and to call for the production of books of account. Would something of that sort, in your view, be workable and useful—because it seems to me it could be done without publicity, without a full-scale inspection? It might not have the same stigmatic effect as the appointment of an inspector; it might lead to such an appointment if you did not get satisfactory answers or if, on production of books, something nasty came to light. But it would possibly serve the purpose of allowing you to make some inquiries of a rather more effective nature than you can do at the moment and without attaching the stigma of a full-scale inspection.—I think it might help. But, of course, one does have this difficulty, that the books

that one gets might not be the books that were there when one asked for them.

6962. I should have thought that if that happened, that might be sufficient reason for the appointment of an inspector.—If one could prove it. But if pages were removed very carefully, it would be difficult to prove, because as you know it is not always easy to find out.

Mr. Clarke: With that sort of provision one could visualise that we probably might get an increase in applications, and we would then have to make up our mind, probably without as much information as we might get in the ordinary way, whether we should go down and snoop about and look into things.

6963. Yes. But surely at the moment you are very reluctant to snoop around because once you do so in practice everybody knows that an inspector has been appointed, and this has an adverse effect on the company; would you be slightly less reluctant if you could do something without that?—*Sir Richard Powell*: I agree, if we could devise means of unobtrusively inquiring without upsetting or disrupting operations, or interfering unnecessarily.

6964. But would you have the staff? *Ex hypothesi*, this would have to be done by your own staff. It would be difficult to enlist outside aid?—As to staff, we have got our own accountants, but they are limited in number and they are not easy to get. I think that if we could find a really effective way of doing this, then this would probably be one case in which some increase of staff would be justifiable. But we would be up against the practical problem of getting them, which we have found very difficult over the last two years for other things.

(Adjourned until 2.30 p.m.)

On resumption

6965. *Chairman*: May we now turn to disclosure of ownership and control. One may begin the discussion by referring to sections 172 (1) and 173 (1) of the Act, which provide for an investigation of the ownership of shares, to put it shortly.

You say in your memorandum that the Board of Trade have interpreted the reference in these sections to "good reason" as requiring, if they are to exercise their discretion in favour of inquiry, that the matter should have some

public importance?—*Mr. Stacy*: Yes, that is so.

6966. How did you arrive at that construction?—On legal advice.

Mr. Dean: I think the view is that that reference does imply a matter of public importance; it really means that the Board of Trade cannot intervene merely to satisfy the interests of some particular individual, but if anybody can put up a case to the Board of Trade which shows some public need for investigation, the Board will investigate. They would not do it merely for the private purpose of the individual, unless, as might be possible, there was a private interest which also showed public interest as well.

6967. Those sections do point the way to a method of requiring disclosure so far as they go, and it has been suggested in our discussions that possibly a solution of this difficult question of disclosure might be found in some modification of these sections, so that possibly the directors of a company could call in aid the Board of Trade to make such an investigation, the procedure thus being made easier than it is at present.—*Mr. Stacy*: I would think there should be protection against too ready an appeal by directors for an inquiry by the Board of Trade. I think it would be acceptable, providing that the directors bad again, as in these other cases, to show good reason why the inquiry should be made.

6968. You have to prevent frivolous and malicious inquiries, and that kind of thing.—I do not think we could rest happily on the assumption that directors would never make unjustified inquiries.

6969. The difficulty would be that if you had a board of directors, one half might be in favour and the other against, and you would probably get representations from both sides.—I would have thought that we would want representations from a united board.

6970. You mean a simple majority of the board instead of requiring, as now, an application by a minimum proportion of the shareholders. I would say that is a possibility. Apart from that you discuss

the system of nominee holdings and its usefulness, and you say that the difficulties foreseen in the past may be less if the obligation to disclose is not imposed in respect of too small a holding. "Thus it might be possible to require disclosure whenever a person acquires control of 10 per cent. or more of any company's ordinary voting rights, wholly or partly through beneficial interest in nominee holdings". As I understand it, therefore, you would impose an obligation to disclose the fact by any person when he acquires control of 10 per cent. or more of any company's ordinary voting rights. Variants of that formula have been suggested to us, but generally the view seems to be fairly strongly held by witnesses that although disclosure would be eminently desirable in many cases the administrative difficulties would be too great. Could you tell me how your scheme would be operated?—*Sir Richard Powell*: May I say first of all that I do not think we have a scheme. This was an idea we thought we ought to put to the Committee for consideration, but we have not fully thought out scheme at all. I think the only way it could be policed would be by providing heavy penalties for discovery after the event, so that you would get a deterrent effect. I do not think you could police in advance. At least I could not think of a sound method of doing that, but if you had a sufficiently heavy penalty which you could impose upon defaulters if you discovered them after the event, that might be the solution.

Mr. Stacy: It has been represented to us strongly that it is important that when a substantial proportion of the voting capital is secured, it should be disclosed in the general public interest, and we have a feeling that we should not continue to be deterred by arguments, doubtless well founded in some measure, as to the difficulty of implementation. We think that one can be deterred too long and too much by that, and that there is perhaps a case for a deterrent. At best, of course, there will be difficulties.

6971. You would put the onus on the individual?—*Sir Richard Powell*: Certainly, Sir.

6972. And no one would know in the first instance whether individuals were complying with their obligations or not, but you think that if a heavy enough penalty was provided, then a man would not resort to subterfuge because the risk of being found out was too serious?—Yes, that is the theory that we have. In fact, it is the only way we could think of doing anything about this. It seemed to us a matter of sufficient public interest to justify trying to do something about it, balancing that against the risk of having something which was not enforceable. In this case I think I would be inclined to throw the balance on having something, even though difficult to enforce, rather than the other way.

6973. *Mr. Brown*: What sort of penalties have you in mind as a deterrent?—It would have to be some pretty heavy financial penalty. I do not think we have got as far as considering that, but it would have to be pretty stiff.

6974. *Chairman*: You measure it by control of voting rights and not by shares held?—Yes, we think beneficial interest would be too difficult to establish.

6975. Then you could come within the sphere of this if you had a voting agreement of any kind, I suppose?—You would have to, I think.

6976. Voting rights could be divorced altogether from the shares?—Yes.

6977. It has been put to us that the best way is to put the onus on the beneficial owner, on the ground that, if you put it on the registered holder to declare, such institutions as banks which hold thousands of securities on nominee account will have their position made quite impossible.—*Mr. Dean*: I think the idea is that if a person has control of 10 per cent. of the voting power, the company should know that he has that control. The offence would be if somebody had such control and did not declare it.

6978. It would be better to base it on voting power than on beneficial interest?—Yes.

6979. *Mr. Lawson*: Will you not have difficulty where voting power is given as

part of a security for loan? What would happen if a bank lends money on those terms? Would the bank have to disclose?—Unless one had an exception for that sort of case, yes. There may be a number of cases which would justify exceptions; we have not thought out a scheme to deal with all difficulties, but are putting forward a general proposition. It may be that it will work even with a number of exceptions, if it was thought desirable.

6980. *Mrs. Naylor*: If the financial penalty was so heavy as to be a deterrent, do you think public opinion would be behind it? Apart from it being a breach of the statute, is this a moral sin?—There are statutes now which allow unlimited fines on indictment. It is not unusual.

6981. Are the fines often imposed?—Very substantial fines—£10,000 or so, not in this class of case, but in the cases where it does now arise.

6982. *Professor Gower*: Another possible solution would be one similar to section 174, whereby you can make an order freezing the shares. If you had power to make an order that, say, for six years the voting rights of the shares should not be exercised, that might be a potent deterrent.—I do not know what the effects of that might be on the companies, if one were to freeze the shares.

6983. *Mr. Althaus*: There are two kinds of concealment really, one where a man is trying to acquire control or a dominant voice in a company, and another where he has it, but does not wish it to appear publicly, and is represented by a director on the board. It might be a good thing if the director were known to be a nominee of such a person, and he would be to that extent, if there were heavy penalties, less likely to encourage his principal to conceal the fact.—Yes.

Chairman: This is a very important subject, and I would like to have any views which members of the Committee care to give on it.

6984. *Sir George Erskine*: I would have thought that trying to control the voting rights would be a very difficult thing. In

certain circumstances the preference shareholders may be given voting rights.—*Mr. Stacy*: We are rather thinking of control of the ordinary voting rights attaching to ordinary shares.

6985. *Mr. Lawson*: I suppose if you had a penalty, even though the penalty was nothing very tremendous a very high proportion of people, particularly in public companies, for example, would in fact carry out the requirements of the law, because of the mere fact that there was a law and a penalty for that sort of thing?—*Sir Richard Powell*: I think that is right. There is a predisposition to observe the law in that case.

6986. *Professor Gower*: You do not think 10 per cent. is too high? It is a very large proportion, say, in the case of I.C.I.?—*Mr. Leckie*: I think the principle in mind here is that a person acquiring the shares might be doing so in a way of which the directors of the company do not know, and they would have somebody, as it were, creeping up on them, gradually acquiring control of the company. We thought of 10 per cent. as a compromise between too small a figure where there is no justification or requirement for disclosure, and too high a figure where disclosure would be too late. The 10 per cent. is a compromise, in that sense. In a very big company such as I.C.I. the chances of an individual acquiring control by buying up the shares is, I think, a little remote.

6987. *Mr. Brown*: It would seem that there are two broad approaches to this. One is a general disclosure of a continued interest. I would have thought that, by and large, this would meet that case. The other case is that just mentioned, of acquiring an interest, and there is a greater chance that the individual concerned will conceal despite a deterrent. It would still in a number of cases cover the point, but not necessarily in all cases. It would, however, have some effect on 95 per cent. of people.—In that latter type of case, if the acquirer went on acquiring, at some stage it would become clear that he had acquired not only 10 per cent. but a great deal more. Then, if he had not disclosed at the 10 per cent. point, surely the question would be raised as to why he had not done so.

Sir Richard Powell: I do not think you need limit it to a financial penalty in that sort of situation.

6988. I think one must go on to say, "What after 10 per cent.?" If you have disclosed at 10 per cent., have you to go on disclosing every time you buy? That sort of thing could be a nuisance to perfectly honest transactions; and it has to be done on purchase, not registration, to be of any use.—*Mr. Leckie*: At least the directors would know who it was.

6989. *Mr. Richardson*: Is that actually what you are out to do?—*Sir Richard Powell*: To give the directors knowledge, and the other shareholders, too.

Mr. Lumsden: The proposal is that this would be made known to the directors, who would immediately be bound to make it known to the public, or the other members.

6990. *Professor Gower*: The American solution is that they treat 10 per cent. shareholders in this context as directors. That in a way is what you are suggesting; anybody who holds more than 10 per cent. of the ordinary voting shares has to register his dealings as if he were a director?—*Mr. Leckie*: It is on that line.

Sir Richard Powell: I can see we might have a situation in which there was an agreement between a group of people each holding less than 10 per cent., whereby they acquired a very large or dominant share. You would have to do something about that too, I should have thought, in that sort of situation to make it very effective.

6991. *Mr. Mackinnon*: Would it not be fair to say that if you had this obligation imposed, sooner or later the breach of it would leak out, almost inevitably if someone were buying? It is hardly likely to remain dormant, so that the penalty must be fairly effective, because the guilt will almost certainly be revealed.—I would have thought that would be so; and once you got one I think it would stop a lot more.

Mr. Brown: I think there was a question raised previously about the difficulty, say,

of family trusts, or reversionary interests. It might be that these holdings involve a conditional potential right to more than 10 per cent. without the individual concerned knowing about it.

Chairman: If, as is now suggested, it is measured by voting power, then it is improbable under the ordinary settlement that the beneficiary will have the right to vote.

Mr. Brown: Surely you have to cover not merely the acquisition of 10 per cent., but the right to acquire 10 per cent., i.e., having an option? They also should be registered.

Sir George Erskine: You also have the converse case, where there may be nominee holdings in the interests of persons friendly to the directors and these might be well known to the directors.

6992. *Mr. Watson:* I am not clear just why the Board of Trade have raised this point. Is there some difficulty that has emerged in the course of their administration of the Act which has caused them to think along these lines?—*Mr. Stacy:* It is based on representations addressed to us.

6993. From companies or directors who have been without this information when they thought they should have had it?—No, I think it is rather on the general basis of the need for more information being made available.

6994. But is it right that there have been complaints that this information has been lacking?—Yes.

Sir Richard Powell: I think we have had Parliamentary questions asked, and that sort of thing, on this point. There were take-over bids happening by stealth. There has been a lot of public concern about it, and that is really why we put our note in.

6995. It is not really any result of breaking the law as it stands?—No.

6996. *Chairman:* We can pass now, I think, to associated and subsidiary companies. In the course of our discussions we have had suggestions that particulars

of associated and subsidiary companies should be included in the parent company's accounts, and it has also been pointed out that such disclosure might be harmful in some circumstances. Some people thought also it was not much good leaving it to the directors' discretion to decide whether it would be harmful or not, and it was therefore suggested, as usual, that the matter should be referred to the Board of Trade, who, of course, could at once say you must disclose these interests, but you need not disclose these other interests. I want to know if the Board of Trade would be prepared to take on another function of that sort?—*Mr. Stacy:* No, Sir. We think that this is sufficiently important to make a general requirement, in the public interest, of as much disclosure as possible with regard to the holding company and its subsidiaries and associated companies and, indeed, the other way round. It is important that this information should be made available, and although we have seen the sort of criticisms that have been made, we are still not satisfied that they are adequate reasons for not pressing this matter, and we would wish to see it pressed to the point that there should be no exceptions to the requirement. We think it important enough that there should be no exceptions.

6997. Even if the company met and passed a special resolution to the effect that these entries should not be disclosed?—It depends on the grounds on which it was thought that the disclosure would be detrimental.

6998. There have been a number of examples given. I cannot remember them all, but there is a case where a company sets up a branch business in foreign parts, where perhaps political feeling might be rather difficult. In cases of that kind it was said that it would be harmful to them, or increase the difficulties of such companies, if they had to disclose their relationship with the overseas company. Do you see what I mean?—Yes, as regards the interest in foreign countries, there might possibly be more of a case there. We were thinking rather of the kind of argument involving the company which is making two types of products, and did not want it to be known that the cheaper

and not so good product was being made by a subsidiary.

6999. Then there is the case of a manufacturer embarking on retail trade, and not wanting his customers to know that he is in competition with them. But I think possibly the most convincing case is the one about the difficulties of companies carrying on business abroad.—Yes, we were not satisfied on the domestic arguments that they were sufficient reasons for the public not knowing. I suppose there might be a case where foreign interests are concerned.

Sir Richard Powell: I am trying to think of any case where that might be so. I do not think the British American Tobacco Company have ever said that they were handicapped by the fact that they declare their overseas interests, and there must be many in the same boat. It seems a difficult argument.

7000. *Mr. Lumsden:* There might be a company who had a subsidiary trading in Israel, and did not want it to be known that another subsidiary was trading in the Arab countries, and that sort of thing.—That might be a case.

7001. *Chairman:* It seems difficult to foresee all eventualities. I started by asking whether the Board of Trade would assume the burden of deciding in particular cases whether disclosure ought to be made.—I think it would be very difficult to have that sort of discretionary power, or to ask us to exercise it. I think if it could be more closely defined, perhaps limited to companies with subsidiaries overseas, that might be a more manageable job, but to give complete discretion to the Board of Trade I would have thought would get us into great difficulties. I would not have thought, for example, it would be right to give us discretionary power in the case of a group of companies, one making a better and the other a cheaper quality product. I really cannot see any kind of public interest policy or any other ground for concealing that. There may be more force in the case of the overseas subsidiaries, especially in the case that Mr. Lumsden mentioned, but I think that will have to be thought further about before I would care to commit myself.

On the whole I would feel that the less discretionary power in this sort of thing we had, the better it would be.

7002. So on the whole you are in favour of having such a requirement as to disclosure without any exceptions, except possibly the overseas company?—That is a view I give off the cuff at the moment, but I think it would need further thought on our part before we give you a considered opinion.

7003. I see. Then perhaps we can pass on to the next point on this. It was pointed out that this suggested requirement should extend to associated companies as well as subsidiaries. The definition of "associated companies" would be companies in which a holding company holds 25 per cent. or more of the shares, for instance.—*Mr. Stacy:* Yes, we have in mind that it would extend to associated companies.

7004. You think that, if any provision of this sort is made, it should cover associated companies as well as subsidiaries as defined by the Act?—*Mr. Dean:* I think it would be difficult to define associated companies in its usual wide sense but the requirement to disclose control of 10 per cent. of voting rights might be useful in this connection.

Mr. Brown: But this goes much further; the holding company would be required to give figures about its associated interests, the profit earned and not distributed, and things like that. The disclosure of the 10 per cent. holding would not give as much as that.

Chairman: There were competing views, and one view would be satisfied with disclosure of such information *en bloc* without distinguishing between the individual associated companies.

Mr. Lawson: And without giving names. I think there would be some difficulty about giving names of subsidiaries. Figures might be given *en bloc* about the results of these associated companies—that is much easier than giving individual names, is it not?

7005. *Chairman:* Would that be a reasonable variation?—*Sir Richard Powell:* I should have thought it was.

Mr. Stacy: It depends how far you want to press this question of disclosure of information.

7006. Perhaps we can pass on from that to our next point, which is the proposal made by the Board that a holding company should be responsible without limit for the debts of its subsidiaries.—On that I would like, if you would agree, that Mr. Clarke should tell you what we think about the evidence of abuse.

Mr. Clarke: The only evidence which we see in the course of liquidations where we do find that parts of a business, which are perhaps unprofitable, have been hived off to subsidiaries, together with liabilities. The holding company in this way gets rid of what is in fact a liability, there are inter-company transactions between the subsidiaries whereby, for example, loans are made by one company to the other, with the complication of guarantees, probably, for the debts and liabilities of other companies within the group, for which the particular guarantor company has received no consideration or benefit. These guarantees may have been backed by debentures so that the ordinary creditors, other than the group creditors are going to get nothing in the course of the liquidation. We were rather looking for something that would help us to deal with this sort of thing. The way suggested was some payment by the holding company. One might, again, think along bankruptcy lines and defer the subsidiary company creditors until other creditors had received something. The abuse certainly occurs in only a few companies because we are only dealing with the few which are liquidated. Nevertheless, there is an evil which there might well be some attempt to remedy.

7007. *Mr. Lawson:* What would you do about the case of a holding company which buys the equity capital of a subsidiary, the subsidiary already having debentures? There may be cases where it is a valuable thing for a new financial interest to come in and buy up a company of that kind, but surely they would not be expected to guarantee debentures which were issued, *bona fide*, before they came on the scene?—I think there are cases of that kind, and I think clearly there would have to be exceptions here.

7008. *Sir George Erskine:* I gather you are thinking along the lines of wholly-owned subsidiaries?—It is, of course, much easier to apply it to wholly-owned subsidiaries, because if you find a subsidiary with a 51 per cent. holding company and somebody else holding 49 per cent., it is a little hard to put the whole liability on the holding company. Perhaps a proportionate payment could be required.

7009. You might have a subsidiary which was a public company, even a public company whose shares were quoted.—Yes, I would hardly think that that sort of company would be allowed to go into liquidation by its holding company in the first place. It is rather where the holding company is perhaps responsible for the liquidation of its subsidiary in which this sort of thing occurs.

Mr. Stacy: I think a good many of these proposals where we have been moved to make representations are rather suggestions in principle to cope with particular weaknesses, or to meet what we see as a responsible public demand. We have made broad suggestions of principle in order that we may be on record as in favour of that, without having pursued the thing to the limit of seeing what exceptions would be necessary and so on, because we rather feel that if we start doing that we are perhaps trespassing on your territory. Admittedly several of these suggestions would be subject to exceptions to cover particular cases, such as those mentioned on this subject.

7010. *Mr. Bingen:* In the cases where you have had inter-company transactions and subsidiaries going into liquidation, have you found the holding company still solvent, and that if you could have had recourse to the parent you would have been better off?—*Mr. Clarke:* I would say at present that they remain with their heads above water. What happens eventually, of course, one cannot always see, but they have real assets, other subsidiaries and that type of thing; they have probably let one or two go, which possibly should not be allowed to go, because of the way they have been financed and in fact incorporated and started.

7011. *Professor Gower*: It is a case of going to the holding company to get recourse, is it, rather than to make sure that the holding company is not allowed to claim for the amounts it has loaned to the subsidiary?—That is clearly the other way of doing it which I did not mention. The first may be by a payment, and the other may be by the deferment of debt, certain creditors coming in after the others had been paid in full or in part.

7012. *Mr. Brown*: Whilst the point is very interesting, you are not suggesting that it is a widespread abuse?—No, I did make the point that I am speaking now of a knowledge of compulsory liquidations which has run between 300 and 400 only for some years; so there cannot be a great number, but the number is sufficient to make us think about it. After all, groups are increasing, and these evils have been noticed comparatively recently where they were not a few years ago.

7013. *Professor Gower*: You would not suggest that in all the cases where there has been this sort of fiddle it has led to compulsory liquidation? There must be a great many cases where they have succeeded in hiding this up by voluntary liquidation?—One would always think that is so, Sir, and perhaps some have just managed to weather the storm and go out of existence.

7014. *Mr. Mackinnon*: But would you introduce your proposal to cover existing cases? I am thinking now of a creditor who has given credit to the holding company. He could be affected by imposing such an obligation.—Yes, certainly.

7015. *Mr. George Erskine*: Would it be logical to apply your proposal to outside preference shareholders, who might equally be left in the lurch?—I am thinking here of a company in which, unfortunately, the shareholders have lost interest in any case, where we are dealing with ordinary creditors. I have not extended this to the question of there being assets available for shareholders, in any case.

7016. But under your illustration, I understood you talked about cases where,

by having guarantees supported by debentures, the parent company in the end would be able to get out at the expense of the ordinary creditors. I presume that would be equally so as far as the outside shareholder is concerned?—It may well be.

7017. *Professor Gower*: The Americans have the "Deep Rock" doctrine, which is similar. The claims of holding companies in these circumstances may be postponed, even the claims of preference shareholders. We really want something like that.—That is the sort of thing that would meet the suggestion.

7018. *Mr. Watson*: And I suppose the whole basis of your case rests on the fact that credit has been extended to a subsidiary company because it has been known to be the subsidiary of another company?—That may well be so, yes, or businesses have been sold to a subsidiary company with liabilities already attaching.

7019. And the creditor has been agreeable to transfer his claim?—I do not know whether that would come into it. If a business was taken over by a subsidiary company the debt might have to go with the business, but that might well be a novation and perhaps we have to think of liabilities only incurred after the formation.

7020. And your suggestion is on the basis that credit has been extended to this company just because it is known to be a subsidiary of another, bigger company?—And, of course, to some extent that holding company has financed and mothered the subsidiary.

7021. In the absence of that public knowledge there would be no case, would there?—I should think probably not.

7022. *Chairman*: There would be lots of ways of getting round any law about making the holding company liable—the subsidiaries would cease to be subsidiaries simply by somebody transferring his shares.—That is always the difficulty in these groups, of course.

7023. So this suggestion is obviously the simple thought which would be very much expanded?—Very much.

7024. Then it has been suggested to us, in regard to loan capital, that registration of satisfaction of a charge should be made obligatory. That may not seem a very important point, but it has been pointed out to us that apparently in the provisions of the Act dealing with debentures, there is no provision making the company, where a debt is paid off, enter satisfaction in the register. I do not know if any of you have any ideas why such an obligation was not imposed?—*Sir Richard Powell*: I do not think we do know why. I think this seems to be a genuine point here. Failure to register satisfaction of charge could mislead creditors, and lead them to settle for less than they might have done.

7025. They might think the company was a lot worse off than it really was, and that if they got half-a-crown in the pound they would be lucky?—Yes, that does seem to be a very fair point. I think the problem, again, is one of enforcement. It would be very difficult to enforce a rule of this kind except on complaint made to us. I do not know that we would have any means of going out ourselves and enforcing a rule of this kind. It would have to be covered, I think, by some reasonably substantial penalty for failure to comply, and then be followed up when we received a complaint from some aggrieved person.

Mr. Scott: Would a creditor not be more affected by a company's balance sheet than a company's registration of a charge, which might or might not still be in force? Would he be misled if he found a debenture outstanding on the register which was not shown in a company's balance sheet?

7026. *Mr. Lawson*: Is it not sometimes convenient to leave the charge on the file in the case of a debenture issued to a bank, because the overdraft might be discharged, and in another six months granted again?—*Mr. Stacy*: We are not clear about what caused this representation to be made, or what is at the back of this comment.

7027. *Chairman*: The theory was that when a registered charge was paid off, in

order to keep the register straight it ought to be someone's responsibility to enter a memorandum of satisfaction. As the law now stands, there is no one who is under any obligation to do it. It is proposed that the company should do it.—But what was worrying whoever made this comment, apart from the liability of keeping the register?

Chairman: I think, having a charge in fact paid off, and continuing to show the charge in the register might mislead people.

7028. *Professor Gower*: It is difficult to see why it should, because the total amount of mortgages have to appear in the registered annual return.—*Mr. Osborne*: The annual return may be out of date, and the mischief done by then.

7029. *Chairman*: That might be the practical answer.—*Sir Richard Powell*: It does seem untidy to have the charge registered and the satisfaction not registered. I think that is about as high as you can put it.

7030. The next point deals with the register of debenture holders and section 86. The section does refer to a register of debenture holders as something that must not be kept in Scotland or England, as the case may be, but it imposes no obligation to keep any register at all, and section 87 provides that every register of holders of debentures in a company shall be open to inspection, and so forth. There again, no positive obligation is laid on anyone to keep such a register. Do you think that the omission of any obligation was because the register of debenture holders mentioned in these sections was assumed to be a register of debenture holders kept in accordance with the terms of issue?—*Mr. Dean*: One suspects that that was the reason for it, yes.

7031. And if you have such a register, it is desirable that it should be open to inspection. If it was not open to inspection it would not be very much use. I want now to ask you whether, in your view, it would be desirable to put any section in this part of the Act laying upon the company an obligation to keep a register of debenture holders?—I do not

know that the Board of Trade have any particular views on whether there should be a register of debenture holders or not, or whether there is any good reason for it or, if there should be a register, the holders of what debentures would have to be registered—whether it is, or might be, material in relation to secured debentures only, or whether it should extend further. I think that is a matter on which the Board would like the Committee's views.

7032. There might be some confusion, because so many different kinds of documents have been held to be debentures.—Ob, yes. I am not sure whether a Customs Bond may not be a debenture.

7033. And it cannot be extended so that a register should be kept of all these sorts of details.—It would make a company's life intolerable, I think.

7034. *Professor Gower*: Where there is an issue of debenture stock a register could be kept.—Yes. If there were some good reason for having a register that could be so.

7035. *Chairman*: One could have some provision whereby if a company has issued any debenture, the terms of issue of which require a register to be kept, then the register should be kept in accordance with the contract. Is that what it comes to?—Yes.

7036. *Mr. Bingen*: And the register might be kept by the trustees instead of the company. The trustees might be made responsible.—Yes.

7037. *Chairman*: A register also serves the purpose of enabling the debenture holders to act as a body. Turning now to take-over bids the Board of Trade's new regulations for licensed dealers seem to have secured almost universal approval. You think these regulations should apply to take-over bids whoever is concerned with them and not merely licensed dealers?—*Mr. Stacy*: Yes. In the notice which we put out announcing these rules we said that we expected them to be observed through whatever channels take-over bids were effected, and we would like to see them given legislative sanction.

Sir Richard Powell: We should like under a new Act to have the power to

issue rules and amend them as necessary in order to keep them up-to-date. It would not be wise to "freeze" these rules by writing them into the legislation.

7038. That seems to be a better way of doing it, certainly.—*Mr. Stacy*: There seems to be in some quarters the impression that these detailed requirements were introduced by the Board of Trade because they were directed towards licensed dealers. Perhaps there was a feeling that licensed dealers needed to be kept under particularly strict supervision but that is not the case at all. We did not think only of licensed dealers when drawing up the rules but of what was generally desirable in regard to take-over bids. It so happened that under the Act we were prescribing for licensed dealers.

Sir Richard Powell: That is the only category of dealers to whom we can issue rules.

7039. But the issue of a prospectus, complying with the Companies Act, would suffice in some cases?—Yes.

7040. The provisions are to some extent alternative?—*Mr. Osborne*: They are alternative. Where the prospectus provisions of the Companies Act apply then the provisions of the rules for licensed dealers would not be relevant.

Mr. Stacy: If the prospectus provisions were changed we would have to take that into account and would have to amend the rules.

7041. Then, you take a rather pessimistic view of human nature in regard to take-over bids because you say that you doubt whether anything would be gained by requiring the offeror to state his intentions as to the future of the company to be acquired.—*Sir Richard Powell*: Such a statement would not be capable of enforcement in law and it would be unreasonable to expect someone to bind himself in advance without having the chance to see what he could do either with the business or the employees of the company. He could not reasonably be asked to bind himself in advance to make no changes or to make specified changes. I certainly do not think it would be reasonable to expect a condition of that kind to

be enforced by law. It is one thing for the bidder to say in advance what his intentions are if he wishes to do so but it would not be right to try and compel everyone to do that.

7042. It is not worth inserting that sort of thing into the legislation?—It would be a mistake to put it into the legislation; there are other and better ways of doing it.

7043. *Mr. Bingen*: Supposing company A took over company B and supposing the directors of company A know exactly how they could streamline and integrate the two companies and whether it would be necessary to put some people from the two companies on the labour market, would it be wrong for company A to say that as far as could be seen they were going to do this or that?—*Mr. Osborne*: Until they have the power to go in and examine the way the business is being run it is difficult for them to know what should be done. They may wish to rationalise and to find out whether it will be necessary to reduce the number of staff employed but they cannot do so until they know what is there.

7044. But they could give a broad indication of what they thought their policy would be as they saw it at the date of the offer, could they not?—*Mr. Dean*: It might lead people to tell deliberate lies. If someone wants to take over a company he might in those circumstances introduce into the circular he addresses to the shareholders something which is quite untrue. It would be a mere statement of intention which no one could enforce and therefore anyone could say whatever he chose.

Sir Richard Powell: Certain other difficulties would also be involved. To say something in advance and then to draw back on it is not a desirable thing to do.

7045. I am thinking in particular, of course, of the employees' interests.—If a weak provision were inserted into the legislation it would be of very limited use; it would be better to deal with this by other methods.

Mr. Stacy: The recommendation that a statement of intention should be required

amounts in effect to a code of conduct which is quite different from something inserted into the Act.

7046. *Chairman*: We will have to think more about this. One sympathises, of course, with the employees and I think it would be a good thing if possible to give them an assurance; but an assurance which cannot be carried out is obviously worse than no assurance.—*Sir Richard Powell*: So also is an assurance you cannot enforce. The statement at the time it is made might be a perfectly genuine one but, in the case both of the deliberate lie and the genuine misconception of what was going to happen afterwards it would be hard to compel someone to stick to a statement he had made when at the time he did not know the full facts.

7047. *Mr. Brown*: Contrary to other recommendations, the Board of Trade's view is that the directors of an offeree company should not be obliged to give information but that if they do give advice it must be in full. Other views are that the directors of the offeree company should be obliged to give any information they can and to make recommendations. Would the Board of Trade hold the same view if the directors of the offeree company were aware of certain information which had not been published and which would affect the views of their shareholders as regards accepting the bid?—*Mr. Dean*: We have not got the power to prescribe what information should be given by the directors of an offeree company. All we can prescribe is what information must be sent out by a licensed dealer and that if a licensed dealer sends out any document on behalf of the directors of the offeree company it must contain all the relevant information.

7048. If there were to be any new legislation you would not object to something being written into it?—If it was thought to be a good thing no objection would be made.

7049. Would it be a good thing if the directors had information which the shareholders had not got?—*Mr. Stacy*: I think if the offeree directors give any sort of information it must be everything, but in the case of an offeree company there

might be a case for the directors remaining completely neutral and saying nothing at all.

7050. If they know something which affects the argument, something which the shareholders do not know, I think an obligation should be placed upon them.—*Sir Richard Powell*: I agree. I think that is right.

7051. *Mr. Lawson*: Can you not imagine cases where the directors of offeree companies might be placed in a very embarrassing position because without consultation they receive notice of a take-over bid whilst they themselves might be carrying on negotiations of great importance and of a delicate nature which, in the interests of their shareholders, ought not to be made known at that time? Are they to be forced to make information of that kind available merely because some other chap has come along and made a bid for the shares of their company?—*Mr. Stacy*: No, there might be a case for the directors remaining completely neutral. It is only when they say something about the offer that the material facts should be given but they should be free to pass on the offer without comment.

7052. If the offeree directors were required to comment, someone could force information out of the directors merely by making a take-over bid, could they not?—*Sir Richard Powell*: In the situation you have described, the directors would want to say something but in their own time—when they would circularise the shareholders and disclose the facts. The directors of the offeree company should not be obliged to say anything until they feel that the appropriate moment has arrived.

7053. *Mr. Brown*: When it might well be too late.—Yes.

7054. *Mr. Bingen*: The directors of an offeree company have a duty to their shareholders. If an offer has been made and if there are other negotiations pending I would have thought it might be possible for them to say "Please do not deal with this now. We have other negotiations pending". I should have thought that would have been a fair and reasonable way to deal with it.—That has happened.

7055. *Mr. Lawson*: My objection would fall to the ground if all they had to do was to say that they did or did not recommend the take-over. However, I think the proposal goes further than that and is to the effect that an obligation should be put upon them to provide up-to-date information about their company.—*Mr. Stacy*: If they went so far as to recommend one way or the other then they should tell the whole story, but if they did nothing to influence their shareholders and passed on the offer without comment we are not satisfied that any obligation should be imposed upon them.

Mr. Osborne: If the directors themselves are making the offer for their company's shares it may be fairer for them to say nothing at all.

7056. *Mr. Lumsden*: Regarding paragraph 87 where you say "Difficulties have arisen on the question whether acceptance of a take-over bid can be regarded as irrevocable on the part of the acceptor while the offeror retains the right to terminate his offer at any time until it has been declared unconditional". I have always felt that this one-way option was a little unsatisfactory. However, I would like to know from your experience of this what sort of difficulties have arisen. I take it you are referring to the usual formula of the offer being subject to acceptance by, for example, 90 per cent. of the shareholders which gives, in effect, a one-way option.—I think part of the difficulty arises from the fact that it is not really known whether such an acceptance is really irrevocable or not. It has happened sometimes that the offeror who has failed to get control has held the accepting shareholders to their acceptance and has then sold to another offeror at a higher price.

7057. That is what I wanted to hear. You have had complaints?—Yes, certainly, to that effect and it does not appear to be certain whether an acceptance is or is not irrevocable once it has been given. It is becoming very common now in the form of acceptance to insert the words "irrevocably accept" but if the acceptance is made irrevocable it would seem to give an unscrupulous offeror the chance to earn a

disbonest penny if another offeror comes along with a better offer half-way through.

7058. Your suggestion is that it should only be irrevocable if the minimum number of acceptances is not less than would secure voting control.—Yes, because that sort of thing could not then happen.

7059. *Professor Gower*: Is not one of the weaknesses this: there may be circumstances in which other information apart from that given under these regulations ought to be provided. Mr. Osborne in reply to an earlier question said that where the offeree company is under the Board of Trade's inspector he would require something to be said about this in any take-over circular. There is nothing, however, in the Board's regulations for licensed dealers to this effect. An offer could go out without any of the information you thought right in the circumstances being there at all. Is there not some case to be made for saying the Board of Trade ought to have a supervisory power over this and the right to insist on something else being put in, where appropriate, in particular circumstances?—*Mr. Stacy*: What has held us back from including further requirements of this sort in the rules is this: we thought we might be felt to be anticipating the recommendations of the Committee. We therefore waited in some respects before including them in the rules. Had it not been for that we might have included further requirements.

7060. I am going further than that because you can do one of two things; either you can put in everything you can think of or you can admit you will not be able to think of every eventuality and therefore require that before anyone can make a take-over bid, the offer must be registered with the Board of Trade or with the Registrar of Companies and cannot be sent out until after three days, during which time the Board has the power to insist that the offeror must put something in. That is what happened under the old system when you went to the Board of Trade to get their consent.—*Mr. Osborne*: We should have to give our consent to all offers which were made.

Mr. Stacy: We do not want to get into a deeper situation than the one we are in already with regard to supervising take-over bid circulars.

7061. *Mr. Bingen*: If a licensed dealer makes an offer you do not have to vet the circular but if a company makes one they have to send it to you. That seems to me to be very odd.—*Mr. Dean*: The Act provides certain channels through which these documents may be sent out. Admittedly a document may be sent out with the permission of the Board of Trade but it was the scheme of the Act that most of them would go out through the authorised channels and only in the exceptional case would the Board of Trade be concerned and have to give permission.

7062. But the large-scale company would make an offer direct?—The Act does provide that it should normally go out only through authorised dealers. There is a provision that the Board of Trade may give permission but the whole set-up of the Act provides that such invitations must normally go out through one of the authorised channels.

7063. Is that a reasonable thing or would you like to see some change? Do you think that companies should themselves be unable to make direct offers without the Board of Trade having to see the circulars.—*Mr. Stacy*: It is provided under the Act that offers should be sent out through certain authorised channels. That is the scheme of the Act. Whether that is right is under review by the Committee. However, there is also this provision that in what was intended to be exceptional cases, cases which do not fit into the outline of the Act and which cannot be despatched through the authorised channels, there should be recourse to the Board of Trade. In fact, there has been much more recourse to the Board of Trade than the Board of Trade like.

7064. Do you think that is a reasonable sort of set-up?—I would have thought not.

7065. *Professor Gower*: From the point of view of the protection of the public there can be little doubt that Mr. Osborne is going to require much more scrupulous

statements of the relevant facts than some licensed and some exempted dealers have made in the past. That is the difficulty.

—*Mr. Osborne*: If the new Act prescribes the sort of information which must be given, if it says that in respect of all offers made through whatever channel this is the information which must be provided and if there were a provision for further information to be required through an amendment of the rules, subject to that general outline being prescribed in the Act, I do not think we would want the Board of Trade to go into the matter more than that.

7066. That assumes you can think of all the facts which are known to be material. If a Board of Trade inspection is going on and the take-over bid does not go through Mr. Osborne, nothing may be said about it.—*Mr. Stacy*: But a company which comes to the Board of Trade and asks for permission to issue a circular is always free to go through a licensed dealer.

Mr. Osborne: The suggestion that all the circulars should come to the Board of Trade is, I think, quite wrong.

Sir Richard Powell: If the rules are going to be made of general application they should be followed by everyone and there should be no reference to the Board of Trade. It should be done one way or another and from the administrative point of view it would be better to do it through the rules and to make the rules as good as one could. The duty of checking up on all these offers in the Board of Trade would be a very onerous job indeed and would require a lot of staff. It would also give rise to a good deal of dissatisfaction and would take a long time.

7067. But if the terms of the offer were lodged with the Board of Trade you could look through them and see whether a company was subject to a Board of Trade inspection.—*Mr. Dean*: The rules would have to be completely exhaustive if they were made general. If the offers go through a licensed dealer there is some power of control. Certainly there is some discipline if they go through authorised dealers.

Sir Richard Powell: This all depends upon the extent of any possible abuse. It

is only justifiable to be grandmotherly if you have something to be grandmotherly about and I am not sure you have in this case.

Mr. Stacy: There is always the danger of misunderstanding created by the fact that some circulars do come from the Board of Trade and, in my view, far more than was ever foreseen or intended. Some people think that because they have been on an official desk in Horse Guards Avenue they must be all right, otherwise they would not have been allowed to go out; for, they think they are all right because the Board of Trade has seen them.

7068. You would not therefore want prospectuses any longer to be registered with the Registrar of Companies and to state they were so registered? A statement appears on the face of all prospectuses that the prospectus has been registered with the Registrar of Companies. That gives some indication to the public that their position is to some extent safeguarded.—*Sir Richard Powell*: It would be wrong to expect the Board of Trade to take any responsibility for the truth or accuracy of the statements made in the prospectus. All we can do is to say it contains all the information the law requires it to contain but we cannot say all that information is right; otherwise one would have to have an enormous corps of inspectors and other people to verify facts. With 30,000 to 50,000 companies being formed every year, I think it would be impossible to undertake that task.

7069. *Chairman*: Perhaps we can pass from that question now. The next one concerns the protection of investors and it raises the general point that in the United States the S.E.C. has responsibility for the whole field of issuing and subsequently dealing in securities. What do you think of the suggestion that there should be a similar statutory body in Great Britain?—This is a pretty big question of policy regarding which we should like to know what you think. From my point of view if we were made responsible for the administration I would view it with the deepest gloom. It is fair to say we have had no representations favouring the establishment of a body of this kind in this country.

No representation has been made to the Board of Trade supporting it.

7070. We have had a number of representations to that effect made to us both in writing and by means of oral evidence, too; but the value of such evidence depends, of course, upon what the deponent knows about what goes on in the United States.—Yes.

7071. We have heard evidence from U.S. witnesses and they seem to think their system suits the conditions in the United States of America but it may or may not suit conditions in this country. One just does not know.—I would not really know, either. I am afraid I know too little of the work of the S.E.C. to express a clear opinion upon it.

7072. And, as you say, it is a broad question of policy.—Yes.

7073. Then there is the question, would it be useful to arrange regular consultations between the Board of Trade and the Stock Exchange?—*Mr. Stacy*: We already have regular informal consultations with the Stock Exchange on all sorts of things. I would not have thought there was any advantage to be gained in making the consultations more formal. We are always free to pick up the telephone and talk to the Stock Exchange and we talk to each other on any subject upon which we think we can usefully help each other.

7074. And you think the position can best be covered in that way: by continuing the unofficial liaison rather than by trying to lay everything down in the form of legislation?—Yes.

7075. The next question concerns offers of unquoted securities which are not subject to scrutiny by the Stock Exchange. The question asked is whether the Board of Trade as an alternative to the Stock Exchange should undertake the scrutiny of such prospectuses. Your answer would be that you consider it to be outside your province.—*Sir Richard Powell*: Yes, definitely. If we were expected to do for unquoted securities what the Stock Exchange does for quoted securities we would say that was

going beyond our province. If it were thought desirable or necessary for us to do this at all someone would have to act as our agent, probably the Stock Exchange, and I think they would find that a very difficult thing to do.

7076. And the utmost you would undertake in the way of scrutiny would be to look at the prospectus and see whether on the face of it the statutory requirements were fulfilled?—Yes.

7077. But if you had to look at the whole of it to see whether it was a proper prospectus or not you would think that was going beyond your proper function?—Yes.

7078. The next question concerns dealers in securities. We will take first of all the Stock Exchanges. Questions have been raised about them. Do you think that all the recognised Stock Exchanges are adequately equipped for the purpose of scrutinising the securities in which they deal?—*Mr. Stacy*: The lists were drawn up in 1948, I think, on the recommendation of the London Stock Exchange. We have close informal contact with the London Stock Exchange and would expect to hear from them if, in fact, they were becoming unhappy about any particular Stock Exchange. If the question is: do we, in fact, go regularly and have a look for ourselves to see whether they are adequately equipped, I am afraid the answer is no. We have not got the staff to do so.

7079. The London Stock Exchange has given you no reason to suppose these other recognised Stock Exchanges are other than proper bodies to carry out these scrutinies?—We have had no suggestion of that sort. If for any reason we began to have doubts ourselves we would then consult the London Stock Exchange. However, a regular scrutiny does not take place.

7080. *Mr. Brown*: You have no doubt that the London Stock Exchange is fully equipped for the purpose of carrying out these requirements?—We think it is.

Professor Gower: The London Stock Exchange told us that the provincial Stock

Exchanges were not as fully equipped as they were to scrutinise securities.

7081. *Chairman*: Is there adequate discipline over members in the case of very small Exchanges? Do you concern yourself with that kind of thing?—*Sir Richard Powell*: We would look to the London Stock Exchange to keep us informed upon problems of that kind. We would not act on our own initiative.

7082. What is your view about having a compensation fund to protect customers?—*Mr. Stacy*: I know the London Stock Exchange have such a fund. I believe Birmingham, Edinburgh, Glasgow and Manchester have them although others have not. However, in the smaller Exchanges I think it would be a difficult thing for them to undertake to build up such a fund.

7083. Someone told us that some of these Exchanges were very small indeed.—I should think it would be difficult for some of them to build up such a fund.

7084. From another aspect, apart from compensation, do you think some of the very small Exchanges should be recognised? There are some which only have half a dozen members?—It has not been put to us that they should not be included.

7085. And no one would say they are not Stock Exchanges?—No; they have not said that to us.

Mr. Leckie: The scheme of the Act is to delegate the control as much as possible. If you did not recognise these small Exchanges you would have to deal with the members individually and you would get back to the position, so far as they are not covered by some authorised or recognised body, of having to deal with them as licensed dealers.

7086. One begins to wonder when one sees an Exchange consisting of only four members what their competence is to scrutinise a new issue and that kind of thing.—In fact a new issue is frequently not dealt with by a small Exchange.

7087. I think it was said in evidence that they did so.—*Mr. Osborne*: I think they all do some local business but the majority

of their business is done through the London Stock Exchange.

Mr. Stacy: One would not think the area of mischief would be very great.

Sir Richard Powell: This is a field which should be looked at more closely before there is any new legislation. It seems to me to be rather a happy-go-lucky situation at the moment which should be looked into further. It is one which will, of course, depend upon what views your Committee wish to express but it is certainly one the Board of Trade ought to look at more thoroughly before putting through any new legislation.

7088. Consideration might be given to the suggestion that a little rationalisation might be a good thing.—Yes.

7089. *Mr. Althous*: All these Exchanges are members of the Associated Stock Exchanges, are they?—So far as I know, yes.

7090. *Chairman*: Then there are the associations of dealers. Have you any observations to make about any of them?

—*Mr. Stacy*: No. As regards the half a dozen associations which we have recognised we have to confess we have no system of sending someone down regularly to have a look and check up on them.

7091. The list was compiled a good many years ago now and I feel it does look as though a little bringing up to date and investigation would be a good thing preparatory to any new legislation being introduced.—*Sir Richard Powell*: This again is a field where it is difficult for the Board of Trade to exercise a great deal of judgment. For example, unless someone is known to be a criminal it is very hard to refuse a licence to a licensed dealer. I think we should be reluctant to see more discretion imposed on the Board of Trade in this field. I would prefer to see it done by means of a reduction in the number of people entitled to deal through some tightening up of the rules.

7092. If you let someone come in and some fearful catastrophe ensued you would be accused of negligence.—Yes, exactly.

7093. I appreciate it is quite a difficult problem.—*Mr. Stacy*: If we adopted the

practice of sending out officials regularly to have a look at the local Stock Exchanges and associations and kept a close rein upon them I think it would soon come to smack of considerable Whitehall control which I am not sure would be either desirable or welcome. One can overdo this sort of thing.

7094. *Professor Gower*: In reply to earlier questions you said the great advantage of canalising things through the Stock Exchange and licensed dealers was that you were thus able to exercise supervision over them. However, because of your replies to the last five or six questions I am not sure what the supervision is.—*Mr. Dean*: I was talking about the scheme of the Act. Really, what has been just said is that it is difficult to make a case for refusing or taking away authorisation.

Sir Richard Powell: There have been cases where licences have been taken away after something has gone wrong. This causes one to get on to a man's suitability for a licence but it would be impossible for the Board of Trade to carry out supervision in such a way that it would prevent anything ever going wrong.

7095. *Chairman*: On, really, the same part of our inquiry is the question of licensed dealers of whom there are now 35. It has been suggested that in any new legislation they should be done away with. Have you any views about that?—*I* think the only thing we should say is that by their very existence they appear to meet a demand, otherwise they would not be in business. However, I do not think it would affect us at all if they disappeared.

Mr. Stacy: Our evidence has not been in that sense but has pointed to the difficulties which we have to face in carrying out the licensing obligations and the weaknesses in the system. Certainly we should have fewer headaches if we did not have to bother with licensed dealers.

7096. The suggestion was that instead of having these separate individuals they should all be required to join some recognised association; then they would be subject to the same discipline as the members of that association.—*I* think the

Association of Stock and Share Dealers was formed after the Companies Act and it was formed very much with the guidance and encouragement of the Board of Trade. Those people who are not members of that Association remain as individuals and are entitled under the Act to be allowed to earn their living and have a licence from us. However, after the introduction of that Act we did try to get a large number of people under the umbrella of the Association of Stock and Share Dealers.

7097. *I* see. Our next question concerns unit trusts. We have had a good deal of discussion about these with various people operating the system and there was a proposal that a model trust deed should be got out and that the Board of Trade should only really be concerned with any variations from the model form. It is suggested that might save time as compared with studying the whole deed on each occasion.—*Sir Richard Powell*: We would have no objection at all to this proposal but we would be sceptical as to whether it would in fact save us a good deal of work; the number of variations might give us as much work as examining the whole deed each time would do. If it would be preferable to the unit trusts or to the public generally to proceed in this way it would cause us no difficulty.

7098. As far as we could gather the majority rather favour the idea and I do not think anyone endeavoured to oppose it.—*Mr. Stacy*: No.

7099. It would be difficult to say how far they agreed until the document was settled. Then one might find some differences of opinion creeping in. The next thing is this: there are, apparently, complaints that the Board's scale of permitted charges is unreasonably low. Those are the charges you allow to unit trusts. I do not know what you say about that.—*Sir Richard Powell*: This is a point upon which we have had direct representations and which we have under examination at the moment. We think there is a point here which needs consideration and which we are hoping to consider. We think we shall reach a decision fairly soon but that decision should be without prejudice to the wider

question of whether the Board of Trade ought to have any control over these charges at all. There is no specific obligation laid on the Board of Trade to control these charges and there is no reason obvious to me why the Board of Trade does do it and why it is not left to the business itself to fix its own charges and to normal competition.

Mr. Stacy: It may have been prompted by the scandals which existed before 1939. Those happened a long time ago. I think the point is quite clear; we have these powers and, as the Secretary says, it is really questionable whether the Board of Trade ought today to be controlling these particular types of charges.

Sir Richard Powell: This is a point upon which we should very much welcome the views of the Committee in their report.

7100. This leads to another point. Is the existing position satisfactory under which the Board insist upon conditions not specified in the Act? The unit trust people told us there are a number of points where the Board of Trade insist upon this or that requirement, although it is difficult to discover any discretionary power to impose those requirements under the provisions of the Act.—*Mr. Stacy:* They are not prescribed in detail but there is undoubtedly this discretionary power. The question of charges arose and it was established legally that we had the power to control charges. The same argument applies as regards these other requirements which we felt we were bound to apply in the early days when we took over this responsibility. However, I think it is still open to question whether and to what extent, as regards charges or anything else, the Board of Trade should do this.

7101. The section of the Prevention of Fraud Act relied upon is, I presume, section 17 (1) (c). A number of conditions have to be fulfilled, and (c) says that "the scheme is such as to secure that any trust created in pursuance of the scheme is expressed in a deed providing, to the satisfaction of the Board, for the matters specified in the First Schedule to this Act." It is in reliance on that that the Board of Trade have exercised the power to insist

upon other requirements than those specified in the First Schedule of the Act?—*Sir Richard Powell:* I believe there has been a Court decision about this but whether it is right that the Board should have the power is a point about which I can think there is some doubt.

7102. If there is going to be discretion concerning particular matters of importance it would obviously be a good thing to have them set out in black and white.—Yes.

7103. *Mr. Mackinnon:* Would you suggest that the statutes should give some indication of the charges so as to remove some of the responsibility or would you leave the question of charges at large?—*Mr. Stacy:* I think there is something to be said for competition.

Sir Richard Powell: Let competition settle it and let the best man win.

7104. *Mrs. Naylor:* Would you insist on revelation of the size of the charge in advertisements?—Yes.

7105. *Mr. Lawson:* And there is also the question of the extent to which the unit trusts advertise. In America something like 7 or 8 per cent. of the amount of the fund is spent upon what might be termed promotion expenditure. Here, as a result of the present charges it cannot be more than about 2 or 2½ per cent. Do you feel there is any reason why there should be a limit?—I do not see why there should. Presumably people would be encouraged to spend more on promotion in order to get the business and in order to hold their competitive position. There is one further point I would like to make on this question of unit trusts: whether it is right to prevent companies from dealing in their own shares and exclude from the British market all Commonwealth and foreign open-end companies. We would be interested to know whether the Committee have any views upon that question.

7106. *Chairman:* Do you mean the open-ended investment trust company?—Yes.

7107. I do not think any of the unit trust people we saw were very enthusiastic

about that.—No, I imagine they would not be. The present law does have the effect of preventing the overseas equivalent of the unit trusts from doing business in this country.

7108. *Mr. Mackinnon*: Have you had a certain number of applications which have had to be barred? There is a demand for overseas unit trusts, is there?—*Mr. Osborne*: We have had considerable pressure in the last year or two not only from the United States but also from the Commonwealth.

7109. Including Australia?—Yes.

7110. *Mr. Lawson*: There is nothing to prevent a unit trust being formed to operate in Australia, is there?—No.

7111. *Chairman*: The Committee will consider that along with all the other things. If a form of open-ended trust company could be evolved in a form suitable to this country and if the dealing in their own shares could be carried out subject to safeguards for creditors there should be no objection to it. There cannot be any objection in principle, can there?—*Sir Richard Powell*: In my view, no.

7112. *Mr. Brown*: The unit trust form has been recommended to us because of the additional safeguard of an independent trustee to hold the investments; I think the evidence in favour of open-end companies was on the ground that the use of separate trustees was an unnecessary expense.—Yes, that is so.

Mr. Brown: The Board have no views on the possibility of abolishing trustees?

7113. *Chairman*: One has to use the word "trust" rather sparingly because the position of the shareholder in an open-ended trust company is not the same as that of a holder of units in a unit trust. The shareholder has a claim against the surplus assets that there are in the company at the end of the day while the present unit trust holder is entitled to have his claim satisfied out of the specific investments vested in trustees. Therefore, the two things are different and it would be important if the open-ended type were introduced here to differentiate very clearly between the two so that the investor is not misled as to the character of the concern.

—We do not want to express any views regarding policy on this matter. We merely wish to mention it as a matter upon which we have had representations. It is of interest to us and we would like to have your views on it and no more than that. Ministers would no doubt want themselves to consider this point.

7114. *Mr. Watson*: Would you consider if that system were introduced into this country that there should be some system of control and inspection of companies with the right to buy their own shares?

—*Mr. Stacy*: As long as we were controlling unit trusts that would be inevitable.

7115. And that would be a duty the Board of Trade might be prepared to undertake in the event of such a system coming in.—If we were still controlling unit trusts it would be inescapable.

7116. *Professor Gower*: Why should the control be limited to open-ended ones? I do not understand this.—Mainly because we feel control would be expected of those because of the control of unit trusts.

Professor Gower: I can see that but I should have thought that you should extend it to all types of investment trust company, closed or open, as they do in the United States.

7117. *Chairman*: The next item is returns. You draw attention to the ambiguous position of the Registrar and the question is, whether he should be given a more positive function in relation to registration and the contents of such things as memoranda and articles, special resolutions, annual returns and prospectuses. Paragraph 184 of your memorandum refers to this question.—The suggestion in paragraph 184 is that the Registrar should have the authority to reject returns on specified grounds. The paragraph sets out the grounds on which it would be reasonable for him to reject documents; a thing he now has no express authority to do. We would like to see these grounds covered without going to the extent of suggesting—this goes back to a point already made—that he has any responsibility for vetting the truth and correctness of statements in the documents submitted to him.

7118. How ought that to stand from an administrative point of view? If a prospectus on the face of it does not comply with the requirements of the Act should the Registrar be given the power to reject it?—He has not got that express power at the moment. He was challenged on a particular occasion whether he was entitled to throw out something he did not think satisfactory. If he had this express power we should still wish to stop short of saddling him with a general responsibility for the truth and correctness, for example, of a prospectus. It is really a tidying up operation and not, therefore, a major proposal.

7119. Of course, one would not want to be left without some clear range of matters on which he could reject?—Quite so, and we would like the Act to be clearer than it is as to what his responsibilities are and on what grounds he may reject.

Chairman: He wants his position defined in the Act.

7120. *Mr. Scott:* If he has power to reject the document and does not do so, the document is necessarily regarded as being acceptable by the Registrar?—

Mr. Langford: At the moment I have rejected some documents and have been challenged as to my right to reject them, but on advice did maintain my rejection. What I need is the power to refuse to file the document if I know it to be wrong.

7121. *Chairman:* You must not become involved in questions of merit, otherwise your position would become untenable?—At the moment I have no express right to refuse any document at all.

7122. Then you think the Act should expressly provide that if it appears to the Registrar that the document does not comply with the relevant requirements of the Act, he may refuse to file it?—Yes, in so far as it does not seem to comply with the requirements of the Act as regards completion of the form generally, but not as to the accuracy of the contents.

Sir Richard Powell: Is it not true that you can only reject if it is not signed or dated?

Mr. Langford: The section in effect seems to provide that I can only refuse a

prospectus if it is not properly signed or dated, or not accompanied by the relevant documents.

Sir Richard Powell: It can be defective in a very large number of other ways.

Mr. Langford: In fact, we do usually get them corrected, but there is no express power to do so.

7123. Once you have all the documents, you are under a statutory obligation, are you not, to register the company? You have no discretion. If you have accepted for filing all the documents necessary to lead to the incorporation of the company, then incorporation follows as an imperative matter, does it not?—Yes, but that is only the memorandum and articles of association at that stage, and the statutory declaration of compliance.

7124. This proposal for clarification will extend to other documents as well?—Yes, but on incorporation it would only be a matter of considering the memorandum and articles. But I could not say I would be responsible for all the articles being strictly in accordance with the law.

7125. If it is obligatory on you to grant a certificate of incorporation, provided all the conditions are fulfilled, it is only right, before you get to that stage, that you should have power to reject the documents?—Yes, we would in fact reject them, and wait for a writ of mandamus to be applied for.

7126. You would not need that if you had a power of rejection for a defect in the document in point of form?—No.

Mr. Dean: We would not like it thought that the Registrar rejects documents without any authority whatever. The Act is not really clear about this. We take the view that when a document has to be delivered to the Registrar that document must comply with the Act, and he has the right to reject if it does not comply with the Act. But the position is arguable, and we want it cleared up, because the power is purely by implication and not by specific authority.

7127. *Sir George Erskine:* Dealing particularly with prospectuses, Mr. Langford, if you had this power of rejection, I

take it as a matter of practice, you would have to follow the same system as the Stock Exchange and would be willing to examine a document in draft form?—*Mr. Langford*: We do in fact do that in many cases.

7128. *Chairman*: The next one concerns business and company names, which is, I gather, a very difficult topic largely because of the enormous numbers involved. You suggest it would be helpful if the similarity test were abandoned and that names were only refused on the ground of identity with the name of some previously registered company?—*Mr. Stacy*: I do not know that we would go so far as to say we recommend that it be abandoned. Our paper is a *cri de coeur*. There has been so much criticism of the Board of Trade both in regard to company names and business names that we thought we really should set out the very considerable difficulties with which we are faced, and our paper does do that. In view of the delays which this means in the registration of companies and the dissatisfaction it seems to provoke, it prompts us to ask the question whether all this is worthwhile to prevent similarities between names. It may well be that the answer is that we cannot abandon this criterion, and we have to make the best of it. We wondered whether, in the evidence you have had before you, there had been any body of opinion saying how valuable this service was and how important it was that the Board of Trade should go on doing it. If we are to go on doing it, it does carry with it the certainty that the registration of companies will become more and more difficult, and, quite frankly, we do not really know what to do about this state of affairs.

7129. Would it be feasible, as an administrative matter, to refuse names on the ground of identity only, as opposed to similarity; one difficulty in that proposition is that it is so hard to say what is identical?—The whole field is a very difficult one, and there is the difficulty even of administration to get it generally understood throughout the office and the large numbers of people dealing with this as to what should be regarded as a similarity which cannot be tolerated.

Administratively, it is a very difficult thing.

Sir Richard Powell: This is so much a matter of taste, on which there can be very legitimate differences of view. This gives rise to a mass of correspondence at all levels, including Ministerial level, and a great deal of dissatisfaction about names. I do not see how we could abandon our present practice of trying to prevent the use of similar names, because I think there would be great public demand that we should go on doing this. It leads to great administrative difficulty in the office and considerable delay in approving the name and, in the end, to great dissatisfaction on the grounds that it is the view of someone in the Board of Trade which has to be accepted, because there is no appeal to any other authority.

7130. Is it not possible in some cases to get over the difficulty by putting into the junior company's name, if I may so call it, some reference to a place or date?—*Oh*, we do a lot of that.

Mr. Langford: It is avoided in that way.

7131. But I suppose, in the end, you exhaust all the possibilities?—*Mr. Osborne*: And, of course, the mere addition of a place or date may suggest some affiliation or association, and mislead in that way.

7132. *Mr. Mackinnon*: That is a very real objection, that it suggests it is one of a group of companies. I imagine that is one of the biggest headaches you have?—It is very difficult.

7133. *Chairman*: Obviously if someone wants A.B. Limited it may be hopeless, but you might be able to say you will register it if it is called A.B. (Colchester) Ltd.?—But if there is another called A.B. (Birmingham) Ltd., the public will believe they are members of the same group.

Mr. Langford: But Brown (Manchester) and Brown (Birmingham) would be all right, because Brown is a common name and the two are some distance apart. It would be different if the name were more uncommon.

7134. Would it be possible to solve this difficulty by making it depend simply on the four corners of the certificate of registration, as opposed to going into all the various questions which would be material in a passing off action in the Chancery Division? If one is going to consider the possibility of associated or subsidiary companies, you get a tremendous inquiry on each name?—You do.

7135. I was wondering if one could curtail the field of inquiry and simply say, taking two certificates of incorporation together, are they too alike as bits of paper with certain names written on them, so to speak?—If you are going to say too alike, you have to get some discernible difference between them, I think.

Sir Richard Powell: You are back to your question of taste, really. What is too alike? It is very hard to say. People have different views on that.

Mr. Stacy: I think we still have this responsibility because the Cohen Committee thought that otherwise there would be too many passing off actions. The Board of Trade does this, and this holds up the Registrar.

7136. It looks as though the Board may have to go on the best way it can?—*Sir Richard Powell:* I am afraid so. There is no way out of this.

7137. There are complaints by the Association of Scottish Chambers of Commerce and the Law Society of Scotland that the Registrar does not give sufficient guidance to the public as to what names will and will not be accepted. I should have thought it was quite impossible to give in advance an exhaustive catalogue of names that would not be acceptable, but you have some circular letters you send out which give a good deal of guidance. I do not know if it could be improved, but obviously it cannot be complete?—I think the circular we have now goes about as far as one can reasonably go in codifying this very difficult subject. It would be very difficult to go any further than this.

7138. Then there is the Institute of Trade Mark Agents, another dissatisfied

customer, and they say there has been a recent change in the registration procedure with regard to company names resembling registered trade marks. Anyhow, up till recently, a search was made for trade marks resembling a proposed company's name?—*Mr. Stacy:* We used to require the applicant to assure us that the name he was asking for was not identical with or did not resemble a trade mark.

7139. You put that on the applicant who registered a company, and that has now been changed?—Yes, because it was represented to us that it was placing an impossible burden on the applicant. How can he satisfy us about something which can only be decided in a Court, that a name he proposes does not resemble a trade mark? So we had to drop the requirement that he should satisfy us there was no resemblance.

7140. Is any check made now to see that it does not represent or resemble a trade mark?—Not now. We do not ask an applicant to satisfy us on the latter point now.

Mr. Leckie: Not on resemblance, but identity, yes.

7141. You confine yourself to a name which does really represent a trademark, but not merely a resemblance which covers a very wide field?—*Mr. Stacy:* We have abandoned the latter request and have been criticised for abandoning it.

7142. Then another and different point, also on company names, is that the removal of a company's name from the register can be ordered if it is too like, can it not? If it is entered through inadvertence, being too like an existing name, then the junior company can on request change its name and, moreover, if that is not done, the Board of Trade can insist on the junior company changing its name?—That is within six months.

7143. It is put to us that the same rule should obtain where the objection to the name is something other than its being too like another name: if a company changes its sphere of operations and for instance goes on describing itself in terms which suggest that it comes from

Wigan whereas it is carrying on business entirely in Timbuctoo, it is thought that might be misleading and that, owing to the change of circumstances, there ought to be some machinery to alter it?—Having gone to the trouble we do to prevent a name which is misleading, then, shortly afterwards, the company enters a line of business where that name is in fact misleading: having satisfied ourselves that a company is entitled to be called The British something or other, the company is then changed and may no longer be entitled to that name.

7144. My question is simply directed to the desirability or otherwise of extending the provisions, under which names can be taken off the register within six months, to cases where names become misleading owing to altered circumstances. That, I think, would involve removing the six months' time limit?—Yes.

7145. But it could be done if such a provision were adopted: a change of name could be insisted on at any time when it was brought to the notice of the Board that circumstances subsequent to incorporation had made the name misleading. Would there be any objection to legislation on those lines?—*Sir Richard Powell*: I do not think there would be any objection to that, so long as it was not expected that the Board of Trade would take the initiative in making a change.

7146. It would have to be brought to the notice of the Board somehow, but they would not have to go out to look for it?—No. I may say I do not think we should welcome this extension to our responsibilities, and we would hope it would not be recommended unless it was felt to fill a pressing need.

Mr. Osborne: It would be a very drastic power if the company had spent money building up goodwill.

7147. That is perfectly true. I put that to you because it is one of the things which have been suggested. Then we are told that some Commonwealth countries, having fewer companies, have a system of advance publication of proposed names so as to give people an opportunity of objecting. I imagine you would say that would

be unworkable here, owing to the enormous number of companies registered every day?—*Mr. Langford*: I would say so. I would not welcome it, as Registrar, at all.

7148. What it would lead to is something like the trade mark procedure where you advertise for objections and then, if objectors come in, the next thing is a trial as to who is entitled to the name. With your 35,000 a year or whatever it is, there would be quite a lot of little lawsuits going on, with probably a right of appeal to the High Court or the Court of Appeal against any decision of the Registrar?—Yes.

7149. That is the kind of difficulty which attends that suggestion, and I do not know what you would think about it from the administrative point of view. Your answer probably would be that it would get quite out of hand?—*Mr. Leckie*: We do not want to extend the registered trade mark system to company names.

Sir Richard Powell: I think we find the existing system difficult enough to contend with. Anything making it more difficult would be very unwelcome indeed.

7150. Then that is not very much good. Then there is this very difficult question of business names, and it looks as though, through no one's fault the register has now become more or less unmanageable?—I think that is a fair way of putting it.

Mr. Langford: Of course it does now contain about 750,000 names.

7151. And apparently people do attach importance to the register, imperfect though it is?—Yes.

7152. Such investigation as we have made suggest that 50 per cent. of the inquiries are fruitless because the name is not on the register for one reason or another, and I do not think anyone pretends it is anything like complete. The constructive suggestion we have had, which has been discussed with varying degrees of approval by our witnesses, is that you should abolish the register and substitute for it the obligation of putting the true name up at the place of business, or at all places of

business if more than one, and putting the name on the note-paper, relying on that as affording a degree of protection to people dealing with these unincorporated firms. Of course, you would not have the register to go and look at, but if you saw your competitor had not got his true name put up over his shops or had not got it on his note-paper, you could report the matter to the Board of Trade and enforce it in that way?—It is already open to a competitor to do that now, if he wanted to report someone who was not complying with the Act.

7153. Some kind of control not involving the register could be evolved. Admittedly the scheme could not be so perfect if you did away with the register, but it would be something?—*Sir Richard Powell*: One alternative would be to keep the register, but make businesses put their registration number on their note-paper and leave it to the local authority or other people to attempt to enforce it. It would stiffen it up to some extent, and give you something to lay your hands on: if there were no registration number on the note-paper, there would be grounds for complaint.

7154. You think the register cannot be dispensed with?—*Mr. Leckie*: There is a point in connection with undesirable company names in that if you refuse a company name, you must take care that the company does not use that undesirable name as a business name. If you did not have the register of business names, you could not prevent that.

Sir Richard Powell: If you have one, you cannot do away with the other. You have to try to make the register of business names more effective than it is. The problem of making it 100 per cent. effective is intrinsically insoluble, but you might make it better.

7155. By putting the registration number on the note-paper?—Yes.

7156. *Mr. Bingen*: You imply that if you have a system of controlling company names, you must have a register of business names; but up till 1917 you had

no register of business names, and that Act was devised during the first war to prevent Germans trading under the names of apparently British companies. Do we really need a register of business names at all now?—*Mr. Leckie*: I was not putting the point forward as a great argument for retaining the register.

Sir Richard Powell: So long as you are supposed to prevent the use of undesirable company names, you have to have a business names register, to prevent the use of names which would be undesirable as company names.

7157. *Mr. Richardson*: You could provide that no company should trade except under its own name?—Is that enforceable? I suppose it is.

Mr. Osborne: Many companies do use several business names. It would be very difficult to limit companies to their own company names as trading names.

Chairman: Failure to put the word "Limited" on as the last word of your name does involve an offence of some sort.

7158. *Mr. Mackinnon*: I think what they very often do is to use a business name, and put the company name underneath in very small letters.—*Mr. Stacy*: In 1923 the Geddes Committee recommended that the Registration of Business Names Act served no useful purpose.

7159. *Professor Gower*: Would it be agreed that in so far as it prevents the use of undesirable business names it is reasonably effective for that purpose?—*Mr. Osborne*: We have had complaints about small businesses being carried on under the names of banks or chambers of commerce. I think it is reasonably effective against that sort of thing, and that is important.

7160. Although it is true it was only introduced as a result of the first world war, it is also a fact that it had been on the stocks for many, many years before. The Associated Chambers of Commerce had been pressing for it for about 30 years?—Yes, that is so. There was a Parliamentary Commission on it in 1900.

24th March, 1961]

SIR RICHARD POWELL, MR. J. LECKIE,
MR. R. J. W. STACY, MR. E. W. DEAN, MR. P. J. MANTLE,
MR. H. OSBORNE, MR. J. M. CLARKE AND MR. W. B. LANGFORD

[Continued]

7161. *Chairman*: I think that completes our questions. I would like to say again thank you very much for coming and giving us so much of your time.—*Sir Richard Powell*: Thank you, Sir; we have been glad to come. If there is anything

you need for your consideration, if the Board of Trade can supply it we will of course do so automatically. We will be glad to let you have anything you need.

Chairman: Thank you very much.

APPENDIX LI

Memorandum by the Board of Trade

In the summer of 1960 the Board of Trade submitted to the Committee detailed papers on each of the matters covered by the Committee's Questionnaire. These papers were however too long for publication and the Board have accordingly summarised the main points in somewhat shorter notes which they now submit.

On many subjects the Board of Trade have thought it proper to restrict their evidence to placing on record the arguments for and against a particular proposal. It has seemed to them undesirable in such cases that they should make firm recommendations on matters which it is more appropriate that the Committee should consider first.

16th March, 1961

(1) Incorporation of Companies—Memorandum of Association

"One-man" companies

There are very many companies commonly known as "one-man" companies. Many are created, it would seem, in order to secure tax benefits, to protect a name, to tender for a contract or to avoid some control or publicity. Many are never brought fully into operation and many are abandoned on the register without the formalities of a liquidation. There are possibilities of abuse if such a company is kept denuded of resources and is used to evade responsibility for business debts.

2. Conditions prescribing a higher minimum membership or a minimum capital could easily be evaded. It would help if all companies were required to file properly audited accounts with the Registrar of Companies. In addition all companies could be required to pay an annual registration renewal fee.

Wholly-owned subsidiaries

3. The possibility of abuse arises when liability is artificially reduced to the amount of the issued capital of each subsidiary while the business of the subsidiary is financed by loans. Possibly a holding company ought to be made liable for the debts of its subsidiaries in a proportion corresponding to the proportion of the issued share capital of the subsidiary which is beneficially owned by the holding company.

*Combination of memorandum and articles:**Common form powers*

4. The memorandum and the articles of association might well be combined in a single document, now that the historical distinction between the two has largely disappeared. Possibly common form powers could be conferred by statute on all companies with the option for any company to contract out. This would revive the distinction between objects and powers and lead to simplification of the objects clauses.

Widely drawn objects clauses

5. Widely drawn objects clauses put excessive power into the hands of directors to change or dispose of a company's business or undertaking without the prior consent of the members, and tend to frustrate the right of a dissentient minority to appeal to the Court against a proposed change of objects. It could be provided that objects and powers (other than common form powers) which remain unimplemented over a period should automatically lapse. Alternatively, and perhaps better, limitations could be imposed on the powers of directors, and the powers of shareholders safeguarded in regard to important changes in a company's activities.

The doctrine of ultra vires

6. The Cohen Committee considered that the doctrine of *ultra vires* had become an illusory protection for shareholders and a pitfall for third parties. They recommended that the memorandum of association should operate solely as a contract between the company and its shareholders as to the power exercisable by the directors. To give effect to this recommendation it would have been necessary to modify, if not to abrogate the rule, that the memorandum is a public document of which third parties dealing with the company are deemed to have notice. This would have been no straightforward matter and the recommendation was not in fact adopted.

7. Instead, the new Companies Act gave to companies wide powers to change their objects by special resolution and without the sanction of the Court. The restrictions which remain on these powers are of little practical effect and it may be well to remove them altogether, other of course than the right of a minority to appeal to the courts.

8. If the doctrine of *ultra vires* were abolished the introduction of common form powers, if decided upon, would not apply to the powers of the company which would then be unrestricted. They would instead constitute the powers of directors to act on behalf of the company.

9. In considering, as they may wish to do, the question of *ultra vires* the Committee will doubtless have in mind the possible effects of a change in weakening the safeguards on capital as a fund of credit.

Prefabricated companies

10. There is a regular business in offering ready-made companies for sale to the public. Such companies often run into default under the Companies Act, until they are purchased, with regard to the obligation to hold meetings, make annual returns and so on. It seems wrong that a regular business of this kind (if indeed it is desirable business or a business useful to the public generally), should be founded on continuous breaches of the law.

(2) Prohibition of Partnerships with More than Twenty Members

11. Section 434 of the Companies Act, 1948, prohibits partnerships, associations or companies which are formed with a view to carrying on business for gain (other than banking) from having more than 20 members unless they are incorporated companies.

12. Although the figure of 20 is arbitrary, a restriction to some such figure is perhaps inherent in the concept of a partnership as an association of persons bound together for a particular enterprise by ties of mutual trust.

13. It was stated in a famous lawsuit that the limitation was intended "to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies, so that persons dealing with them did not know with whom they were contracting, and so might be put to great difficulty and expense, which was a public mischief to be repressed." In practice this mischief is not now a danger in the field of commerce and trade but there is always the possibility that the partnership structure might come back into popularity if, for example, it were decided to make incorporation more difficult. The Board consider therefore that the restriction on membership ought not to be removed in the field of commerce and trade, especially as it is not onerous in that field.

14. The Board of Trade would have no objection to an alteration of the present law in the field of professional activities if there is no other way of meeting the difficulties which the limitation causes such partnerships and there is no objection by those who use their services. Difficulties have been experienced by some firms of solicitors and accountants, particularly, owing to the present restriction to 20 partners.

(3) Classification of Companies

Public and private companies

15. At the beginning of 1959 there were 15,500 public and 319,000 private companies on the register, and the majority of the latter were exempt private companies. It seems sound in principle to retain a distinction between public and private companies based primarily on whether their securities are or are not on offer to the general public. It seems necessary however to review the criteria which distinguish a public from a private company and the privileges which the latter enjoys, with special reference to the privileges of the exempt private company.

16. The Committee may wish to consider whether the maximum number of 50 members for a private company is too high and whether the present form of the requirement of section 28 (1) (a) (about the obligation to restrict the transfer of shares) could not with advantage be more clearly defined.

17. It is increasingly common practice to register a £100 private company with the intention in the near future to issue a statement in lieu of prospectus, increasing the capital and converting the company into a public company. This means that it is possible to avoid compliance with section 130 of the Companies Act about holding a statutory meeting, or section 181 about the nomination of directors. If these sections serve a useful purpose in relation to companies registered initially as public companies, the position in regard to the conversion of a private company into a public company seems to call for review.

18. The present category of exempt private companies derives from the recommendation of the Cohen Committee who were in favour of exempting from the obligation to make their accounts public what they described as the small family business incorporated as a company. The provision has not worked out in accordance with the ideas of the Cohen Committee or the intention of the legislature. Thus, many companies are exempt private companies which are not very small in membership or capital or in the extent of their undertakings. They include many companies with a very considerable business, such as finance and banking companies. The exemptions enjoyed by exempt private companies in regard to filing accounts, qualified audit and loans to directors have been widely criticised and the Board of Trade have found the administration of the provisions of the Seventh Schedule, which prescribe the conditions for exemption, both cumbersome and complicated.

19. There is a strong public demand for the disclosure of the financial affairs of all limited liability companies and the publication of accounts has probably been a most potent single factor operating against fraud and incompetent management. Again the importance of properly qualified audit is obvious and it does not seem suitable that the directors of an exempt private company should, by their voting control, be able to appoint auditors who are without accountancy qualifications and who may be persons amenable to their influence.

20. The exemption from the ban on loans for directors (not recommended by the Cohen Committee) is also open to objection. Its purpose was stated to be to help family businesses to avoid the alienation of control when a loan is necessary to meet death or estate duties on the death of a major shareholder. However, family businesses in the sense intended by the Cohen Committee are today a small minority of all exempt private companies and there exist companies whose business it is to provide finance in the circumstances in question. Moreover, the inability of a director to repay sums owed by him to the company is often the cause of a company's insolvency.

21. The Board of Trade consider accordingly that while the category of private company should be maintained, the Committee should review the privileges enjoyed by private companies and in particular those enjoyed by exempt private companies. If the Committee feel that there is perhaps a case for the small company with certain privileges they may care to consider whether there should not be more effective penalties

for the wrongful arrogation of those privileges. These penalties might include the loss of limited liability or a sanction whereby the rights of a defaulter are not enforceable by legal proceedings.

Companies limited by guarantee

22. The company limited by guarantee is usually the form chosen for companies which do not propose to trade with a view to making a profit for distribution among their members. It is the ordinary structure of charitable companies, professional and trade associations, research institutes and in general of companies whose objects are altruistic and non-commercial.

23. The provisions of the Act bearing on such companies have received somewhat scanty attention in the successive revisions of the Companies Act and the time has perhaps come for a comprehensive overhaul. In particular it is open to question whether such companies ought to be exempt private companies with freedom from publishing accounts, properly qualified audit and from the ban on loans to directors. Moreover, the question arises whether the provisions of the Eighth Schedule regarding the profit and loss account are adequate in the case of companies of this kind. It seems important that there should be public accounts and that these accounts should be such as to disclose what proportion of the income is swallowed up in administrative expenses and how the remainder is divided among the various charitable purposes which the company exists to promote.

Section 19 companies

24. Companies licensed by the Board of Trade under section 19 to be registered as limited liability companies, without the addition "Limited" in the name are almost exclusively companies limited by guarantee. The privilege was attractive to associations such as charitable associations, art societies, and chambers of commerce which considered that a Royal Charter would be too expensive, or which were not considered appropriate for incorporation by Royal Charter. The Board of Trade have used their powers under the section to impose a number of fairly elaborate conditions whose object is to ensure that the provisions of the section will be kept in the spirit as well as in the letter and in particular to prevent any indirect distribution, at any stage, of the income or property of the company among members. The Board of Trade licence has come to be regarded as implying a measure of Government recognition that the company is altruistically established for the furtherance of purposes of value to the community or to a broad section of it and that it is a stable and well run body. The Board consider that the provision serves a useful, if limited, purpose and should be retained in substantially its present form.

(4) Donations by Companies for Charitable and Political Purposes

25. It is sometimes suggested that companies should be encouraged by statute to regard themselves as having social responsibilities and thus be able, for example, without question to subscribe to a Lord Mayor's Fund for Flood Relief. This could be achieved, if it were thought right, by including powers to make charitable donations under the common form powers referred to in the Board of Trade note on Heading 1 of the Committee's Questionnaire. Any company would be able, if it wished, to contract out of any of the common form powers including that which enabled it to make charitable donations.

(5) Exercise of Powers of Companies by Directors and Degree of Control retained by Shareholders

26. The culmination of the tendency of the modern shareholder not to intervene in his company's affairs is seen in the unit trust where the investor delegates his voting rights to the trust managers. Moreover, the institutional investors do not ordinarily intervene to influence the management or policy of the companies in which they invest.

It may well be, therefore, that the influence of shareholders in the management of their companies has diminished even beyond what was found to be the position by the Cohen Committee in 1948.

27. There are three directions in which changes could be made if it were thought desirable:

- (a) The provisions of the Act about the appointment of directors.
- (b) The provision of information to shareholders.
- (c) Express reservation to shareholders of some powers which they tend to delegate to directors.

28. Matters which might perhaps be reviewed in regard to directors are the age qualification, the question of qualification shares, the possibility of reserving certain matters for decision by the board of directors as distinct from individual directors, whether there should be sole directors, and whether it should be possible for a corporation to be a director. The Board of Trade consider that it should not be possible for a company to have a corporation among its directors.

29. Already the Companies Act prescribes a certain amount of information which must be made available to shareholders. The Committee will wish to consider whether it is as much as can be reasonably afforded without damage to day-to-day transaction of the company's business. In particular the Committee may wish to consider whether a prescribed minority of shareholders should be given right of access to the books of account where fraudulent manipulation is suspected.

30. Under the Companies Act there are certain matters which must be dealt with by the shareholders in general meeting. They cannot be delegated by them to the directors. The question is how far it is proper and sensible to go on extending these matters if the generality of shareholders appear unwilling to undertake additional responsibilities. Their unwillingness does not in fact deter them from complaining afterwards.

31. If the Committee feel that on balance the shareholders who wish to exercise some control should be further assisted to do so, they may wish to consider the following matters in which it has been suggested that the powers of directors might be curbed and the powers of shareholders entrenched:

- (i) a material change in the company's undertaking or substantial variation or disposal of the company's assets;
- (ii) the exercise of the company's borrowing powers beyond certain limits;
- (iii) the raising of additional capital within the authorised capital;
- (iv) the appointment by directors of additional directors (e.g., the suggestion that the appointment should be subject to approval in general meeting) and the fixing of their own remuneration where they hold an executive office;
- (v) the exercise of any powers which the company may have to make contributions for charitable or political purposes. This is distinct from the question raised under Heading 4. The point is whether, if a company has these powers, their exercise should be delegated without restriction on the directors.

32. Finally, the Committee may wish to consider whether in respect of such matters as a change of undertaking, disposal of assets or the exercise of borrowing powers debenture holders should have some right of appeal.

(6) Directors' Duties

33. The occupation of company director has not become a profession and there are no accepted standards of skill and competence. It is generally accepted that directors have duties, but there is no general understanding as to what these duties

are and the case law on this subject is difficult for the layman to understand. Perhaps there is a case for a codification of the duties of directors either in any new Companies Act or, perhaps better, in the form of a Code of Conduct for Directors, based on existing case law and agreed principles as to the best practice. Provided that there is flexibility and the Code is kept under review it might be helpful if one were drawn up.

34. Under the Act a register has to be kept of directors' shareholdings and this register has to be open for inspection by members and debenture holders for a prescribed period. There is probably a case for requiring that the register should be open for inspection by members and debenture holders at all times.

35. There has been some public criticism of the power of directors to deal in their company's shares in connection with take-over bids and the transfer of control generally. It is worth considering whether restrictions should be placed on the board of directors to dispose of their shares by private treaty if by doing so they place the other shareholders in the position of a minority, and further whether they should be free to dispose of their shares by private treaty with an offeror, on terms different from those offered to other shareholders, during a period when a take-over bid is open to acceptance.

36. Directors have a statutory duty to disclose to a directors' meeting any interest they may have in contracts which their company concludes with third parties. There have been representations to the Board of Trade that strict compliance with that requirement is unnecessarily onerous and the matter might be looked into. There is probably a case for requiring by statute that a director should be prohibited from voting on any contract in which he has directly or indirectly a material interest.

37. If a resolution is to be proposed at a company meeting on a matter which would enable a director to obtain a benefit which he might not otherwise with propriety obtain, it would seem right that the intended benefit should be made clear in any notice of the company meeting. This might be made a statutory requirement.

(7) Shares with Restricted or No Voting Rights

38. The issue of fixed interest preference shares, with restricted or conditional voting rights or indeed no voting rights at all, is a well established feature of the capital structure of companies and is not the subject of criticism.

39. In the case of equity shares, however, there has been considerable criticism of the issue of such shares with reduced voting rights. It is thought inequitable that a body of shareholders should be deprived of voting rights although they take the same risk as other shareholders, while the latter, with sole or disproportionate voting power, may hold a minority of the risk capital or indeed none at all, if all the voting power rests with preference shares. Again, it is urged that, if widespread ownership of industry and commerce is desirable, then on general social grounds ownership should involve some measure of control with its attendant responsibilities for shareholders.

40. As regards the first criticism one possibility would be to impose a statutory maximum on the percentage of a company's issued equity share capital which may be without voting rights and a necessary minimum of the total issued share capital with full voting rights which must be equity capital. The purpose would be to ensure that holders of equity shares always held at least a specified majority of all voting rights. As to the second, it is perhaps doubtful whether democratic control should be encouraged by the process of preventing investors from buying voteless shares if they wish to buy them. There seems clearly to be some public demand (though perhaps a decreasing one) for ordinary shares without votes if they are offered at a lower price than similar shares with voting rights. What in the view of the Board of Trade is important is that the investor should be made aware at all times which shares carry no votes.

41. Some companies have taken steps to enfranchise their voteless shareholders. This is a different matter from requiring them to do so by legislation. A possibility

which has been suggested is that all equity shareholders, whether voteless or not, should be given an inalienable statutory right to vote on certain important classes of resolution outside the ordinary conduct of company affairs, such as changes of capital, changes of the objects of the company, or the appointment or dismissal of directors. But the Board of Trade are not satisfied that equity shareholders, who have voluntarily taken up voteless shares, should be given a right to vote in certain circumstances although no statutory right exists for holders of fixed interest securities.

42. The Committee may wish to consider therefore whether legislation is desirable in regard to non-voting equity shares, including the question of fixing a maximum percentage of non-voting equity capital or establishing entrenched voting rights for certain more important company resolutions.

(8) Protection of Minorities

43. The Companies Act prescribes for minorities certain rights of appeal to the Court and there are also some important matters which under the Act can be effected only by special resolution. Nonetheless where the majority is large, or where the minority shareholders cannot easily concert action, the minority can find themselves in an unenviable position. The risk of becoming a minority shareholder may well be a risk inherent in investing in equity shares, at any rate in small companies and it is not possible to go very far in safeguarding minority shareholders without giving them powers which properly should belong to the majority. There are however some points which require consideration in the case of companies which become subsidiaries in the manner described below, and in the case of private companies.

44. Section 209 (2) of the Act enables minorities in companies which become subsidiaries to sell their shares, for a period of three months only, on the same terms as the majority of the shares were acquired. This facility applies only where the holding company acquires a 90 per cent. majority as a result of "a scheme or contract" which usually takes the form nowadays of a take-over bid. There may be a case for extending the section to cover any minority up to 25 per cent. (that is, a minority unable to prevent the passing of a special resolution) instead of only 10 per cent., or to cover the case where the new majority shareholder is an individual or a group (and not a company) or where the majority holding has been wholly or partly acquired by purchase on the market or by private treaty instead of by means of a take-over bid.

45. Section 209 is one of the group of sections 206-209 headed "Amalgamations and reconstructions". In fact sections 206-208 may be obsolescent since even agreed amalgamations and reconstructions are nowadays put through by means of the take-over procedure.

46. There is a further point which is related to Heading 18 of the Committee's Questionnaire. Under the Prevention of Fraud (Investments) Act a holding company is free to circularise the members of its subsidiary company with an offer to purchase their shares and none of the restrictions of the Act apply to such circulars. This means that when a company seeking to take over another has obtained 51 per cent. of the voting power, it can circularise the minority 49 per cent. without the safeguards afforded to shareholders by the Act, other than the provisions against fraud. Until the offeror has obtained 51 per cent. he may circularise the shareholders only through an approved channel. There may be a case for his being required to do so even after he has acquired 51 per cent.

47. The position of the minority holder in a small private company is still more precarious, especially as the directors are frequently the majority holders or are under the control of the majority holders. Section 225 of the Act had for its object making the remedy of winding up more readily available and it would be interesting to discover how the section has worked. Section 210 of the Companies Act was intended to deal with the situation where a winding-up order might not in fact benefit the oppressed minority and it gives the Court wide powers to make orders rectifying oppression.

In fact, however, section 210 seems to have been of little help to the small minority shareholder generally, at least until 1959. It may well be that oppression exists on a wider scale than the evidence would suggest because shareholders may have been advised that the Board of Trade would not intervene in a matter which lies within the discretion of the Court and that application to the Court is certain to be expensive and without strong supporting evidence is unlikely to be successful. The minority shareholder is in a particular difficulty in this respect since he has no right of access to the minutes of directors' meetings or to the books of account. (This is a matter which might be remedied). Generally, it seems to the Board important that the position of shareholders in private companies should be made as secure from oppression and injustice as is reasonably possible. The problem is difficult since one has to steer clear of embroiling either the Board of Trade or the courts in disputes about the proper way to run a company's business.

(9) Protection of Special Classes of Shares

48. The Board of Trade have no evidence to submit.

(10) Board of Trade Powers to Appoint Inspectors

49. The Board of Trade consider that their powers under sections 164 and 165 are wide enough to enable them to appoint inspectors in any case which they feel needs investigation. Naturally they are criticised by applicants who fail to secure the appointment of an inspector. The Board have to bear in mind however that great harm can be done to a company by the publicity which results from the appointment of inspectors and they require to be satisfied therefore that evidence submitted to them is sufficient to justify such a serious step. The Cohen Committee expressed the hope that knowledge of the wide powers possessed by the Board of Trade might cause the directors on representations from the Board of Trade to meet the grievance of shareholders. Indeed, this has many times proved to be the case, because the Board have been able to encourage the parties to reach a mutually satisfactory agreement so that an investigation is not necessary.

50. It is the practice of the Board of Trade to invite the applicant for the appointment of an inspector to submit a statement of facts verified by statutory declaration setting out fully the reasons for requiring an investigation. If the applicant consents, this statement of facts is sent to the directors in question for their observations. This undoubtedly takes time and the Board of Trade have been criticised on this score of delay. Nonetheless it seems to the Board of Trade important that they should hear both sides of the case before deciding whether the serious step should be taken of appointing an inspector. Many of the applications for investigation come from unpaid creditors of the company. But the Board of Trade take the view that a creditor in such a case has the alternative open to him of petitioning the Court for a winding-up order. Often shareholders are under the mistaken impression that the Board of Trade can appoint an inspector to stop directors doing something of which the shareholders disapprove or to protect their assets. The reason for the appointment of an inspector is, however, to discover facts which cannot otherwise be elicited. It is certainly not the function of the Board of Trade to intervene in management or to set themselves up as arbiters between two contending parties.

51. On occasion an application for the appointment of an inspector is based on alleged oppression of a minority when the applicants are in possession of all the facts. In such circumstances no useful purpose would be served by appointing an inspector and the proper remedy for the applicants is a petition under section 210.

52. The Act requires the Board of Trade to send a copy of the inspector's report to the company which has been investigated. This can cause embarrassment where criminal proceedings are contemplated or have been instituted as a result of the investigation. The Board of Trade suggest that they should be given power to withhold an inspector's report if they think fit.

53. The expenses of an investigation may be considerable. The circumstances in which the cost of investigation may be recovered from one or other of the parties are limited, particularly if a prosecution results from an inspector's report. In a recent case heavy expenses will have to be paid out of public funds. It seems desirable that there should be provision for payment of the costs either by the company concerned or by the applicants, even where a prosecution results from the inspector's report.

(11) Disclosure of Ownership and Control

54. Probably most nominee holdings are for quite proper purposes, such as trustee purposes. They may be held by agents on behalf of members of a company who are abroad or they may serve the purpose of expediting the delivery of securities. The system is admittedly capable of abuse and the Cohen Committee noted in their report some of the objections. They made three recommendations one of which involved disclosure of the beneficial owner but, because of the considerable difficulties of administration and enforcement which were foreseen, only the third recommendation was adopted, namely that the Board of Trade should be given power to investigate the ownership of shares.

55. The Board of Trade have interpreted the reference in sections 172 (1) and 173 (1) of the Act to "good reason" for investigation as requiring, if they are to exercise their discretion in favour of inquiry, that the matter should have some public importance. They have not in fact found it necessary to make great use of their powers. While it is widely accepted that the nominee system offers substantial advantages, there is a growing opinion that the acquisition by nominees of a substantial proportion of the voting capital may provide a strong case for compulsory disclosure. The difficulties foreseen in the past may be less if the obligation to disclose is not imposed in respect of too small a holding. Thus it might be possible to require disclosure whenever a person acquires control of 10 per cent. or more of any company's ordinary voting rights, wholly or partly through beneficial interest in nominee holdings.

56. As regards effective control as distinct from ownership, it was the Companies (Particulars as to Directors) Act, 1917, which not only required disclosure of a company's directors but also extended the definition of a director to include any person in accordance with whose directions or instructions the directors of a company are accustomed to act. This definition was included in the Prevention of Fraud (Investments) Act, 1939, and in certain sections of the Companies Act, 1948. In fact the requirement has been difficult to enforce. Indeed, its implementation could be confusing as to who are in fact the directors.

57. It has been represented to the Board of Trade that there should be an obligation on any company which is a subsidiary of another to disclose publicly the name of its holding company. If this were made law, it would be necessary to provide against a holding company concealing its identity behind nominees by placing on the true owner of control in such a case an obligation to disclose its identity.

(12) Share Transfer and Registration Procedure

58. There is nothing in the Companies Act to prevent registration of transfer being delayed at the discretion of the transferor by agreement with the transferee. There have been suggestions in connection with take-over bids that shares have been bought by private treaty but transfer delayed by the purchaser so that the company should not be aware that concentrated buying was going on. It is difficult to see what can be done about this since a purchaser can always buy an option to become holder of the shares at some later date.

59. There has also been criticism about the power in the hands of directors to influence the result of a vote at a meeting or a poll by delaying the registration of transfers up to the limit of two months permitted by the Act. Possibly this maximum ought to be reduced.

60. Some discontent has been expressed where directors in a private company have refused to register the transfer of shares to a person to whom the shares have been transmitted by operation of law. For example when a majority shareholder dies, the remaining directors may refuse to register a transfer to his widow. The right to transfer is however a right to transfer membership and the Board do not consider that the right of a company to restrict its membership should be taken away. It is incidentally the main feature which makes the non-exempt private company attractive.

61. The Blagden Committee on Bankruptcy and Deeds of Arrangement mentioned another case of this kind which they thought was a matter for company law. They referred to the difficulties in which a trustee in bankruptcy is placed (in obtaining for the benefit of the creditors the value of shares held by the bankrupt in a private limited company) where the articles limit the transfer of the shares and may prevent the trustee from becoming registered as owner of the shares held by the bankrupt. The Committee may wish to consider whether a trustee in bankruptcy should not have the same right as a contributory to petition the Court for a winding up.

62. Shareholders may not always appreciate the effect of Table A (Part II) Regulation 3 in prohibiting the bequest of membership rights. If Regulation 3 were modified so as to reduce the absolute power of directors, shareholders would still be free to confer absolute discretion on the directors but they would need themselves to take the initiative. Naturally, the directors would need to retain power to refuse transfer if otherwise the statutory maximum of members would be exceeded.

(13) Multiplicity of Directorships Held by One Individual

63. Section 200 of the Act requires the register of directors to contain particulars of any other directorships (other than directorships of wholly-owned subsidiaries) held by each director. There is nothing in the Companies Act which limits the number of directorships which may be held by one person.

64. The Board of Trade recognise that it may be undesirable for a large number of companies to be formed with the same, or preponderantly the same, individuals as directors and members. Such companies are not related as holding company and subsidiaries, do not lay group accounts, and can be manipulated so as to give a false impression of financial stability by inter-company borrowings and book transactions. One small group of individuals can thus form tens and even hundreds of companies, which are independent only in the sense of being separate persons but which have no capacity for independent decision. This can lead to abuse and is an undesirable state of affairs.

65. In general, however, the Board of Trade do not regard the holding of a large number of directorships by one individual as in itself a mischief. They do not think that a solution should be sought by limiting the freedom of companies to appoint directors who may hold a number of other directorships.

(14) Practice of Carrying on Business through Associated and Subsidiary Companies

66. The practice of conducting business through subsidiaries has become increasingly popular and so has the type of holding company the sole purpose of which is to hold the share capital of the subsidiaries and to centralise their management.

67. Section 154 of the Companies Act defines the relationship between a holding company and a subsidiary. It followed from a recommendation of the Cohen Committee that the acid test of the relationship between the two should be control. There seems however to be a case for amending the definition. Thus, the section equates the idea of control with the power to appoint or remove a majority of the board of directors and this involves having a voting majority. But the section also uses the

criterion of a majority of the equity capital and this need not involve having a voting majority since equity shares can be issued without ordinary voting rights. Hence the two criteria conflict.

68. Further, since the definition does not cover the case where the voting rights of a company are held in equal parts by two other companies, evasion is easy of certain provisions of the Act which derive from the subsidiary/holding company relationship, e.g., those of section 27 which debar any allotment or transfer of shares in a company to its subsidiary and those of section 54 which prohibit financial assistance by a company in relation to its own shares or those of its holding company. What seems to be necessary in this case is that the control of the composition of a company's board of directors should be defined in such a way that a power to prevent the appointment or removal of directors would constitute control.

69. Consortia are closely allied to holding companies and subsidiaries but are not necessarily subject to the provisions of the Act referred to above. The Act makes no provision for consortia.

70. While the practice of carrying on business through subsidiaries and through consortia has legitimate uses and conveniences, it is open to abuse. By hiving off its business on to subsidiaries a company can finance them by loans and by its goodwill secure credit for them while reducing its risk to the extent of the issued capital, which may be quite small, of the subsidiary. The shareholders of the holding company thus achieve a double limitation of liability. If a consortium is incorporated a rather similar situation can arise. For example, damages for non-performance of contract could be enforced only to the extent of the issued capital of the consortium-company. The question of fuller responsibility of the holding company for the debts of its subsidiaries, referred to in the Board's evidence on heading 1 of the Committee's Questionnaire, is relevant also to consortia.

71. Another point of difficulty is that the directors of subsidiary companies, although having the position and responsibilities of directors to those companies will stand in a position more akin to that of employees towards the board of directors of the holding company. There may well be a conflict of interest in such cases between the duty of these directors to their company, which may have substantial minority shareholders, and to the board of the holding company.

72. Finally, as has been stated elsewhere in this evidence, where groups of companies are linked only by common directorship there is a temptation to create a fictitious impression of capital resources by means of inter-company borrowings which have reality mainly on paper.

73. The Committee may wish therefore to review the definition of the holding company/subsidiary relationship and to consider whether the law should take account of developments in associations between companies, including consortia, particularly in regard to the possible abuse of limited liability.

(15) Loan Capital

74. It seems to the Board of Trade that the obligation to register charges should be limited to requiring the delivery to the Registrar of Companies of prescribed particulars and not in addition the delivery also of the instrument of charge. Responsibility for the accuracy of the particulars of charges should rest with the person who furnishes them to the Registrar.

75. There are obscurities in the Act as to the effect of default in registering charges. For example, default in notifying new charges results in their becoming void against a liquidator or any creditor and in these circumstances it is not clear why there should be a continuing default fine. Such a fine is appropriate in the case of charges already affecting property acquired by the company, since under the Act they do not become

void by reason of default in registration. Again, it is not clear whether an order under section 101 of the Act extending the time for registration of a charge has the effect of relieving the company and its officers from the criminal liability for the default.

76. It has been represented to the Board of Trade at various times that the list of registrable charges specified in the Act should be reviewed.

(16) Take-over Bids

77. The Board of Trade do not consider that it would be in the general interest to discourage take-over bids by legislation. On the other hand, existing company legislation needs adapting to what is in a sense a relatively recent development, and certain safeguards seem to be necessary. The Board of Trade have indicated what they think these safeguards should be in their new Licensed Dealer Rules which came into force in August, 1960.

78. The rules require, among other things, disclosure of the identity of the true purchaser; submission of the offer to the directors of the offeree company at least three days before it is sent to the offeree company's shareholders; the provision of information about quotations or dealing prices of the shares subject to the bid; disclosure of the interest of the offeror in the offeree company, and of the steps taken to obtain information about the availability of the necessary finance. The offer must remain open for at least 21 days.

79. Where the consideration for the shares in the offeree company consists of shares in the offeror company the rules require information about the financial position and the dividend record of the offeror company, the market value of its shares and information about the first dividend in which any newly issued shares will participate and about their voting rights and whether a resolution of the offeror company is necessary for their issue.

80. The Board of Trade doubt whether anything would be gained by requiring the offeror to state his intentions as to the future of the company bid for. Such a statement would not be legally enforceable and might well therefore not be of help.

81. Where the directors recommend to shareholders acceptance of an offer in a circular distributed with the permission of the Board of Trade or by a licensed dealer in securities they must give information showing their interest (if any) in the success of the offer and such information as they may be expected to have as to the financial affairs or prospects of the offeree company and the market value of its shares. (It should be said here that the interpretation of the provisions of the Act in regard to directors' circulars is far from clear.) The Board of Trade do not think, however, that there should be any statutory obligation on directors of an offeree company to give advice if they prefer not to.

82. Although the Board of Trade rules as to the disclosure of information have been prescribed for licensed dealers they should, in the view of the Board, be made compulsory in regard to all channels through which take-over bids may be effected.

83. If the possible restrictions referred to in paragraph 31 of the Board's evidence on the power of directors were implemented, it would follow that the directors of an offeror company would not ever be able to make an important take-over bid unconditionally without having put the matter to their own company and obtained their agreement. It would seem right, however, that this agreement should always be obtained.

84. The sections of the Companies Act dealing with accounts contain special provisions to meet the case when one company becomes a subsidiary of another but they are not appropriate to the special circumstances of the take-over. Thus it seems to the Board of Trade that the directors of the offeror company should be obliged to have audited accounts of the company taken over prepared as at the date of the take-

over, and should be obliged to lay these accounts subsequently before the members of the offeror company. Further, the accounts should be accompanied by a directors' report which would state (a) the amount paid per share, and in total, for the company taken over and (b) the reason why the directors paid that amount.

85. In many arranged take-over offers the directors of the offeree company enter into a provisional agreement with the offeror on behalf of such shareholders as may accept the offer. The Board of Trade think it wrong that in any such agreements directors should bind themselves not only to accept an offer in respect of their own shares but also in such a way as to inhibit them from recommending to shareholders any subsequent better offer.

86. The Board of Trade do not think that it could reasonably be made compulsory in every case for a company's assets to be valued in connexion with a take-over bid. What would be desirable, if it were practicable, would be that the directors of the offeree company should disclose, if they recommend the offer, any variation known or thought to exist between the book value of the company's assets and the current value which might be the break up value in a liquidation, or the estimated realisation value as a going concern.

87. Difficulties have arisen on the question whether acceptance of a take-over bid can be regarded as irrevocable on the part of the acceptor while the offeror retains the right to terminate his offer at any time until it has been declared unconditional. Possibly it could be required that take-over offers should state the minimum as well as an upper figure of acceptances and that this minimum should not be less than would secure voting control. If an offeror terminates his offer before the closing date, or fails by that date to receive his minimum number of acceptances, then those shareholders who have accepted should be free to reconsider and revoke their acceptances if they so desire.

(17) Prospectuses

88. Legislation concerning the issue of securities and dealings in them is divided between the Companies Act and the Prevention of Fraud (Investments) Act. The two sets of provisions have grown on no very coherent plan and constitute two different systems of control. A requirement about prospectuses was introduced for the first time in company legislation as far back as 1867, but apart from the general criminal law there was until 1929 no statutory control over the subsequent trading in securities after the initial issue. The provisions of the Companies Act, 1929, while they improved the position as regards the initial issue did not prove adequate as regards subsequent trading and strengthened control was introduced by the Prevention of Fraud (Investments) Act, 1939. Under this Act the business of dealing in securities was regulated, as it still is, by restricting the classes of persons permitted to engage in it and not by prescribing the information which should be given, which is the Companies Act approach. It would probably be an advantage if the law about the issue of securities and subsequent dealing in them were co-ordinated in one Act.

89. It seems to the Board of Trade that the definition of a prospectus should be widened to cover an offer of securities for a consideration other than cash. For their part, they already require in their Licensed Dealer Rules that prospectus type information should be given in connexion with take-over bids on a share exchange basis.

90. At present, prospectus information as set out in the Fourth Schedule is not required in regard to (a) new issues to existing shareholders or debenture holders, or (b) new issues which are uniform with securities quoted or dealt in on a prescribed stock exchange. There is a case for requiring such prospectus information in regard to (a) because a rights issue may change the asset basis of securities already in issue in those cases where new capital is contributed by existing members and debenture holders, and because some members and holders may wish to sell their rights to third parties who do not know the company and need this information.

91. The Committee may wish to review the position generally in regard to prospectuses. In particular, they may wish to consider under (b) the exemption enjoyed by securities which are uniform with securities already dealt in but not quoted.

92. The definition of a prospectus should also cover advertising of securities by wireless and television. Special provision may need to be prescribed since full prospectus information could obviously not be given in advertisements through these channels.

93. Conflicting views have been submitted to the Board of Trade from time to time as to the adequacy of the Fourth Schedule. In the Board's view the object of a prospectus is not primarily to enlighten the lay investor and to be readily readable and understood by him, but rather to enable his professional advisers and the financial press generally to assess the merits of the investment proposed in any prospectus and to offer their skilled advice. The Fourth Schedule is probably not therefore too detailed (as is sometimes suggested) but it probably needs adaptation to modern conditions.

94. The Fourth Schedule was not drafted with what are known as "open end" companies in view, namely companies which purchase their own shares on demand and which place newly issued shares continuously on offer. If it were decided to permit such companies to purchase their own shares it would be necessary to adapt the Fourth Schedule so as to take account of the change and also to provide the necessary safeguards. Similarly, the Schedule would need to be adapted if no par value shares were permitted.

95. The interpretation of many terms and expressions used in the Act is obscure. Thus, the meaning of "prospectus" defined as "any invitation offering to the public" is full of difficulty. The meaning of the references in section 55 to an offer of shares in "any other manner" or as being of "domestic concern" is also obscure. The Committee may wish to consider whether a clearer understanding could be reached as to what should constitute an offer to the public.

96. Every prospectus is required by the Act to be dated but there is no statutory obligation to indicate a closing date for the invitation which it contains. Possibly it would be desirable to require that such a closing date should always be stated, particularly as regards unquoted companies. The Committee may wish to take evidence on whether a maximum period could be prescribed during which an offer in a prospectus could remain open.

97. It might be advantageous if the duties of company promoters as recognised in case law were codified in any new Act and thus made more generally known.

98. The Act empowers stock exchanges prescribed by the Board of Trade to grant exemption from compliance with the Fourth Schedule on certain conditions where compliance would be unduly burdensome. The section gives no guidance as to the circumstances in which compliance should be so regarded.

99. There are lacunae in the Act as regards offences relating to prospectuses. Thus the Act makes it a criminal offence to issue a prospectus without delivering a copy for registration to the Registrar of Companies. It has been argued (but it is not the Board's view) that it is not an offence to put out a prospectus which does not comply with the Fourth Schedule (unless it is accompanied by a form of application in which case there would clearly be an offence) or to put out a prospectus which, although it has been delivered to the Registrar, has not in fact been accepted by him for registration because, for example, on the face of it it does not comply with the Schedule. The position ought to be made clear. It may be necessary to provide in the latter case for a right of appeal to the Courts against a refusal of the Registrar to register.

100. There is also confusion as to the responsibilities of the Registrar. Thus, although the Registrar may not register a prospectus unless it is dated and duly signed, and the specified documents are endorsed or attached, the Act does not charge him explicitly with the duty of declining to register a prospectus which does not contain the

information required by the Fourth Schedule. It seems desirable that it should. At the same time the Registrar is in no position to do more than check that the required information is given. It seems to the Board that it should be provided in any new Act that the prospectus itself should state, not only that a copy has been accepted by the Registrar for registration, but that the Registrar takes no responsibility for the accuracy of any statements made or for the financial soundness of the company or the value of the securities concerned.

101. In regard to the allotment provisions, section 47 prohibits a company from making a first allotment of shares offered to the public for subscription unless it has obtained what is known as the minimum subscription. It has been put to the Board of Trade that a similar principle should apply to all subsequent invitations and that a company should be required to specify the purpose for which a new issue is proposed.

102. It has been represented to the Board of Trade that the minimum compulsory period prescribed under section 50 (1) between the issue of a prospectus allotment is too short to enable the public to obtain professional advice and benefit from press comment.

103. There has been criticism of the requirement under section 52 that a return of allotments should be made to the Registrar of companies within one month. Shares are so frequently issued now by means of renounceable letters of allotment which may change hands several times, that any such return is usually out of date.

(18) Control over the Business of Dealing in Securities

104. As already stated under heading 17, the marketing of securities at first issue is regulated by the prospectus and allotment provisions of the Companies Act while subsequent dealing is controlled by the provisions about circulars of the Prevention of Fraud (Investments) Act. The many obscurities and anomalies in the provisions of the two Acts reinforce the suggestion made under heading 17 that all control of the business of dealing in securities should be embodied in one Act.

System of Control

105. The Bodkin Committee recommended a system of registration of all dealers which was to be based on objective criteria with a right of appeal to the Courts. In fact it proved impossible to draft satisfactory provisions on these lines and the scheme of control established by the Prevention of Fraud (Investments) Act is that under section 1 there is a prohibition on the carrying on of the business of dealing in securities, except under licence. This prohibition is lifted for the London Stock Exchange, organisations which receive Board of Trade recognition, dealers who are individually exempted by the Board of Trade and other persons licensed by the Board of Trade to deal in securities.

Bodies specifically exempted by the Act

106. The Board of Trade have no comments on the statutory exemption given by the Act to the Bank of England, members of the London Stock Exchange, local government bodies which are statutory corporations, and municipal corporations. As regards the similar exemption given by the Act to other statutory corporations, most of the public utility undertakings for which the exemption was originally designed have been nationalised, while amalgamations of water companies are now effected by schemes under the Water Act, 1945. The Board doubt whether retention of the exemption is justified for the small residue of such undertakings which have not been nationalised or for statutory trading companies. The reasons for the statutory exemption of industrial and provident societies and building societies are, in the view of the Chief Registrar of Friendly Societies and the Treasury, still valid. As to the building societies, the arguments have been reinforced by the Building Societies Act, 1960.

Recognised Bodies

107. The list of Stock Exchanges outside London recognised by the Board of Trade was drawn up on advice furnished to the Department and there has been no change in the list since 1944. In addition, the Board have recognised six associations of dealers. It seems to the Board that the exemptions granted to the members of these recognised bodies is a reasonable decentralisation of administration.

Exempted dealers

108. It was found impossible to frame a statutory definition of the classes of persons who in the view of the Bodkin Committee ought to be automatically exempted from the prohibition on the carrying on of the business of dealing in securities. Accordingly the Board of Trade were given power at their complete discretion to declare a dealer to be an exempted dealer, subject to certain conditions with regard to the nature of his business being fulfilled so long as the order of exemption is in force. The Board of Trade have however no power under the Act to make rules for the conduct of business by such exempted dealers and the holder of an order of exemption is free of all restrictions imposed by the Act other than those imposed by section 13, subject always to the Board of Trade's power to revoke exemption.

109. The status of exempted dealer has acquired a prestige value. The Board of Trade have found the administration of this section of the Act difficult. They would welcome the views of the Committee on whether the status of exempted dealer should be maintained and if so, what the conditions for exemption should be.

110. If the Committee conclude that the category of exempted dealer ought to be retained they may feel able to agree with the Board of Trade that the exemption should not extend to the requirements bearing on information which must be supplied in circulars.

111. The foregoing presupposes that the conditions for exemption will be reasonably easy to administer. The present statutory provisions are extremely complicated, and difficult of interpretation. In particular there is no yardstick laid down by which to determine what is the "main business" of a dealer or on what basis the greater and lesser parts of the business are to be calculated. The Board of Trade have considered such criteria as net profits, expenditure of man-hours, number of transactions and so on. But none of these is suitable over more than a small part of the field. The Board think that the most likely standard to prove applicable in all cases, if the category of exempted dealer is retained, would be one based upon total turnover.

112. Again, if this exemption is retained, the Board consider that they ought to have power to make inquiries in order to ascertain whether the statutory conditions on which a dealer is exempted are, or continue to be, fulfilled and to impose any further conditions they may think necessary (including the furnishing of prescribed information) on the grant of exempted dealer status. Failure to comply with any such condition should be a ground for revocation of the exemption order.

Licensed dealers

113. The system of the licensing of dealers not otherwise covered by the Act was introduced to provide for the small external broker who was not a member of an association. Only some 35 persons are at present licensed. The figure is small because most dealers are members of recognised stock exchanges or other bodies or are exempted by the Board of Trade. The Act does not expressly provide that a licensed dealer must be a person whose main business is, or is intended to be, dealing in securities, or who has experience in the business of dealing in securities. It would seem desirable that it should.

114. The Board of Trade have found the administration of the conditions which justify the refusal or revocation of a licence difficult. They are prescribed by the Act as such as to be "likely to lead to improper conduct of business or to reflect discredit

upon the method of conducting business". In the 15 years since the Act came into force the Board have very rarely felt able to refuse or revoke a licence. The independent tribunal of appeal has been convened only once. The difficulty is inherent in the circumstances of the case since precise factual information in such matters is seldom available without detailed investigations.

115. An applicant for a licence does not have to give evidence of competence or to show any knowledge or experience of the share-broking business. The Board recognise that it would not be easy to prescribe requirements for proving these qualities or capacity. Nonetheless the Board's licence inevitably confers a certain cachet of respectability on the holder and creates in the eyes of the general public an assumption of competence and reliability which may or may not be justified. The Committee may wish to review the licensing provisions.

116. The original Board of Trade Rules for Licensed Dealers were formulated at a time when take-over bids had not become the development which is now familiar and accordingly they did not make provision for the supply of information when the invitation put out by the dealers is for the purchase and not the sale of securities. The Board of Trade have amended the rules so that they do now govern the conduct of dealers in regard to take-over bids. The Board of Trade think that the principles established in this respect by the new Rules should be made of general application to all dealers in securities.

"Reckless" forecasts

117. Section 13 of the Act makes it an offence to induce persons to do any of the acts mentioned in the section "by the reckless making of any statement, promise or forecast which is misleading, false or deceptive". There have been differing legal decisions as to the meaning of "reckless". Whatever may be the true construction of section 13, it seems to the Board that a person who induces others to invest money by making false, misleading, or deceptive statements and forecasts should be guilty of an offence unless he has made all reasonable inquiries to verify the grounds on which his statement or forecast is based, and indeed has explained why he feels able to make the statement or forecast.

Commodity pools

118. The Act is also concerned with solicitations to invest in schemes like commodity pools. The activities intended to be affected by these provisions were finance pools, where the public are asked to participate in the financing of an undertaking such as the shipment of a commodity; or pools, where the public are asked to participate in the purchase of a quantity of some metal or other commodity in the expectation of a rise in value; mushroom farms, apple orchards and the like, schemes whose place has now been taken by mink or pig farms, real estate pools, whisky pools and so on. It is to be noted that while the Act prohibits all circularisation in connexion with investment in such schemes, the business of promoting or running the schemes themselves is not prohibited by the Act although there are penalties if the schemes should be fraudulent.

Advertisements

119. There are obscurities as to the intention of the Act in regard to advertisements. The Board think that the law should be clarified on this point and that the prohibition on circularisation ought to extend to advertisements in newspapers and periodicals, subject to safeguarding the position of *bona fide* comment on investment. On this the existing provisions of the Act are obscure. Further there should be an exemption, subject to safeguards, for investment advisory newspapers which are sold to subscribers as an incidental or subsidiary business by newspaper proprietors, who already qualify for exemption.

120. Advertisements offering "businesses" for sale are a common feature in the daily press. A number of persons describing themselves as "business consultants" advertise regularly and such advertisement is part of their ordinary business. The sale

of businesses owned by companies in consequence of such advertisement often involves a sale of the share capital of the company which owns the business. It is for consideration whether this sort of business is fulfilling a need and in any case, whether it affords opportunity for abuse and consequently needs to be brought under control.

121. Another aspect of this subject which has caused much difficulty is the status of the genuine "investment consultant", i.e., a person who simply sells advice about securities without himself having any interest in the securities concerned. Literature purporting to be issued on this basis does provide a convenient cover for abuse. On the other hand there is no reason why genuine consultants should be interfered with. Their position under the Act is unsatisfactory.

122. The Committee may wish to consider whether provision should be made for the registration and control of the business of an investment advisory bureau whether or not such business is combined with investment management.

Shares on instalment purchase

123. The Board of Trade Rules for Licensed Dealers prohibit transactions in securities involving payment by instalments except on certain conditions. Managers of unit trust schemes have announced schemes for investment in unit trust schemes on instalment purchase terms (with transfer of ownership deferred until payments have been completed) combined in some cases with schemes of insurance. Since the instalment purchase business has developed very considerably since 1939 in both extent and complexity, the Committee may wish to consider whether transactions in securities involving payment by instalments and deferred transfer should continue to be regulated generally.

124. The Act contains a large number of exceptions to the prohibition on circularising. It excepts circulars which contain an invitation (or information) put out by or on behalf of a permitted person. There is doubt however whether a permitted person may legally put out a circular containing an invitation made on behalf of a client although this is what usually happens. The Board of Trade take the view that there ought to be an express exemption for circulars issued by a permitted person on behalf of a client.

125. There is also a general exception as regards circulars for which the Board of Trade give permission. The debates in Parliament suggest that what was intended by this permission was the exceptional unforeseen case. In fact this exception has often provided the only means whereby directors of an offeree company can legally issue circulars to shareholders of the company conveying to them the terms of a take-over bid together with advice about it. Board of Trade permission for the issue of such circulars has accordingly been sought increasingly. This is liable to lead to misunderstanding. It is true that the Board of Trade require the circulars to bear in a prominent position the warning that the permission given by the Board of Trade for distribution of the documents does not imply approval by them of the terms of the offer or responsibility for any of the statements made or for the soundness of any of the opinions expressed. The fact that the circular has been seen by the Board of Trade suggests nonetheless that its contents are to be relied upon. What the Board of Trade have done is to ensure that the necessary information is provided but they cannot check the accuracy of that information. The necessity to have recourse to the Board of Trade arises from the fact that when the Prevention of Fraud (Investments) Act was passed the present development of take-over bids was not foreseen. In any revision of the Act to take account of this development this is a matter which needs attention. The Board of Trade do not consider it desirable that their permission should be sought for these circulars. The more so as they may become involved in a war of circulars if a counter circular is put out which advises against the acceptance of the offer and which needs no Board of Trade permission. Such a circular does not have to be sent out through authorised channels. This results from the fact that the existing legislation does not apply to circulars which recommend against the

acceptance of a bid. Advice against the acceptance of a bid needs to be backed by full and accurate information just as much as advice which is in favour of the acceptance of a bid.

126. In general the provisions of the Prevention of Fraud (Investments) Act governing the issue of circulars are extremely complicated and are the subject of differing interpretations. Any new Act would need to state the position much more clearly.

(19) Unit Trusts and Open End Mutual Funds

(a) Unit Trusts authorised by the Board of Trade

127. No circulars may be issued (except to dealers) in relation to a unit trust scheme unless the scheme has been authorised by the Board of Trade. The Prevention of Fraud (Investments) Act gives the Board of Trade power to authorise such schemes provided that certain conditions are satisfied. In particular the trust deed must provide "to the satisfaction of the Board" for the matters specified by the First Schedule to the Act. Under this discretion the Board of Trade have laid down detailed requirements as to the contents of accounts, the manner in which the price of units is to be determined and the manner of calculating yield. The Board's power under this discretion to regulate the cost to the unit holder of the administration of a unit trust has been challenged but was confirmed by the Court.

128. The Board have also a wider and more general discretionary power on which they rely to support the conditions which they attach to authorisation in addition to the matters specified in the First Schedule, for example, that the funds of a trust shall, in general, be invested in more than 50 different companies at any one time, but that not more than 5 per cent. of the total fund shall be invested in any one company and not more than 5 per cent. of the total issued ordinary capital of any one company shall be owned by the trust.

129. A consequence of the statutory requirement that the managers and trustees must be incorporated in the United Kingdom is that the Board of Trade cannot authorise any unit trust scheme formed abroad. This makes it very difficult for such trusts to operate in this country since, although an unauthorised trust is not illegal, no one may put out circulars in relation to it except to dealers. On the other hand the Anderson Committee seems to have envisaged in their Report on Fixed Trusts (paragraph 97) that overseas trusts should be enabled, subject to supervision, to operate in the United Kingdom.

130. So long as existing Board of Trade controls over United Kingdom trusts continue (particularly the control over the share borne by the unit holder of the administrative costs), the Board can see no equitable basis on which foreign and overseas commonwealth trusts could be permitted to operate, except under full compliance with Board of Trade rules. This is not generally practicable.

Other Statutory Requirements

131. The authorised capital requirement for the trustee corporation (or its parent) of £500,000 (of which only £250,000 has to be paid up) may not be adequate to the purposes which the Anderson Committee had in mind and should be reviewed. The trustee ought also to be a limited liability company (i.e., subject to the safeguards which attach to limited liability) and a public company, and not a company whose assets and accounts can be concealed from public view.

132. One of the most potent safeguards for the unit trust investor is maximum publicity for the affairs of the unit trust. The Board suggest therefore that, like the trustee, the manager should be required to be a limited liability company, and not an exempt private company. (The present Act already requires that the trustee or manager should have a place of business in Great Britain.) If the manager company is a subsidiary of another company, the Board think that it should be obliged to state

the name of its holding company in all publicity relating to the trust and that the holding company should be a company incorporated under the United Kingdom law with a place of business in Great Britain.

133. The Board of Trade require undertakings when they authorise a unit trust that they will be informed as to changes in the trustee and the manager companies. It would be more satisfactory if it could be provided in any new Act that the Board of Trade order authorising a unit trust scheme may itself include conditions, particularly as to the giving of information.

134. *Should managers act as principals?* The Anderson Committee in their Report on Fixed Trusts strongly recommended that managers should not be permitted to act as principals in regard to the issue and sale of units and the London Stock Exchange has consistently maintained the same thing. There are few, if any, who would dispute the correctness of this principle, although present managers as a whole feel, with one important exception, that it would be impracticable to enforce it strictly to the letter.

135. The Board of Trade have hitherto accepted the view of the majority of managers that it would be impracticable to enforce a rule against dealings by managers as principals. They have, however, taken steps, for example, in the case of repurchase bargains, to prevent managers from dealing, as principals, at the expense of unit holders. The Board also consider that managers should be debarred from making a profit for themselves from transactions in regard to the portfolio. The Committee will wish to consider the general question whether managers should act as principals.

136. One effect of paragraph 1 of the First Schedule is to oblige the trust to create a market for its own units and to require managers to act as principals at least in respect of the repurchase of units from unit holders. The Board of Trade consider that the paragraph should be amended so as to enable managers, if they so wish, to act as agents for the trust instead of as principals for the repurchase as for the issue and sale of units.

Board of Trade control of prices

137. Paragraph 1 of the First Schedule to the Prevention of Fraud (Investments) Act requires deeds to contain provisions determining how the sale price, purchase price, and yield of units are to be calculated but there is no statutory indication as to the basis or the methods by reference to which these calculations should be made. The Board of Trade have evolved their own requirements.

138. Thus, the Board of Trade have required that the price of units on sale or repurchase shall be determined from day to day on the basis of asset value. In principle, the price must be calculated by dividing the total value of the property vested in the trust by the number of units in issue at any time. To this basic price the Board allow certain strictly calculated modifications to cover fiscal and brokerage charges and administration costs of the trust, including the remuneration of managers and trustees.

139. The Board have sought to limit the impact on the unit holder of the administrative costs to a total of $13\frac{1}{2}$ per cent. over a 20-year period. This includes a preliminary charge on the purchase of a unit of between 2 per cent. to 5 per cent. on the price as calculated above, and an annual charge, deducted from income distribution, of up to $\frac{1}{2}$ per cent. on the capital value of the trust. The Board have taken the view that a higher preliminary charge than 5 per cent. would penalise the small investor too heavily if he realised his investment before completion of a 20-year term. The limit of $13\frac{1}{2}$ per cent. does not take account, so far as remuneration to the manager is concerned, of the additional preliminary charges which are levied on the repurchase of units.

140. Paragraph 1 of the First Schedule does not prohibit managers from purchasing at less than current asset value if they are able to agree a "repurchase bargain" with the unit holder. The Board of Trade take the view that the right of the unit holder to what is known as the Board of Trade price should always be expressly brought to his

notice. In fact, it has since been accepted by all unit trust managers that these special bargains shall not be permitted. It will be necessary to make appropriate provision accordingly in any new Act.

141. The Board would, however, welcome the recommendations of the Committee on the question whether it is desirable that a Government Department should continue to control costs. If however the control of charges were to be relaxed or abandoned, the question of a specific ban on the possibility of door-to-door sales of the units of unit trusts would need consideration. Such selling by licensed dealers is already forbidden under the Board of Trade rules for licensed dealers.

Block offers

142. Block offers, i.e., offers of units at a fixed price for a limited period of time are defended by managers, with, once again, one exception, on the practical ground that they are a useful sales technique. Their effectiveness depends upon suggesting to the investor that he is being offered a bargain for a short time only. If the units are offered at bargain prices, this can only be to the prejudice of the existing unit holders. The fundamental principle of the well-managed unit trust is to maintain strict equivalence at all times between the new investor, existing unit holders and those who sell out. The Board of Trade therefore ensure that trust deeds provide that any element of bargain in the block offer is restricted to a maximum of 2½ per cent. variation from current price based on asset value. The suggestion that a certain quantity of units is available for a short time only is also misleading. Units will be continuously available, as indeed is often stated in block offer advertisements, though not necessarily at the price at which the block offer is made. The Committee will wish to consider whether block offers should continue to be permitted.

Consultations with unit trust managers

143. The Board have been engaged for some time in discussions with the unit trusts concerning certain changes which the Board wish to introduce in the departmental requirements concerning trust deeds. The intention was that this should be an interim measure, pending the Committee's report.

(b) Mutual Fund Companies

144. The expression "mutual fund company" is used in Canada and the United States to denote the sort of investment company which issues its shares continuously to demand and which has the power and obligation to repurchase its own shares on demand. The sale price and the repurchase price of shares are usually calculated on the basis of asset value (the sole assets of such company often being its portfolio of investments) with allowance made for administration costs, cost of advertisements, fiscal charges, and so on. The business of the mutual fund company is thus closely akin to that of the unit trust in the United Kingdom.

145. A mutual fund company cannot legally be created under United Kingdom law with limited liability. There is, however, no impediment to an unlimited company registered in Great Britain taking power to repurchase its own shares at will. Nor is it illegal for a limited liability company, incorporated abroad with powers to repurchase its own shares, to carry on business in Great Britain. Any mutual fund company, however, runs into difficulty in the United Kingdom because of the prospectus provisions. The shares of such a company are continuously on offer at a varying price calculated on asset value. In the Board's view the statement of a "formula" price would not sufficiently comply with paragraph 6 of the Fourth Schedule, which requires a prospectus to state the amount payable on application and the allotment of each share. The Fourth Schedule was clearly not designed with the mutual fund company in view and is not drafted so as to elicit the sort of information which such a company should give.

146. The admission of overseas mutual fund companies would seem to require a control which would be extremely difficult, namely, discrimination between such com-

panies, according as to whether or not they were subject to close control in the country of incorporation.

147. The Board of Trade think however that there might be a dispensation in respect of companies whose business is confined to investing in securities, so that they might be permitted both to purchase their own shares and to hold them for resale to the public. If this were allowed, the mutual fund company on the North American model would be possible in the United Kingdom with limited liability. Control of any such investment companies would, however, seem to be inescapable so long as unit trusts are subject to Board of Trade regulation. If, however, the Committee think there are objections to any such departure from the general principle which precludes the purchase by a company of its own shares, they might wish to consider whether the Fourth Schedule relating to prospectus provisions should be amended so as to render it possible for unlimited companies in the United Kingdom, subject to adequate safeguards, to transact the business of mutual fund companies.

148. The Committee may wish to consider whether all unit trusts (and investment companies if permitted to operate in the way described), should be required to issue a statement in lieu of prospectus both before they solicit investments from the public and thereafter annually (or at six-monthly intervals) and further whether every prospective investor should be entitled to receive a copy of the latest such statement before he invests.

Investment Clubs

149. Investment clubs are increasing in popularity. They differ from the usual unit trust scheme since it is the investors who are the members of the club and take their own collective decisions about the investment of their contributions and management of the portfolio. The Board of Trade have no direct information about these clubs whose business is not subject to any statutory control. If in fact they set up what constitutes an unauthorised unit trust scheme they would not be able to issue circulars without contravening the Prevention of Fraud (Investments) Act.

(20) Reduction of Capital and Purchase by a Company of its own Shares

150. As the law now stands a company is free to issue documents giving its nominal capital without disclosing the amount of its issued capital. This can be misleading and the Committee may wish to consider whether it would not be in the public interest to require companies to disclose their issued share capital and the proportion thereof which is paid up, in any document in which they state their authorised capital.

151. The law requires that the full amount of the issued capital, stated in the annual return to be paid up, should actually be raised. The Act recognises that shares may be paid for otherwise than in cash and ordinarily, subject to the possibility of challenge, the company's valuation of consideration other than cash is accepted. The requirement in section 52 to make a detailed return of allotment in such cases is often evaded by an arrangement whereby a vendor purports to sell for cash, relying on a set-off from the company. The Committee may wish to consider whether the provisions of the Act should be tightened against such evasion.

152. The Act does not expressly prohibit the reduction of capital but it has been held that the terms in which section 66 permits it clearly imply that it is prohibited except to the extent expressly permitted. By "reduction of capital" is usually meant the return of any part of a company's issued capital to its members or any operation that, directly or indirectly, has this effect. Except as provided in section 65 the Courts have refused to countenance any indirect forms of reduction of capital. Thus they have held that a company cannot purchase its own shares, even if such a power exists in the memorandum or articles, because to do so would be a return of capital to members. This decision of the Courts was supplemented in 1928 by the statutory provision (now section 54) prohibiting a company from giving financial assistance for the purchase of its shares and in 1947 by the provision prohibiting a company from being a member of its holding company (now section 27).

153. Both these sections were designed to prevent evasion of the prohibition against reduction of capital by a return of capital to members. The Courts have also sought to prevent indirect return of capital to members under the guise of interest and by implication section 65 prohibits the payment of interest out of capital, except in the conditions specified in the section.

154. In general the Board think that provision should continue to be made to safeguard the capital as a permanent fund and to prevent its return to members except under proper conditions. They are doubtful whether the existing provisions, many of which go back to 1862 and 1867, are either adequate or suitable to modern conditions. (They would need amendment if no par value shares were introduced.) The Board think that the Act should be clarified in respect to the conditions under which a company may take power to purchase its own shares. They take the view that subject to proper safeguards, companies restricted to investment business only might be allowed to reduce capital by purchasing their own shares. In their evidence on heading 19 the Board of Trade express their view in favour of mutual fund companies.

155. Section 54 prohibits a company from giving financial assistance for the acquisition of its own shares or its holding company's shares, subject to a criminal penalty. The Board of Trade believe that this section is frequently disregarded because of the small penalty, particularly where companies are associated by common members and directors. (See the Board's evidence on headings 1 and 14.) If the provision is to be retained, the penalty should be materially increased.

156. Section 54 contains exceptions from this prohibition in favour of co-partnership schemes designed to encourage employees to become shareholders of the company and of its associated companies. It has, however, been represented to the Board of Trade that the section is now out of line with modern developments of co-partnership schemes and that the Act should be amended so as to facilitate such schemes. The argument is that under modern schemes the company issues shares direct to employees and that the requirement about trustees could be abolished. The Board of Trade have also been informed that by virtue of the inclusion of directors who hold salaried employments in the company as beneficiaries under schemes which are covered by proviso (b) of section 54 such schemes may be abused in order to secure for the directors voting control of the company.

157. The conversion of irredeemable into redeemable preference shares technically involves a reduction of capital and cannot be effected without separate recourse to the Court under sections 66 to 69. The Committee may wish to consider whether such separate recourse should be necessary in this case.

(21) Accounts

158. The Companies Act imposes no direct obligation on a company as such to make its accounts public. Therefore, if accounts for the period have not been laid, the Registrar of Companies is obliged to accept and file an annual return without annexed accounts, even when the company is not an exempt private company. By far the largest proportion of complaints made to the Board of Trade relate to delays in the laying and publication of accounts, particularly by unquoted companies. It would be better, therefore, that there should be an express obligation to publish accounts and that it should not, as now, derive from the obligation of the directors to present accounts to the company.

159. At present accounts may legally become as much as three-and-a-half years out of date before the next set of accounts become available for public inspection on the files of the Registrar. The Board suggest further, therefore, that the laying of accounts should be tied to the annual general meeting. This would give more importance to the requirement for an annual general meeting to be held every year and would materially reduce the length of time by which accounts available to the public could be legally out of date.

160. Apart from their primary and proper function, company accounts are of considerable value as sources of information for the purposes of general economic analysis. The Board have been engaged in bringing together the information already available in the annual accounts of companies engaged in industry and trade. This work continues, and is designed to extend, the analysis initiated by the National Institute of Economic and Social Research into the sources and uses of company funds. The purpose is to throw light upon the way in which industry is financed, the variety of experience and policy of companies differently circumstanced, the structure of industry in terms of enterprises and the relationships between financial circumstances and economic action. In order to do this work, it is necessary to be able to identify all the subsidiaries whose activities are covered by the consolidated accounts. Work of the kind described would be much facilitated if subsidiary companies indicated that they were subsidiaries and named their parents, and parent companies their subsidiaries. There are many other respects (too detailed to specify here) in which changes in accountancy practice would assist this work.

161. There is dissatisfaction among shareholders and debenture holders about the adequacy of company accounts to give a fair and accurate indication of the present value of fixed assets. The Board feel that this basic problem should be reviewed, including suggestions which have been made that fixed assets ought to be revalued at regular intervals. Perhaps paragraph 4 (3) of the Eighth Schedule should be amended so as to remove its present ambiguity and to require that the particular method adopted in arriving at the amount of fixed assets should be clearly stated and that, if more than one method has been adopted, the fixed assets under each head should be subdivided accordingly.

162. The other most important general point where the Board have been made aware of widespread dissatisfaction is the lack of any requirement to disclose turnover or gross revenue, which, it is claimed, would do much to make accounts more informative and to facilitate valid comparisons between businesses.

163. Where a company has a subsidiary or subsidiaries it is required to present group accounts or, in certain circumstances, to provide the information under paragraph 15 (4) of the Eighth Schedule so as to give shareholders information as to their share of the subsidiaries' profits and revenue reserves which they would have been given had consolidated accounts been presented. But there is no provision in the Act which requires a holding company to disclose either the identity of, or the extent of its holdings in, its individual subsidiaries. The Board of Trade take the view that a holding company should be required to disclose in its balance sheet the identity of its subsidiaries. This would appear to be a necessary corollary if subsidiaries are required to disclose the identity of their holding companies as is suggested in the Board's evidence on heading 11 about ownership and control. The holding company should also show the amount of its holding in each subsidiary, and possibly inter-company loans. There is also the question whether companies should be required to disclose in their accounts the identity of, and salient facts about, "associated" companies in which they hold more than, say, 10 per cent. of the issued share capital or have a material debenture holding, and the current value, so far as it is ascertainable, of their investment in each. Perhaps, too, paragraph 16 (1) of the Eighth Schedule should be amended so as to include disclosure of shareholdings, in addition to indebtedness, in fellow subsidiaries.

164. Subsection (1) of section 157 requires a director's report to be attached to the balance sheet and subsection (2) states that the report shall deal, so far as is material and is not harmful to the business, with any change during the financial year in the nature of the company's business, or in the company's subsidiaries, or in the classes of business in which the company has an interest, whether as a member of another company or otherwise. The Board receive frequent complaints, particularly from small and private companies, that the directors' report has been uninformative or misleading. Directors could be required to justify under section 157 (2) any failure to give complete

relevant information and to include, as under section 207 (1), a statement of any material interests of their own, whether as directors or as members or as creditors of the company or otherwise, in the matters required to be disclosed in the directors' report.

165. The Board have power under the Act to exempt directors from dealing with any subsidiary in group accounts if the result would be harmful or if the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking. Application for Board of Trade approval is often made because directors prefer not themselves to take the responsibility of deciding not to deal with a subsidiary, or subsidiaries, in group accounts. These are not, however, proper matters on which the Board should have to take a decision.

166. Paragraph 23 of the Eighth Schedule allows banking and discount companies relief from the requirements to disclose their reserves and certain of their provisions and places on the Board of Trade the responsibility for deciding which companies ought to be treated as banking or discount companies for this purpose. The concession has come to acquire a prestige value additional to its practical convenience and the Board have been under considerable pressure from classes of companies which claim to come within the "recognised conception" of a bank. There is, however, no accepted definition of a bank. The Board have frequently found it difficult to decide whether or not a particular company ought to be treated as a banking company for this purpose. At present 107 companies enjoy the exemption. It is for consideration whether in modern conditions there is sufficient reason for this concession, giving power to build up, and reduce, undisclosed reserves, to continue at all and if so, whether the sort of companies which enjoy the exemption could be objectively defined.

167. There is also a similar exemption for insurance companies applicable to all companies which are insurance companies within the meaning of the Insurance Companies Act, 1958. According to the 1959 returns made to the Board of Trade under the Insurance Companies Act, 1958, 308 U.K. companies and 124 overseas companies enjoy the exemption, of which 73 and 48 respectively did not make use of it. The Committee will wish to consider whether this exemption should continue and, if so, whether it should in any way be modified.

168. Paragraph 25 of the Eighth Schedule empowers the Board of Trade, if it appears to them desirable in the national interest, to prescribe other classes of companies which shall enjoy similar concessions. The Board have so prescribed shipping companies, defining them for the purpose as companies the major part of whose business consists of shipping other than coastal shipping. About 250 companies enjoy exemption under this order. It is for consideration whether the exemption should continue at all, or on this scale.

The Board themselves doubt further whether this concession to build up, and reduce, undisclosed reserves should be extended to any additional class of company.

169. It has been suggested that the financial year of companies should be standardised as in certain other Commonwealth countries, on the ground that this would greatly enhance the value of accounts for purposes of economic analysis and comparison. At present roughly 50 per cent. of companies whose accounts are filed with the Registrar make their financial year coincide with the fiscal year, about 25 per cent. make it coincide with the calendar year and of the remaining 25 per cent. the majority end their financial year with the end of the third quarter.

170. Section 153 (1) of the Act requires that the financial years of companies associated as holding company and subsidiaries should be made to coincide unless there are good reasons against it. (There is in fact no penalty for non-compliance.) With this latter qualification companies are free to choose their own financial years and to alter them at will. It must be conceded however that while standardisation might have distinct advantages, it would also tend to throw a heavy burden of work on the accountancy profession at certain seasons of the year and might prove impracticable for this reason, particularly if all companies were required to have audited accounts.

171. It has further been suggested that the Act should contain a standard form of accounts and various forms of allegedly simplified accounts have been proposed for the Board's consideration. The Board doubt whether it is possible to devise a standard form of accounts which would be appropriate for all companies. The Board have frequently been consulted on the propriety of publishing so-called "simplified accounts" when a company has filed with the Registrar accounts complying with the conditions of the Act. The Board see both advantages and dangers in this practice. It is probable that a simplified balance sheet published in a newspaper could be more revealing to the general public of a company's financial position than the full and often complicated accounts laid before the company and filed with the Registrar in accordance with the Act. On the other hand such simplified balance sheets, not being subject to control, could be used to mislead the public generally.

172. The phrase "true and fair view" has been the subject of considerable criticism, particularly where material figures are permitted to be omitted from the accounts, as in the case of banking, insurance, and shipping companies. The question arises whether it is suitable to be retained or whether it should be modified, possibly in the direction of the phrase "present fairly" which is current in the U.S.A.

173. It seems to the Board that it should be made clear that the obligation under section 147 to "keep" proper books of account includes an obligation to preserve them for a period of five years. Further, liability for default should be imposed not only on the directors but on all the company's officers who are in default.

174. The Board have received no representations on matters covered by sub-heads (b) to (c) of this heading.

(22) Audit

175. Auditors may not be removed from office by the company between one annual general meeting and the next. This provision would be effective if the laying of accounts were tied to the annual general meeting as the Board have suggested elsewhere in this evidence.

176. Section 159 (3) gives the Board of Trade discretionary power to appoint auditors where at an annual general meeting no auditors have been appointed or reappointed, and subsection (4) requires a company to notify the Board within a week of this power becoming exercisable. The power has been exercised on 22 occasions and the Board have been notified under subsection (4) on 31 occasions. Defective appointments of auditors are probably much more common than this, and the Board think that in connection with their proposal that all companies should be required to publish properly audited accounts, a penalty should be prescribed in the case where a company is in default in appointing qualified auditors.

177. It has been suggested to the Board that any new Act should provide for the compulsory removal of an auditor from office between annual general meetings if he has been convicted in the Courts of an offence of a nature which makes him unfit to perform the duties of his office, or if he has been suspended from membership of an accountancy body for reasons which demonstrate that reliance cannot properly be placed on his integrity and honesty. It seems to the Board important that if any general power of this kind should be given to remove an auditor during his year of office the circumstances in which removal may take place should be strictly defined.

178. Until 1947 no professional qualifications were required of an auditor of a company registered under the Companies Acts. In 1945-1947 a Public Accountants Bill was promoted by the leading accountancy bodies, which would have regulated the practice of accountancy by instituting a system of registration. The project was not proceeded with and the accountancy profession is subject to no statutory regulation. The requirement that auditors of companies (other than exempt private companies) should be professionally qualified persons was introduced on the recommendation of the Cohen Committee. They took the view that an audit by an unqualified person

could not as a general rule be regarded as satisfactory. Section 161 (1) (a) of the Companies Act qualifies for appointment as auditor the members of the United Kingdom accountancy bodies recognised for this purpose by the Board of Trade. These are the three Institutes of Chartered Accountants, the Society of Incorporated Accountants and Auditors (whose members are now absorbed by the chartered bodies) and the Association of Certified and Corporate Accountants. Where bodies corporate are created by Act of Parliament it is also usual to restrict the auditors to members of these recognised accountancy bodies.

179. Section 161 (1) (b) of the Act empowers the Board of Trade also to authorise individuals in the circumstances there specified. The Board have authorised foreign accountants to be appointed auditors if they are advised that the professional standards of the foreign accountancy organisations to which the applicants belong are similar to those of the recognised United Kingdom bodies. As a condition of authorising other individuals the Board of Trade have required evidence that an applicant has been in the employment of a member of a recognised body of accountants for, in general, five years and that his employment has been such as to enable him to obtain adequate knowledge and experience in the work of auditing the accounts of companies other than exempt private companies. It can be argued that it is not a proper function of a Government Department to assess professional competence and indeed the Board of Trade have experienced difficulties in regard to their responsibility in this matter.

180. As regards safeguards to ensure the independence of the auditor it has been represented to the Board of Trade that section 161 (2) should be amended so as to prevent the auditor of a company providing from his staff the board of directors and the secretary of the company, and further so as to ensure that the same individual should not be able to act both as registrar (or transfer agent) and auditor of a company. Similarly in the case of exempt private companies the auditor ought not to be, as he may be at present, a partner or an employee of an officer of the company.

181. Exempt private companies are not obliged to appoint properly qualified auditors, mainly because it was thought that otherwise the strain imposed on the accountancy profession would be too great. The Board have elsewhere suggested that the position of exempt private companies in this respect should be reconsidered.

182. The extent to which auditors should go behind and check the books of account, and the extent to which they may accept directors' certificates, are to some extent governed by case law and professional codes. But there is no uniformity of practice and it is for consideration whether the duties of auditors in this regard should be clarified in any new Act.

183. The form of auditors' report required by section 162 in conjunction with the Ninth Schedule has been much criticised to the Board of Trade as being over elaborate and too complicated for reading before the company in general meeting. There may be a case for simplification if this can be done without impairing the value of the report to the members.

(23) Provisions as to Returns

184. The Companies Act is defective as to the duties of the Registrar of Companies in relation to documents sent to him in pursuance of provisions of the Act. Among other deficiencies he is not expressly required to keep a register of companies. In practice he does keep a register drawn up *ad hoc*. There is also obscurity as to his responsibilities in regard to the verification of the returns made to him. Thus he has no express authority to reject returns and his power to do so has been challenged. On the other hand, if he files all returns indiscriminately, even if they are in his opinion invalid or improperly made, the public inspecting them on the files may well assume that they are satisfactory and will be misled. In practice the Registrar concerns himself as a general rule only with the formal correctness of the returns. Specific difficulties of the kind referred to arise in regard to the registration of the memorandum and articles;

notification of (and change of) name, registration of company resolutions, and the filing of prospectuses and of annual returns. In any new Act it should be made clear what powers of verification and what measure of responsibility are placed upon the Registrar. In general the Board think that he should not be responsible for the truth or correctness of statements in documents submitted to him. He should however have express power to reject a document which he has reason to believe is contrary to the law, invalid, or submitted by an unauthorised person. It would be a necessary corollary that there should be provision for appeal to the Court against the Registrar's decision. It would also be necessary to include a saving clause to the effect that acceptance by the Registrar does not of itself guarantee the correctness of a document.

(24) Company and Business Names

Similarity between names

185. The main purpose of the Registration of Business Names Act, 1916, was to require persons who trade in names other than their own to disclose their true names. The major impetus to give legislative effect to what had long been felt to be a need came from the strength of popular feeling against persons of German extraction during the 1914-1918 war.

186. The Registrar had also a duty (and still has) to reject any name which was misleading because it wrongly suggested British ownership or control.

187. The Companies Act, 1929, included a prohibition against too similar company names and also included a list of words which a company either could not include in its name at all or only with the consent of the Board of Trade. Such words were "building society", "royal", "imperial", "municipal", "chartered", "co-operative". Further, the words "chamber of commerce" could be used only by companies which held the Board of Trade licence to be incorporated as limited companies without the word "Limited" in their name. The Act also contained prohibition of registration, without the consent of the Board of Trade, of names which in the opinion of the Registrar suggested royal or government patronage.

188. The Cohen Committee reported that these provisions were unsatisfactory and recommended that, as it was not possible to devise a comprehensive list of the features which could make a name undesirable, the best way of preventing the registration of undesirable names was to leave it to the discretion of the Registrar and the Board of Trade.

189. The Companies Act was accordingly amended in 1947 so as to prohibit the registration of a company by any name which is in the opinion of the Board of Trade undesirable. There is no appeal against the Board of Trade's decision.

190. At the same time the Registrar of Business Names was given power (similar to the Board of Trade's power in relation to company names) to refuse to register any name which is in his opinion undesirable. (There is an appeal from his decision to the Board of Trade.) The intention was to stop the frustration of the control of company names. A company which had been refused a company name because the Board of Trade had judged it to be undesirable would without the amendment, have been free to use that name as a business name while having a registered company name which was innocuous.

191. It would be reasonable to argue that, when the criterion of undesirability was introduced into the fields of company names and business names alike the same criterion of misleading similarity should be applied over the whole field of names. This has in fact proved impracticable because of the very large number of company names and of business names. There are some 370,000 company names and 750,000 registered business names and both are being added to at the rate of 35,000 a year.

192. In fact the Registrar of Business Names on being charged in 1947 with the responsibility of preventing the registration of undesirable business names, found

himself in charge of a register, built up over the previous 30 years, which was not indexed in a form adapted for checking against identity or similarity of names, since before 1947 he had had no responsibility of this kind. Moreover since that date the Register of Business Names has been incomplete for the purpose of checking for similarity if only because a large number of names which should have been registered have not, in fact, been registered. There seemed to be little utility therefore in checking against such a register.

193. The practice has been that an application for a company name is checked for similarity against the companies register but not against the business names register. Similarly an application to register a business name is not checked against either register, unless the application is from a company to register a business name different from its corporate name. In that case the desired business name is checked against the index of company names. It is true that if it happens to be noticed that the name applied for by the company is too like a well-known trading name, it would be refused registration.

194. The Board of Trade may within six months of registration direct a company to change its name if it has been registered by a name which is in the opinion of the Board of Trade too like one already registered. There is no power however to require a change of business name once it has been registered.

195. A decision on whether a name is undesirably like another is often a far from straightforward matter. Moreover the Registrar of Companies endeavours also, as was envisaged by the Cohen Committee, to have regard to the danger of confusion with existing trade marks. The problem has therefore become increasingly difficult with the rapid increase in the number of names on the register so that decisions cannot always be reached as speedily as is desirable.

196. Again there are so many names on the companies register that quite small differences in names have to be accepted as adequate differentiation, although the companies concerned often do not agree that the distinction is enough to avoid confusion.

197. In general it is for consideration whether the results of the control of similarities between names by the Board of Trade which can involve considerable delay in the registration of a company, justify the extensive administration which is necessary. It is a matter on which the Committee may care to take evidence.

Advance publication of a proposed name

198. In many Commonwealth countries the Registrar of Companies has power to reserve a name on application for a period of from 30 to 60 days and the applicant is required to publicise in the Press the proposed name of a company, whether it is a new company or a new name for an existing company. A provision of this sort would give persons wishing to do so an opportunity to bring facts about a name to the knowledge of the Board of Trade in advance of its registration. This would be a considerable improvement in some respects over the present situation. It would, however, increase the time needed for the incorporation of a company or a change of name and already delays on this account have been the subject of criticism. Moreover, it would mean that any company interested would have to employ somebody to examine daily a list of some 250 names, since it is at that rate that new applications for company names are made.

199. Detailed comment on matters affecting company and business names are set out in the following paragraphs. The proposals which are made relate to the legislative requirements as they stand at present.

Business names

200. The register of business names provides a means of ascertaining the proprietors of the business. (The name of the proprietor is also required to be shown, both

under the Business Names and the Companies Act, on the firm's note-paper.) Inspections of the register by the public now number approximately 200 a day and in addition about 50,000 searches a year are made by the Registrar in response to applications for copies or extracts of registered statements. The majority of the latter are from companies registration agents who seek the information for the purpose of sending circulars to the proprietors, for advertising purposes or with suggestions, for example, as to the desirability of incorporating as a company. One reason for the inquiries from the public seems to be to find the true name of the proprietor whom a creditor may wish to sue for a debt incurred under the business name.

201. Ignorance of the Act is widespread and there are serious weaknesses in the register, because of inadequate compliance with the Act and failure to notify the Registrar on cessation of business or of changes of address or membership. The register is therefore full of "dead wood".

202. The question does arise for consideration whether the registration of business names serves a worthwhile purpose. If it does, then the defects must be remedied. In particular each trader could be required to follow up his registration by annual statements, whether or not there has been any change of the particulars registered. He could perhaps be charged an annual registration fee. There is already a sanction under the Act, namely disabilities for the defaulter in regard to rights under contracts but this does not seem to be generally appreciated.

203. The registration of a business name affords no protection for the name and gives no guarantee that the name registered is not already in use.

Use of the words "Chamber of Commerce"

204. It has been represented to the Board of Trade by the Association of British Chambers of Commerce that it is contrary to public interest that any group of two or three individuals should be able to associate together and hold themselves out to be a chamber of commerce, suggesting by their title that they are representative of commerce or trade in a given locality although these representations may be contrary to the fact. Owing to the fact that such associations are not ostensibly organised with a view to carrying on business for profit they are not subject to control under the Registration of Business Names Act, 1916.

Business descriptions, as distinct from names

205. The Act applies only to business names, but it may be in the public interest for certain business descriptions to be brought under control. Companies, firms and individual traders ought not to be free, without justification, to use such business descriptions as "bank" or "bankers", "trust", "charity", "corporation", "co-operative", or "building society". Already they are not permitted to use names which contain these words, unless there is justification.

206. In the opinion of the Board of Trade the requirement to state the proprietor's name in trade catalogues, trade circulars and showcards could be dropped if the corresponding requirements to state particulars of company directors are dropped from section 201 of the Companies Act, 1948, as the Board recommend in paragraph 214.

Company names

207. The number of applications for company names continues to increase. In 1948 there was an average of 700 a week, and this has increased to 1,225 a week in 1959. In the first 17 weeks of 1960 the figure rose to some 1,360.

Change in a company's activities after registration of name

208. The Board cannot do more than prevent an obvious incongruity between the name of a company and the company's activities. A company would not be registered with the name "bank" unless it was substantially engaged in ordinary banking business. The Board do not normally allow a company to be registered as a "foundation"

unless there is a permanent fund held for charitable or benevolent objects. But the extent to which a name can be adapted to the known character of a company and its activities is very restricted and even in cases such as these a company's character or activities may change after incorporation and the Board of Trade will then have no power to compel a change of name. Great care may be taken to control the use in a name of the word "British". Events may, however, make it inappropriate, but the Board of Trade can do nothing about it. Promoters often desire a resounding name which corresponds with their hopes and intentions and which (they claim) will materially facilitate the promotion of the ambitious projects which they cherish for the future company. Since a company can change its name with the Board's consent, whereas the Board cannot compel a company to change its name if events prove the name misleadingly pretentious. The Board of Trade have in general not allowed names which were pretentious at the time of incorporation even if they correspond with the expressed intentions of the promoters. Possibly promoters ought to be required to give undertakings on behalf of the company before incorporation, and the Board of Trade to have power to direct a company to change its name in the event of these undertakings ceasing to be honoured.

Use of the word "bank"

209. The Cohen Committee recognised that a special problem exists in the use of "bank" in a company name. In accordance with the general sense of the evidence before the Cohen Committee the Board of Trade have allowed its use very sparingly since 1947. There still exist however on the register companies incorporated before 1947 with such words as "bank" in their names, many of which do not carry on what is commonly understood as banking business. As already shown, there is no power to control the use of the word "bank" as distinct from its use in names. In fact the term "industrial banker" has come into common use in recent years.

Board of Trade direction to change a name

210. The Board have used very sparingly their power to direct a company to change its name if it is too like the name of an existing company. They consider that the power to direct a company to change its name (for which Board of Trade approval has already been secured) after incorporation should not be used lightly. If, however, such a power of rectification is to be retained, along with the control of similarity, it ought to extend also to other sorts of undesirability, since inadvertence or error in permitting registration can extend to other matters than resemblance. The period during which the Board can direct a company to change its name is limited to six months.

Some points of detail

211. It is uncertain whether the expression "other official publications" in section 108 (1) (c) includes trade circulars, showcards and catalogues. The implication of the words "in which the company's name appears" in section 201 (1) is that a company's name may or may not be mentioned in its trade circulars and catalogues. The Board of Trade think that the law should be clarified and that companies should be required to mention their names in trade circulars and catalogues.

212. The obligation to state the company's name in advertisements was dropped from the Companies Act, 1947, on the recommendation of the Cohen Committee (see paragraph 109 of the Committee's report). The Board of Trade think that this freedom should be continued. But the absence of any regulation bearing on advertisements has enabled companies to advertise under names other than their own and names which might have been refused as undesirable if applied for as company names. The Board think that there should be an obligation, if the advertisement purports to state the name of the advertiser, and if the advertiser is a registered company, for the true name of the company to be stated in the advertisement. In this respect the Board of Trade think that showcards, posters, cinema and television advertisements should be subject to the same requirements.

Names of directors under section 201

213. Section 201 has come to be almost universally disregarded in regard to trade catalogues, trade circulars and showcards. Probably there is better compliance with regard to business correspondence. The section does not require the publication of any information which is not otherwise available, since the same information has to be kept available, at the company's registered office and has also to be furnished to the Registrar of Companies and is available to the public on payment of an inspection fee. It does not make the difference between disclosure and concealment. Its effect is to make more easily accessible information which is elsewhere available with a little more trouble.

214. The Committee may therefore wish to consider whether the requirement should be retained. The Board themselves doubt whether the provisions with regard to trade catalogues, trade circulars and showcards are worth retaining but think that the requirement to show the names of directors on business letters may be useful.

Exemption from section 201 (1)

215. By the proviso to section 201 (1) the Board have power to grant exemption from any or all of the requirements of the section on such conditions as they may specify, when "special circumstances exist which render it in the opinion of the Board of Trade expedient that such exemption should be granted". The proper construction of the phrase "special circumstances" is open to doubt and the Board of Trade consider that if the requirement to show directors' names and particulars on business and official documents is to be continued, objective criteria should be written into the Act for determining the classes of companies (if any) which should be allowed exemption from this requirement. At present new applications for exemption run at about 300 a year and most of them are granted. Renewals, which are required when there is a change of directors, or when a company changes its name, average about 900 a year. There are companies which have been enjoying this exemption for between 30 and 40 years.

(25) Foreign Companies

216. The following paragraphs refer to companies which are incorporated outside Great Britain, including other Commonwealth companies.

217. The main purpose of Part X of the Companies Act is to ensure that when overseas companies establish a place of business in Great Britain certain minimum information about them will be available to the public in this country. It is also important because registration in this country, by a company incorporated outside Great Britain of a name and an address for service is tantamount to submission to the jurisdiction of the Courts in this country.

218. It is for consideration whether the term "oversea companies" which is used in the Act should not be changed. In ordinary language a company incorporated abroad is an overseas company but it is only so for the purpose of the Act if it has an established place of business here.

219. The Courts have put a fairly narrow construction on the words "establishes a place of business". It seems to the Board that any company incorporated outside Great Britain which "carries on business" in this country in such a way as to render it subject to the jurisdiction of the Courts should be brought within the ambit of Part X. Thus, insurance companies constituted outside Great Britain which carry on business in Great Britain are required by section 23 of the Insurance Companies Act, 1958, whether or not they have an "established place of business" here, to furnish information as if they were "oversea companies" under the Companies Act. Similarly the requirements of Part X of the Companies Act as to prospectuses apply to all companies incorporated outside Great Britain, whether or not they have an established place of business in Great Britain.

220. There is a case for requiring companies incorporated outside Great Britain which have an established place of business in Great Britain to file specified information about their holding company.

221. It has been a principle of the Companies Acts to put companies incorporated outside Great Britain which establish a place of business within Great Britain on the same footing as companies registered in Great Britain as regards the obligation to prepare accounts and deliver copies of them to the Registrar for filing. But to insist that these companies should deliver to the Registrar accounts which comply in all respects with the provisions of the Act in relation to United Kingdom companies would in the view of the Board of Trade impose a burden which would be unnecessarily onerous in several respects. It seems therefore desirable that the Board of Trade should have power to relax these requirements in particular cases. The provisions of section 410 also need clarification in some respects. In particular it should be made clear that, subject to any modification granted by the Board of Trade, the accounts furnished by these companies to the Registrar should be accompanied by directors' reports and reports of auditors possessing qualifications which satisfy Board of Trade requirements.

222. The control of company names does not operate in the case of companies with a place of business in the United Kingdom but incorporated abroad under names which would have been considered undesirable by the Board of Trade. However, there would obviously be difficulties in any control of the use in Great Britain of their own names by companies incorporated outside Great Britain. Nonetheless it is a matter which requires consideration. It would certainly seem desirable to prevent any company incorporated outside Great Britain from carrying on business in Great Britain under the name of a "bank" if the name has no justification.

223. It may be desirable in any new Act to prescribe some test for determining whether a body formed outside Great Britain has been incorporated or not.

224. Enforcement of the requirements of Part X of the Act (with the exception of sections 417-423) is not an easy matter and the requirements are probably frequently disregarded. The Board of Trade suggest therefore that there should be provision for automatic disabilities in the case of default against Part X of the Act, possibly on the lines of section 8 of the Registration of Business Names Act, 1916, under which the rights under a contract of a defaulter under that Act are not enforceable.

225. The Board of Trade have already referred to the exemption afforded by section 417 (5) (b) in respect of issues uniform with securities for the time being dealt in or quoted on a prescribed Stock Exchange. The regulations of the London Stock Exchange place little restriction on dealings in the securities of companies incorporated abroad and it may be desirable that the exemption should be restricted to issues which are uniform with securities quoted on a prescribed Stock Exchange. On the other hand, this exemption should apply whether or not the prospectus is accompanied by a form of application, as in the case of United Kingdom companies.

(26) Internal Management and Administration

226. The two pivots of company administration are the annual general meeting and the laying of accounts. There is widespread neglect by unquoted companies of the requirements with regard to annual general meetings and because the business required by statute to be done at the annual general meeting is no more than the appointment of auditors, the Board of Trade have been unable to take vigorous action to secure more general observance. Because of the large numbers involved, when the Board of Trade are put on notice on the receipt of annual returns that a company is in default with regard to the obligation to hold an annual general meeting, they find it impracticable to take action, unless there is a complaint from a member of the public. Their first endeavour is then to induce the company to hold a general meeting within a reasonable time. When, as often happens, the company requests in advance the

permission of the Board of Trade to exceed the statutory time for holding an annual general meeting, the Board reply that they have no power to grant such permission but add (if the concession is justified) that provided the company holds a meeting before such and such a date, the Board will not themselves take action in respect of the default although it is open to any other person to do so. The Board have issued 18 directions under section 131 (2) in cases where the company was unable itself to convene a meeting. It is desirable that they should have power to take this action before a company is actually in default.

227. This neglect of the statutory requirements with regard to holding annual general meetings is an unsatisfactory state of affairs and should be remedied. The Board suggests for this reason, among others, that the laying of accounts should be tied by statute to the annual general meetings. The appointment of directors where there is in force a system of retirement by rotation, or reappointment where there is not, should also be tied to an annual general meeting. This would be without prejudice to the power of members under section 184 to remove directors from office at any general meeting.

228. If the annual general meeting is thus linked by statute with more important matters of business, the Board's powers under section 131 of directing the holding of an annual general meeting should be brought into line with their power under section 148 to extend the period within which accounts should be laid. They could thereby extend the period for the annual general meeting, in advance of default.

229. It is the general sense of the Act that the members of a company can express their will only by resolutions passed in general meeting. While making provision for proxy voting, the Act does not provide for resolutions passed by majority consent given outside a formally convened meeting. It may be represented to the Committee that in the case of public companies at any rate it should be made possible for resolutions to be passed by postal voting where there is a substantial majority in their favour. The abolition of the necessity for a general meeting would inevitably weaken shareholder control and strengthen that of the management. Shareholders would be deprived of the opportunity afforded by the meeting to discuss resolutions and ask questions about them and it would therefore be especially important, if the change were made, for the notices of resolutions to be fully explanatory. It would therefore be necessary to consider what additional safeguards would be desirable to ensure (i) that the nature and implications of resolutions are fully and fairly explained in notices, and any interest of the directors in them is declared (ii) that notices are sent in good time to all shareholders who are entitled to receive them (iii) that the votes are received and counted by some impartial person and (iv) that proper records are kept corresponding to the minutes of meetings which the Act at present requires and that such records are available to members.

230. It seems desirable that similar safeguards should be available in regard to proxy voting. Further, there ought to be provision for two-way proxies enabling a person to vote either for or against a proposal.

231. In addition to ordinary resolutions, which are carried by a bare majority, the Act provides for extraordinary resolutions and special resolutions which require a majority of three-quarters of such members as are entitled to vote and vote. The only difference between extraordinary and special resolutions lies in the length of notice required. The Board of Trade see no good reason for continuing the distinction.

232. Certain types of business are at present reserved under the Act for special and extraordinary resolutions. It is for consideration whether these matters are appropriate to be reserved for special resolutions and whether there are any other matters which should be so reserved. In particular if it is recommended, as is suggested in the Board's evidence elsewhere, that certain powers of shareholders should be entrenched (such as the power to decide on a radical change of the company's

objects, to issue new capital, or to dispose of a substantial part of the company's undertaking) the question should be considered whether such powers should be exercisable by ordinary or special resolution.

233. As the Act now stands every member has a right to inspect or receive copies of the minutes of general meetings (section 146) but members have no absolute right to receive advance notice of meetings or of the business to be conducted at meetings unless this is provided for in the articles. The Committee may wish to consider whether all members should have a statutory right to receive advance notice of general meetings, including annual general meetings, and of the business to be transacted thereat, whether or not they are entitled to attend and vote at the meeting in question. It is the experience of the Board of Trade that there is laxity with regard to the giving of proper notice and due specification of business to be transacted and that, in consequence, shareholders may fail to attend meetings where decisions are taken which they subsequently regard as damaging to their interests. It is for consideration whether the main principles of case-law with regard to the information to be contained in notices should be consolidated into the Act in the form of statutory requirements.

234. Representations have from time to time been made to the Board of Trade that the notice of three weeks for a meeting at which a special resolution is to be proposed and two weeks for extraordinary general meetings is unnecessarily long and causes inconvenience by preventing a meeting from being rapidly convened in an emergency. The Act does however permit a meeting to be validly held by shorter notice with the agreement of 95 per cent. of those concerned and the Board believe that the present length of notice should be retained, both in order to give shareholders adequate time to consider business to be transacted and to arrange to make their views known and also as a safeguard against decisions being taken on important matters at poorly attended meetings and against the wishes of the majority of shareholders.

(27) Winding Up

235. In general the liquidation sections of the Act work quite well in practice and the Board of Trade see no occasion to suggest any major changes. There are points of varying importance which have been brought to their notice and are referred to in the following paragraphs.

Voluntary winding up

236. Where a company passes a resolution for voluntary winding up and a declaration of solvency is duly made and delivered to the Registrar of Companies the winding up is a "members' voluntary winding up". It occasionally happens that the declaration is either not made, or not delivered, to the Registrar within the time prescribed. Section 283 (4) is so worded that the winding up thereby becomes a creditors' voluntary winding up. The Board suggest that where a company passes a resolution for a members' voluntary winding up and the winding up cannot proceed as intended because of a failure to comply with the provisions relating to the declaration of solvency, the resolution should automatically be avoided and the company empowered to start the process afresh. If this proposal were accepted it would be necessary to provide that a resolution for voluntary winding up must be expressed to be either for a members' or creditors' winding up.

237. There seems to be no particular virtue in the requirement that the declaration of solvency should be received by the Registrar at the latest on the day before the day of the passing of the resolution to wind up. It should be enough that it should reach the Registrar at the same time as, or before, the resolution itself is received.

238. It seems desirable that in a creditors' voluntary winding up a statement of affairs should have to be filed. Such a statement is already required in a compulsory liquidation and when a receiver for debenture holders is appointed. Moreover, in a members' voluntary winding up the declaration of solvency which has to be filed at least summarises the company's financial position.

239. Section 334 deals with the prosecution of delinquent officers and members. The Board of Trade suggest that before a company in voluntary liquidation is dissolved the liquidator should file with the Registrar of Companies a statutory declaration to the effect that as a result of his investigation into the company's affairs he has either submitted a report under section 334 (2) or that in his opinion there are no matters which require to be so reported. In a compulsory liquidation the Official Receiver is required under section 236 to report to the Court on similar lines and it seems desirable that a provision of this kind should be made in regard to voluntary liquidation.

240. Section 341 which relates to the disposal of the books and papers of a company which has been wound up presupposes, but does not expressly impose, the duty on a liquidator to preserve the company's books and papers. The Board suggest that a liquidator in a voluntary winding up should be expressly required to preserve the books and papers of the company for a period of five years, subject to his being relieved of this obligation in any of the ways now mentioned in section 341.

241. The Board consider that section 342 (1) which requires reports on the progress of winding up should be amended so as to ensure that it applies to voluntary liquidations only. Compulsory winding up is covered by section 249. The Board of Trade also suggest that a voluntary liquidator should be required to submit his first account after six months instead of one year. This change would bring voluntary liquidations into line with liquidations by the Court.

242. The requirement of section 343 (1) concerning payment into the Companies Liquidation Account of minimum balances involves in voluntary liquidations elaborate investigation in order to ascertain the precise amount payable. Voluntary liquidations run at the rate of over 3,000 a year so that a great deal of work is involved. It is suggested, therefore, that the subsection should be amended so as to require a voluntary liquidator to pay into the Companies Liquidation Account the whole balance of money representing undistributed assets.

243. This change would have the effect of reducing the time for which a voluntary liquidator could hold assets without distributing them, but on balance, the system now proposed would be more convenient, both for the Board of Trade and for voluntary liquidators.

Compulsory winding up

244. Among other recommendations, the Senior Official Receiver has suggested that the claims of the "parent" and associated companies in the same group as the liquidating company should be deferred to those of unsecured creditors. He has in mind a particularly bad case in which by an elaborate system of inter-company guarantees and charges, companies forming part of a group have succeeded in defeating the claims of unsecured creditors in the winding up. Possibly such guarantees ought to be registered and shown as contingent liabilities in the annual returns.

245. The Senior Official Receiver has also suggested that where a provisional liquidator is appointed by the Court prior to the winding-up order being made it would be more convenient from every point of view if the Official Receiver alone could be appointed.

246. The Committee of Inspection in a compulsory winding up is appointed by the Court under section 252 (3) but the Court has no power to remove any member of it. The Board of Trade suggest that the Court should be given such power.

247. Where a subsidiary is in liquidation it is not clear from section 285 (2) whether the holding company is required to deal in group accounts with that subsidiary. The Board of Trade think that the company ought to be so obliged.

General

248. There is much difference of opinion about the preference given by section 319 (4) to persons (usually banks) who make loans for the payment of wages. It is argued that

the provision has outlived its usefulness in a period of full employment and pension rights and should be repealed outright. It is argued on the other hand that the preference should be maintained on the ground that its very existence must be presumed to have the effect, in many cases that never come to light, of enabling banks to help companies over difficult periods and on the further ground that, while it does not matter to the general body of unsecured creditors whether the bank or the workman gets the preference, it is better from the workman's point of view that he should be paid in full and his preferences vested in the bank in cases where the assets are not enough to pay all the preferential debts in full. The Committee may wish to consider this matter as well as the proposals made at paragraph 97 of the Blagden Report (Cmd. 221) for giving a further preference in respect of wages.

249. Section 320 applies the bankruptcy rule on fraudulent preferences to the winding up of companies. The operation of this rule in bankruptcy was criticised in the Report of the Blagden Committee, which also recommended that the trustee in bankruptcy should proceed in the first instance against the surety rather than the principal creditor where the intention was to prefer the surety. (See paragraphs 116-125). On the other hand the Cohen Committee, in relation to winding up, reached a different conclusion on the second point. (See paragraph 147 of their Report).

250. A bankrupt is disqualified by section 367 from acting as a receiver for debenture holders unless he is appointed by the Court. In the opinion of the Board of Trade the saving in regard to appointment by the Court should be deleted. Admittedly there must have been some good reason for this departure from the recommendations of the Cohen Committee (paragraph 69) that "in no circumstances" should an undischarged bankrupt be allowed to act as a receiver. It is difficult to see however why the disqualification should not apply to receivers appointed by the Court as well as to those appointed under hand.

251. The Board of Trade suggest further than an undischarged bankrupt should also be prohibited from acting as a liquidator in either compulsory or voluntary liquidations. Rule 168 already provides that a liquidator shall be removed in the event of his bankruptcy but it does not prohibit the appointment of an undischarged bankrupt. It is not, in the view of the Board of Trade, enough to amend the rule and appropriate provision should be made in any new Act.

252. A receiver for debenture holders who has filed accounts of "no receipts or payments" under sections 372 (2) and 374 (1) is not in default and a liquidator has no power to require him to furnish information about the company's assets. Neither section 258 nor 268 really provide for this disclosure. The Board of Trade suggest that a receiver ought to be required to satisfy a liquidator as to what is happening in regard to the company's assets which have not been realised.

Dissolution of companies

253. Section 353 affords the Registrar an opportunity of removing from the register companies defined in the section as "not carrying on business or in operation" and provides that, when he does so, they shall be dissolved. The Board of Trade have been advised that, though a company is not carrying on any business or trading, it may be in operation by virtue of holding annual general meetings and making annual returns. Dormant companies are often for various reasons kept "in operation" as shell companies. The position frequently arises where a company with ample assets after successful trading is abandoned as an alternative to the more complicated process of winding up provided for in Part V of the Act. After satisfying outstanding liabilities (or running the risk of subsequent challenge by unpaid creditors), the remaining assets are shared out among the members by way of a return of capital and in defiance of the Act. The company then goes out of operation and is left defunct. It is becoming quite common in the case of small private companies for the directors and secretary to resign together on a given day with effect as from a future date (e.g., the next day) and to notify the Registrar of Companies accordingly while they are in office. The Board

have suggested in their evidence on heading 28 that they should be given the power there described to remedy such a situation.

Provision for automatic dissolution

254. The Act contemplates in section 274 that, when, in a winding up by the Court, the affairs of the company have been fully wound up, the Court should order the company to be dissolved on the application of the liquidator. This procedure is now rarely followed. The practice is for the liquidator to obtain his release under section 251 and then to take no further action; in due course the company is struck off the register under section 353 (4) and (5). The Board suggest that provision should be made for the automatic dissolution of a company wound up by the Court at the end of a prescribed period running from a fixed event, such as the date of the liquidator's release. This would bring the provisions for the dissolution of a company wound up by the Court into line with those for the dissolution of a company wound up voluntarily. Some consequential changes would be necessary.

Conditional restoration to register

255. A company which has been struck off the register under section 353 (5) must be restored to the register, if the Court so orders, upon an application made by the company or any member or creditor within 20 years of the publication of the notice of the striking off. The Court has at present however, no power to do more than either grant or refuse restoration. It seems desirable that the Court ordering the restoration should be empowered to do so subject to conditions. Thus the Court could require the remedying of defaults in making returns, or enforce responsibility for liabilities incurred after the dissolution. The Board of Trade may also wish to exercise their powers in regard to the name of the restored company if they find the name undesirable.

(28) Problems of Enforcement and Administration of the Law

256. Except where fraud or misfeasance is in question and damage has been caused, the Board of Trade do not ordinarily proceed to prosecution unless attempts to persuade a company to comply with the Act have been made and have failed.

Annual returns

257. The most serious difficulties of enforcement have been in connection with annual returns. The Registrar now maintains a continuous review of this matter and with a staff of about 40 persons covers the entire register of companies about once in every three years. When a company is found to be in arrears a letter of reminder is sent and, if this does not secure compliance, the directors are notified individually. A final warning is sent to the directors before proceedings are instituted. In recent years some 45,000 cases of default have been dealt with annually and there have been approximately 800 prosecutions a year. In a great many of the cases where a conviction was obtained no fines have been imposed by the Court.

258. Proceedings were however during 1960 launched with more effect under section 428 of the Act under which the Registrar of Companies may apply for an order requiring the defaulter to comply and the defaulter is then in contempt if he fails to do so. The Court may then commit the person to prison or order the sequestration of the company's property.

Annual renewal fee

259. The Board of Trade have suggested elsewhere in their evidence that an annual fee for renewal of registration should be required of all companies incorporated with limited liability. Such an annual renewal fee might facilitate enforcement since it would promote general consciousness of the fact that the enjoyment of the advantages of registration with limited liability carries with it continuous statutory obligations and is not a thing to be bought once for all.

Annual general meetings

260. As the Act now stands, the Board have not felt able to enforce the holding in each calendar year of an annual general meeting at which in fact no essential business need be transacted. They have therefore suggested (under heading 26) that certain of the most important matters of company business should be tied by statute to a general meeting which must be held once every calendar year as required by section 131.

Proceedings on indictment

261. A number of cases relating to the activities of companies and their officers are referred to the Board of Trade every year and many of these result in the institution of proceedings on indictment. While there is nothing in the Act to deprive the Board of their general power to prosecute on indictment, there are two provisions in particular which are not well adapted to present day practice. Section 169 relates to prosecutions for offences disclosed by the reports of inspectors appointed by the Board of Trade under section 164 or section 165. While section 169 seems to contemplate that in practice the prosecution in England will always be taken by the Director of Public Prosecutions, cases arise which justify a prosecution on indictment but are not of sufficient public importance to necessitate a prosecution by the Director of Public Prosecutions. The benefits conferred by section 169 (2) (which requires officers and agents of the company to assist in connexion with the prosecution) and by section 170 (1) (a) (which empowers the Court to order a convicted person to reimburse the Board of Trade for their costs of the investigation) are limited to prosecutions instituted by the Director. This seems anomalous and the Board suggest that these benefits should be extended to prosecutions instituted by the Board.

262. Most prosecutions under the Companies Act are instituted as a result of matters which come to light in compulsory liquidations. Under section 334 (1), in a compulsory winding up, the Court may direct the liquidator to report the matter. Under section 334 (2), in a voluntary winding up, the liquidator must report it. In practice most prosecutions arising out of compulsory liquidations are instituted as a result of investigations made by the Official Receiver. Subsection (1) is hardly ever invoked and prosecutions arising from reports by voluntary liquidators under subsection (2) are comparatively infrequent. The Board suggest that the procedure laid down in subsection (1) and subsection (2) should be modified and that it should be provided that the liquidator both in a compulsory and a voluntary winding up should report to the Board of Trade and not to the Director of Public Prosecutions.

263. The foregoing proposals relate only to proceedings in England.

Summary proceedings

264. The Board institute summary proceedings in a large number of cases every year. It frequently happens that the acts complained of come to light after the period of six months generally fixed for the institution of summary proceedings. This is to some extent covered by section 442 (1) which allows an extension of time for summary proceedings in respect of offences made punishable only by fine. There are instances where an extension of time is often desirable but is not available because the punishment is not confined to a fine: sections 148 (failure to lay accounts) and 187 (undischarged bankrupt taking part in the management of a company) are good examples.

Relief provisions

265. In some cases there are provisions which appear to be misconceived for relief from penalties already incurred. Examples are the proviso to section 52 (3), which empowers the Court to give relief where there has been default in delivering a return of allotments, and section 101, which empowers the Court to make an order extending the time for registration of charges, the order apparently having the effect of relieving any person in default from the penal consequences of his default. The Board suggest that the proviso to section 52 (3) should be repealed. If section 101 is retained, the order granting extension of time should not affect any penalty already incurred.

Absence of penalty

266. In some cases no penalty is imposed for a contravention of the Act. The absence of a penalty for issuing a prospectus not complying with section 38 (1) has already been noted under heading 17. It is suggested that a penalty should normally be provided for any failure to comply with the Act.

Section 54

267. The Board have received complaints that section 54 (which prohibits a company from giving financial assistance for the purchase of its own shares) is frequently contravened in connexion with take-over bids. The existing penalty, a fine not exceeding £100, seems quite inadequate in view of the amounts which may be at stake in a large take-over.

Further sanctions

268. The Board are convinced that the prosecution of offenders alone is not an effective method of enforcing the Act. Many companies and their directors have been repeatedly prosecuted for the same offence without showing any sign of changing their ways; in other cases the circumstances of the company and its directors are such that prosecution is not worth while. The Board make the following proposals for more effective enforcement under the following heads:

- (a) extending the present provisions under which applications may be made to the Court for an order requiring the officers of a company to perform duties imposed by the Act;
- (b) extending the present power to disqualify offenders from taking part in the management of companies;
- (c) introducing more drastic provisions for eliminating persistent defaulters, by extending the present provisions for compulsory winding up and striking a company's name off the register;
- (d) tightening up the present provisions for tracing the persons responsible for a company's activities.

Application for a Court order

269. Section 428 contains provisions empowering the Court to enforce the duty of rendering returns, accounts or other documents or of giving notice of any matter to the Registrar of Companies. Such an order may be directed to the company in default and to any officer thereof and it is a most effective method of enforcement since it renders a person who fails to comply with it liable to be committed for contempt of Court. The section might well be extended in two respects; it could be made applicable to a wider range of defaults and to cases where the default is on the part of the directors or other officers and not merely on the part of the company. It would be necessary of course to make provision for those cases where the default cannot be made good because the statutory time has passed.

Disqualification

270. Section 188 empowers the Court to disqualify certain persons from being concerned in the management of a company for a period of up to five years. It is suggested that:

- (i) the power should be extended to cover persons convicted of any offence, whether in connexion with a company or not, which necessarily involves a finding of fraud or dishonesty and that this additional power should be exercisable only by the High Court on the application of the Board of Trade;
- (ii) there should be power for the High Court on the application of the Board of Trade or the Registrar of Companies to disqualify persons shown to have been persistently in default in complying with the provisions of the Act.
- (iii) there should be a similar power to disqualify persons from acting as liquidators in a voluntary winding up.

Persistent defaulters

271. Cases occur in which neither prosecution nor an application for an order under section 428 is really appropriate. It is suggested that the Court should have power on the petition of the Board of Trade or the Registrar of Companies to order the winding up of a company which has persistently failed to comply with any of the provisions of the Act. Where the expense of a petition for winding up would not be justified the Board or the Registrar should have power to apply to the Court for an order to strike the company off the register.

Tracing persons responsible

272. Companies which remain mere names or subsequently disappear from official scrutiny are constantly in default under the Act, but their names remain on the register until they are struck off under section 353 and they are the source of much unnecessary trouble to the Registrar and of confusion to the public. In the Board's view it should be a condition of incorporation that there will be persons, or in the case of a private company, a person, responsible for the company's carrying out its statutory duties as soon as the company comes into existence. It could be provided either that the subscribers to the memorandum should be responsible for carrying out the duties of a company and its officers have been properly appointed, or that a company cannot be incorporated unless the names of the persons who will thereupon become its directors and secretary have been notified to the Registrar. It would then be possible, as it is not possible now, to deal effectively with the company which is formed and then put in cold storage for an indefinite period, sending in no returns and not notifying the Registrar of Companies of the situation of its registered office. There should also be provisions to ensure that a company, once it has appointed its directors and a secretary should continue to have them as a condition of remaining a going concern. Any director or secretary who resigns should be personally responsible for notifying the Registrar of Companies of his resignation, subject to his continuing to be liable for failing to carry out the statutory duties of his office until he has so notified the Registrar.

273. Where the number of directors falls below the statutory minimum or the company has no secretary and this is not remedied within a prescribed period, not only should the company and any remaining director be liable to a default fine, but the Registrar (or the Board of Trade) should be empowered to apply to the Court for an order that the company shall within a prescribed time appoint the necessary number of directors (or a secretary, as the case may be) and that, in default of such appointment, the company shall be wound up by the Court or ordered to be struck off the register by the Registrar. If this proposal is accepted it will be possible to deal with the abuse mentioned in the Board's evidence under heading 27 (Winding Up), whereby assets are returned to the members, the directors and secretary resign and the company is left derelict.

274. Difficulty is often experienced in securing the lodgment of returns because none of the officers of the company is resident in the United Kingdom. It is suggested for consideration that at least one director, or the secretary should be required to be resident in the United Kingdom. This requirement would be in line with the requirement to have a registered office in Great Britain.

Miscellaneous

275. Section 332 (3) imposes a penalty on any person who is knowingly a party to the carrying on of the business of a company for a fraudulent purpose. From the context in which this provision appears it seems that a prosecution for this offence can be brought only when winding up has commenced. It ought to be possible to prosecute for this offence while the company is a going concern. The present practice in such a case is to prosecute under section 13 (1) of the Debtors Act, 1869 (obtaining credit by fraud) or section 32 of the Larceny Act, 1916 (obtaining any chattel, money or valuable security by false pretences). These provisions are not however always appropriate in cases of fraudulent trading, since they require fraud to be established in individual transactions.

276. There seems to be no reason for restricting under section 438 the offence of making a false statement to documents required by, or for the purposes of, the sections mentioned in the Fifteenth Schedule.

277. There are restrictions under the Act as to who may, under section 426, inspect and require copies of documents kept by the Registrar of Companies which cause difficulty where inspection is required for the purposes of a criminal prosecution. It is suggested that the Registrar should have power to permit inspection by any person who, in the Registrar's opinion, has an interest in those documents.

278. It would be useful to have an express provision that a document may be served on a company by serving it on any officer of the company.

279. There is occasionally delay because the person called upon to submit a statement of affairs to the receiver or manager under section 372 denies that he is liable to submit it. It is suggested that the Board of Trade should be given the right to apply to the Court for an order directing the submission of the statement of affairs. This would provide a more appropriate method of determining the dispute than a prosecution under section 373 (5).

(29) Any other Matters within the Terms of Reference

280. Certain provisions of the Companies Act apply to unregistered companies such as bodies incorporated by Royal Charter or by Special Act of Parliament if they are formed "for the purpose of carrying on business which has for its object the acquisition of gain by the body or by the individual members thereof". The provisions in question include those which relate to prospectuses, allotments, annual returns, accounts and audit, as specified in the Fourteenth Schedule.

281. Several of the older chartered bodies were formed for the purpose of commercial trading and come within this section. Some do in fact make annual returns to the Registrar of Companies with audited accounts annexed, as the Act requires. Some chartered bodies which do not operate for profit in the ordinary sense of the word find themselves brought within the section because of the wide interpretation which has come to be placed on the concept of business for gain. Under this wide interpretation, for example, a charitable company prohibited by its own statutes from distributing profits among its members (and perhaps also qualifying for a Board of Trade licence under section 19 of the Act) may nonetheless have to be regarded by the Board of Trade as "carrying on business which has for its object the acquisition of gain". An educational institute which charged for its services and operated on its income but which was prohibited from distributing its profits (if any) to its members would be an example of such a company. Many of the bodies incorporated by Royal Charter in recent years have been bodies of this sort.

282. The Board of Trade suggest that section 435 should be modified so as to exclude companies which are prohibited from making any distribution of income or property of the company among its members, either whilst a going concern or in a winding up.

283. So far, however, as concerns those companies incorporated outside the Companies Act which do trade for gain and distribute profits, the Board of Trade think that they should be required not only to fulfil the requirements of the Fourteenth Schedule but should also file with the Registrar a copy of their charter or statutes and of any changes made thereto, and that they should also be subject to the provisions relating to the registration of charges.

284. The Act provides for a limited company to have directors, managers or a managing director with unlimited liability. The Board doubt, however, whether this provision now serves any useful purpose. It is understood that the provision was introduced originally (in the Companies Act of 1867) in order to give British businessmen the advantages of the French system of partnerships *en commandite*. This purpose is perhaps better served now by the Limited Partnerships Act, 1907, which enables partners to limit their liability for partnership debts so long as there is at least one partner with unlimited liability.

Supplementary Memorandum by The Board of Trade

Companies Act, 1948

Number of orders appointing inspectors under section 164 and 165

Year	Orders appointing inspectors under Section 164 Section 165				Total number of orders
	Public companies	Private companies	Public companies	Private companies	
1949 ..	1	1	—	7	9
1950 ..	1	3	2	2	8
1951 ..	—	—	1	1	2
1952 ..	—	—	—	1	1
1953 ..	1	1	—	—	2
1954 ..	—	—	2	—	2
1955 ..	—	1	—	1	2
1956 ..	1	2	—	3	6
1957 ..	2	—	—	—	2
1958 ..	1	1	—	1	3
1959 ..	1	1	—	1	3
1960 ..	—	—	13	1	14
	8	10	18	18	54

Supplementary Memorandum by The Board of Trade

Companies Act, 1948

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1950 ..	1	3	2	2	8
1951 ..	—	—	1	1	2
1952 ..	—	—	—	1	1
1953 ..	1	1	—	—	2
1954 ..	—	—	2	—	2
1955 ..	—	1	—	1	2
1956 ..	1	2	—	3	6
1957 ..	2	—	—	—	2
1958 ..	1	1	—	1	3
1959 ..	1	1	—	1	3
1960 ..	—	—	13	1	14
	8	10	18	18	54

BOARD OF TRADE

COMPANY LAW COMMITTEE

Index to the
Report of the Committee
and to the Minutes of
Evidence taken before
the Committee



LONDON

HER MAJESTY'S STATIONERY OFFICE

1962

TWO SHILLINGS NET

MINUTES OF EVIDENCE

TAKEN BEFORE THE

1

COMPANY LAW COMMITTEE

FIRST DAY

Friday, 23rd September, 1960

WITNESSES

Mr. HAROLD WINCOTT, Editor-in-Chief, *Investors' Chronicle*
COURTAULDS LTD., represented by Mr. H. R. MATHYS,
Mr. H. L. LIGHT and Mr. J. M. EDWARDS
Mr. GORDON NEWTON, Editor, *Financial Times*



LONDON

HER MAJESTY'S STATIONERY OFFICE

1960

FOUR SHILLINGS NET

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING,

MINUTES OF EVIDENCE

TAKEN BEFORE THE

2

COMPANY LAW COMMITTEE

SECOND DAY

Friday, 30th September, 1960

WITNESSES

J. LYONS AND COMPANY LIMITED, represented by
MR. I. M. GLUCKSTEIN and MR. H. E. LOPTHOUSE

THE LORD PIERCY, C.B.E.

GUEST KEEN AND NETTLEFOLDS LIMITED, represented by
MR. W. A. NICOL, MR. W. W. FEA and MR. G. T. HUGHES



LONDON

HER MAJESTY'S STATIONERY OFFICE

1960

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MR. ERIC ALBERT BINGEN.

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR.

MR. GORDON WILLIAM HUMPHREYS RICHARDSON.

MR. CHARLES HILARY SCOTT.

MR. RON SMITH.

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

3

COMPANY LAW COMMITTEE

THIRD DAY

Friday, 7th October, 1960

WITNESSES

PROFESSOR W. T. BAXTER

MR. H. C. EDEY

JOHN LEWIS PARTNERSHIP LIMITED, represented by
MR. O. B. MILLER and MR. S. A. WETHERFIELD, O.B.E.

PROFESSOR B. TEW



LONDON
HER MAJESTY'S STATIONERY OFFICE
1960

FOUR SHILLINGS NET

op 2.2

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

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MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING,

Dated this 5th day of January, 1960

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MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

4

COMPANY LAW COMMITTEE

FOURTH DAY

Friday, 21st October, 1960

WITNESSES

THE ECONOMIST represented by Mr. R. E. BIRD,
Mr. G. LEE and Mr. F. HIRSCH

PROFESSOR E. V. MORGAN

THE TRADE INDEMNITY COMPANY LIMITED represented by
Mr. S. E. PHILLIPS and Mr. R. C. STEVEN



LONDON

HER MAJESTY'S STATIONERY OFFICE

1960

PRICE 3s. 6d. NET

MINUTES OF EVIDENCE

TAKEN BEFORE THE

5

COMPANY LAW COMMITTEE

FIFTH DAY

Friday, 28th October, 1960

WITNESSES

MR. REGISTRAR BERKELEY, REGISTRAR OF THE COMPANIES COURT
THE NATIONAL CHAMBER OF TRADE, represented by MR. H. AUSTRAL RYLEY,
MR. P. J. MORTLOCK, and MR. J. W. STEVENSON
GENERAL COUNCIL OF BRITISH SHIPPING, represented by MR. A. F. HULL,
MR. C. W. ASTON, SIR JOHN BROCKLEBANK, Bt., MR. F. CHARLTON,
MR. J. A. MANN, MR. H. E. GORICK, C.B.E., and MR. ROY HILL



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FOUR SHILLINGS NET

Dated this 5th day of January, 1960

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MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(*Signed*) R. MAUDLING,

MINUTES OF EVIDENCE

TAKEN BEFORE THE

6

COMPANY LAW COMMITTEE

SIXTH DAY

Friday, 4th November, 1960

WITNESSES

ACCEPTING HOUSES COMMITTEE and THE ISSUING HOUSES ASSOCIATION
represented by SIR EDWARD J. REID, BT., O.B.E.,

MR. H. J. S. FRENCH, O.B.E., MR. K. C. BARRINGTON and MR. J. W. HATCH

THE SOCIETY OF INVESTMENT ANALYSTS LIMITED represented by
SIR HENRY WARNER, BT. and MR. P. W. FREEMAN

ASSOCIATION OF INTERNATIONAL ACCOUNTANTS LIMITED
represented by MR. E. P. HUBBARD, MR. K. MINES,
MR. J. W. BARTER, M.P. and MR. C. E. TAYLOR



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 4s. 6d. NET

op 23

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

7

COMPANY LAW COMMITTEE

SEVENTH DAY

Friday, 18th November, 1960

WITNESSES

ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE represented by
MR. S. R. HOGG, MR. D. B. TRACEY, MR. W. J. LUXTON and MR. H. CRUMP
THE COMMITTEE OF SCOTTISH BANK GENERAL MANAGERS represented by
MR. W. R. BALLANTYNE and MR. R. D. FAIRBAIRN
NATIONAL ASSOCIATION OF TRADE PROTECTION SOCIETIES represented by
MR. E. C. ASTIN, MR. C. G. LAMB, MR. W. NORMAN PEET and
MR. C. MCNEIL GREIG, M.C.



LONDON
HER MAJESTY'S STATIONERY OFFICE
1961

PRICE 4s. 6d. NET

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

8

COMPANY LAW COMMITTEE

EIGHTH DAY

Friday, 25th November, 1960

WITNESSES

THE COUNCIL OF ASSOCIATED STOCK EXCHANGES, represented by
MR. C. T. OCKLESTON and MR. A. OWEN

MR. CHARLES CLORE and MR. L. SAINER

THE ASSOCIATION OF STOCK AND SHARE DEALERS, represented by
MR. P. G. SMITH and MR. W. A. TUCKWELL



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 3s. 6d. NET

ap2

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

9

COMPANY LAW COMMITTEE

NINTH DAY

Friday, 16th December, 1960

WITNESSES

BRITISH INSURANCE ASSOCIATION, represented by MR. H. A. WALTERS,
MR. J. B. H. PEGLER, MR. J. F. BUNFORD, MR. H. J. HENDERSON SMITH,
MR. L. W. KEMPE and MR. R. C. W. BARDELL

COMMITTEE OF LONDON CLEARING BANKERS, represented by
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E., MR. F. KEIGHLEY,
MR. R. G. THORNTON and MR. H. B. LAWSON, M.C.

INSTITUTE OF ACTUARIES, represented by MR. J. H. GUNLAKE, C.B.E.,
MR. F. M. REDINGTON and MR. R. E. BEARD, M.B.E.



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FIVE SHILLINGS NET

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be

(Signed) R. MAUDLING,

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MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(*Signed*) R. MAUDLING,

MINUTES OF EVIDENCE

TAKEN BEFORE THE

10

COMPANY LAW COMMITTEE

TENTH DAY

Friday, 6th January, 1961

WITNESSES

ASSOCIATION OF UNIT TRUST MANAGERS represented by SIR OSCAR HOBSON,
MR. E. D. L. DU CANN, M.P., MR. G. H. FLETCHER, MR. O. P. STUTCHBURY
and MR. W. G. N. MILLER

ASSOCIATION OF INVESTMENT TRUSTS represented by SIR EDWIN HERBERT, K.B.E.,
MR. G. L. C. TOUCHE and MR. W. S. GAMMELL
MR. S. I. FAIRBAIRN



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 4s. 6d. NET

of 21

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

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MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

11

COMPANY LAW COMMITTEE

ELEVENTH DAY

Friday, 13th January, 1961

WITNESSES

THE INSTITUTE OF DIRECTORS, represented by Mr. A. READ, C.B.E., Mr. P. L. FLEMING, Mr. J. GODFREY, Mr. A. E. S. MENZIES and Mr. A. T. PURSE.

THE CHARTERED INSTITUTE OF SECRETARIES, represented by Mr. E. G. HARDMAN, Mr. W. F. TALBOT, Mr. J. F. PHILLIPS, O.B.E. and Mr. G. N. GABELL

Mr. E. S. FAY, Q.C.



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 4s. 6d. NET

Dated this 5th day of January, 1960

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THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

12

COMPANY LAW COMMITTEE

TWELFTH DAY

Friday, 20th January, 1961

WITNESSES

THE ASSOCIATION OF CERTIFIED AND CORPORATE ACCOUNTANTS, represented by
MR. J. E. HARRIS, MR. J. H. HILLS, MR. P. PHILLIPS, MR. N. R. TRIBBLE and
MR. J. R. SPAREY

COUNCIL OF SCOTTISH CHAMBERS OF COMMERCE, represented by
SIR ROBERT A. MACLEAN, MR. A. M. HODGE, G.C., V.R.D.,
and MR. M. NEIL



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FOUR SHILLINGS NET

op 23

Dated this 5th day of January, 1960

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MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

13

COMPANY LAW COMMITTEE

THIRTEENTH DAY

Friday, 3rd February, 1961

WITNESSES

GENERAL COUNCIL OF THE BAR, represented by
Mr. P. J. SYKES and Mr. T. D. D. DIVINE

TRADES UNION CONGRESS, represented by
Mr. H. DOUGLASS, Mr. G. WOODCOCK, C.B.E., Mr. L. MURRAY
and Mr. N. FERGUSON

BRITISH OVERSEAS BANKS ASSOCIATION, represented by
Mr. R. E. WILLIAMS, Mr. W. G. PULLEN, Mr. R. V. LOW,
Mr. S. K. BROOKE and Mr. R. G. DYSON



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 4s. 6d. NET

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MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

14

COMPANY LAW COMMITTEE

FOURTEENTH DAY

Friday, 10th February, 1961

WITNESSES

MR. H. S. MORGAN, MR. J. M. YOUNG and MR. F. A. PETITO
of MORGAN STANLEY & Co., NEW YORK

MR. G. A. BROWNELL and MR. F. A. O. SCHWARZ
of DAVIS POLK WARDWELL SUNDERLAND & KIENDL, NEW YORK

MR. C. D. MCDANIEL of ARTHUR ANDERSEN & Co.



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FIVE SHILLINGS NET

Dated this 5th day of January, 1960

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MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING,

MINUTES OF EVIDENCE

TAKEN BEFORE THE

15

COMPANY LAW COMMITTEE

FIFTEENTH DAY

Friday, 17th February, 1961

WITNESSES

THE STOCK EXCHANGE, LONDON, represented by THE LORD RITCHIE OF DUNDEE,
MR. J. A. HUNTER, M.B.E., T.D., MR. R. C. QUIRK, O.B.E.,
MR. W. D. WALKER, O.B.E., MR. C. D. MORLEY and MR. W. S. WAREHAM

THE LAW SOCIETY, represented by SIR CHARLES NORTON, M.B.E., M.C.,
MR. K. D. COLE, MR. G. F. H. DENNEHY, MR. N. F. HENLÉ,
MR. A. M. WELSFORD and MR. D. D. MACKINTOSH



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 5s. 6d. NET

Dated this 5th day of January, 1960

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MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE **16 & 17**

COMPANY LAW COMMITTEE IN EDINBURGH

SIXTEENTH & SEVENTEENTH DAYS

Thursday and Friday, 2nd and 3rd March, 1961

WITNESSES

FACULTY OF ADVOCATES, represented by MR. I. H. SHEARER, Q.C. and
MR. J. P. H. MACKAY

THE LAW SOCIETY OF SCOTLAND, represented by MR. J. SUTHERLAND,
MR. W. A. COOK, MR. G. K. V. CLARKE and MR. R. B. LAURIE

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND, represented by
MR. T. LISTER, MR. G. D. H. DEWAR and MR. E. H. V. McDUGALL



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE ~~6s. 6d.~~ NET



Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

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MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

18

COMPANY LAW COMMITTEE

EIGHTEENTH DAY

Friday, 17th March, 1961

WITNESSES

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES,
represented by MR. HENRY BENSON, SIR THOMAS ROBSON, MR. P. F. GRANGER
and MR. F. M. WILKINSON

FEDERATION OF BRITISH INDUSTRIES, represented by
SIR NUTCOMBE HUME, K.B.E., M.C., MR. HUGH SAUNDERS,
MR. A. A. SHENFIELD and MR. C. P. COTTIS



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FIVE SHILLINGS NET

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

19

COMPANY LAW COMMITTEE

NINETEENTH DAY

Thursday, 23rd March, 1961

WITNESSES

MR. M. F. COHEN, U.S. SECURITIES AND EXCHANGE COMMISSION

PROFESSOR L. LOSS, LAW SCHOOL OF HARVARD UNIVERSITY



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

FOUR SHILLINGS NET

Dated this 5th day of January, 1960

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MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint Mr. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

20

COMPANY LAW COMMITTEE

TWENTIETH DAY

Friday, 24th March, 1961

WITNESSES

THE BOARD OF TRADE, represented by SIR RICHARD POWELL, K.C.B., K.B.E.,
C.M.G., MR. J. LECKIE, C.B., MR. R. J. W. STACY, C.B., MR. E. W. DEAN,
C.B.E., MR. P. J. MANTLE, C.M.G., MR. J. M. CLARKE, MR. W. B. LANGFORD,
M.B.E., and MR. H. OSBORNE



LONDON

HER MAJESTY'S STATIONERY OFFICE

1961

PRICE 4s. 6d. NET

Dated this 5th day of January, 1960

The President of the Board of Trade was on the 10th day of December, 1959, pleased to appoint the undermentioned persons to be a Committee to review and report upon the provisions and working of the Companies Act, 1948, the Prevention of Fraud (Investments) Act, 1958, except in so far as it relates to industrial and provident societies and building societies, and the Registration of Business Names Act, 1916, as amended; to consider in the light of modern conditions and practices, including the practice of take-over bids, what should be the duties of directors and the rights of shareholders; and generally to recommend what changes in the law are desirable:—

THE RIGHT HONOURABLE LORD JENKINS (*Chairman*)

MR. FREDERICK RUDOLPH ALTHAUS

MR. ERIC ALBERT BINGEN

MR. LESLIE BROWN, F.I.A.

SIR GEORGE ERSKINE, C.B.E.

PROFESSOR LAURENCE CECIL BARTLETT GOWER, M.B.E.

MR. WILLIAM HALFORD LAWSON, C.B.E., F.C.A.

MR. JAMES ALEXANDER LUMSDEN, M.B.E.

MR. KENNETH WULSTON MACKINNON, Q.C., M.B.E., T.D.

MRS. MARGOT NAYLOR

MR. GORDON WILLIAM HUMPHREYS RICHARDSON

MR. CHARLES HILARY SCOTT

MR. RON SMITH

MR. WILLIAM WATSON, C.A.

The President was further pleased to appoint MR. PETER EUSTACE THORNTON to be Secretary to the Committee.

(Signed) R. MAUDLING.